State Law & State Taxation Corner

By Thomas E. Rutledge

The Disputes over Check-the-Box, SMLLCs and Liability for Employment Taxes

Recently there has been a spike in activity regarding the validity of the Check-the-Box classification regulations[1] in general and more specifically the question of a sole member's direct liability for employment taxes arising from the operation of a SMLLC. In each instance,[2] the IRS has prevailed on its position that employment law taxes not properly satisfied by a SMLLC are, *ab initio*, an obligation of the single member.

Employment Taxes

In summary, contributions pursuant to the Federal Insurance Contributions Act ("FICA") finance Social Security and Medicare benefits, with FICA being calculated based upon the wages paid to an individual with respect to his employment. A similar tax is imposed on self-employment income under the Self-Employment Contribution Act ("SECA"). The FICA tax itself has two components. That for old-age, survivors and disability insurance ("OASDI"), the taxes are assessed at the rate of 6.2 percent on the employee[3] and 6.2 percent on the employer,[4] both of which are subject to an annually adjusted cap ($97,500 for 2007).[5] The second component is the hospital insurance ("HI"), determined at a rate of 1.45 percent imposed upon the employee[6] and 1.45 percent imposed upon the employer;[7] the HI tax is not subject to a wage cap.[8] The employee portion of OASDI and HI is withheld by the employer.[9] Unemployment taxes ("FUTA") are assessed only against the employer.[10] Employers, as well, act as withholding agents for employee income tax liabilities.[11]

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Check-the-Box and the Treatment of SMLLCs

Broadly speaking, the Code recognizes and provides rules for the taxation of four categories of taxpayers: individuals (Code subchapters A & B), corporations and associations (Code subchapters C & S), partnerships (Code subchapter K) and trusts and estates (Code subchapter J). A "partnership" is defined by the Code to include "a syndicate, group, pool, joint venture, or other unincorporated organizations who or by means of which any business, financial operation or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate."[12] As such, the Code defines a partnership in the negative by excluding from the scope of "partnership" those businesses carried on as a corporation or a trust or an estate." In contrast, a corporation is defined as including "associations, joint-stock companies, and insurance companies."[13] What the Code does not do is define what is a corporation, what is a partnership, *etc.*[14]

> In each instance, the IRS has prevailed on its position that employment law taxes not properly satisfied by a SMLLC are, ab initio, an obligation of the single member.

From 1960 through the end of 1996, that classification of a business organization as either a "partnership" or as a "corporation" was accomplished by reference to the so-called *Kintner* regulations,[15] promulgated by the Service subsequent to the decision rendered in *A.R. Kintner,*[16] Implementing the decision of the U.S. Supreme Court in *T.A. Morrissey*,[17] the *Kintner* regulations based the classification determination on the presence or absence of four factors and weighted the classification test in favor of partnership classification[18] for the purpose of precluding the use of business organizations classified as "corporations" by professionals.[19]

With the development of the limited liability company and the limited liability partnership, as well as other avant-garde forms of business organization, [20] and in response to the realization that time and resources devoted to what were often Byzantine classification determinations was not beneficial to either the IRS or to taxpayers,[21] the Check-the-Box regulations were promulgated with an effective date of January 1, 1997, thereby abolishing the four-factor *Kintner* classification test as applied to business organizations that are to be classified as either partnerships or corporations. At the same time, the Check-the-Box regulations ushered in the "disregarded entity," an unincorporated business organization with a single member that, as a default, is disregarded from its sole owner for purposes of classification.[22] In response, the states amended their LLC acts to delete previously existing requirements that an LLC have at least two members.[23] The Check-the-Box regulations were issued by the Treasury pursuant to its general authority to prescribe "all needful rules and regulations" for the Code.[24]

As set forth in Notice 99-6,[25] "Section 1361(b)(3) and §301.7701-2(c)(2) caused the owner of a disregarded entity to be treated as the employer of the disregarded entity's employees for federal employment tax purposes." Under the temporary employment tax procedures of Notice 99-6, where reporting and payment of employment liabilities is done by the disregarded entity, "the owner retains ultimate responsibility for the employment tax obligations incurred with respect to the employees of the disregarded entity."[26] This treatment is different than that afforded multiple member LLCs wherein the business entity is treated as, for tax purposes, the employer.[27] Under the temporary employment tax procedures of Notice 99-6, the employment tax obligations arising from the activities of the SMLLC may be reported and satisfied in the name of the LLC with, as noted above, the LLC being treated as satisfying the sole owner's obligation, or directly by the sole owner. In none of the cases discussed below is it made clear how any of the SMLLCs/sole owners filed any required reports.

The Proposed Regulations

In October 2005, the IRS gave notice of proposed rulemaking under the Check-the-Box regulations and their application to unsatisfied employment taxes.[28] These proposed regulations would, with respect to disregarded entities, treat them as separate from their owners for employment tax purposes and related reporting obligations.

Littriello, McNamee and Kandi

The Littriello dispute was the first to proceed to a decision from a Court of Appeals. Frank Littriello organized Kentuckiana Healthcare as a Kentucky

limited liability company, in which he was the sole member, which operated a nursing home through June 30, 2002. Between December 2000 and December 2001, $533,257.79 in unsatisfied withholding and FICA tax obligations accrued. The LLC was classified as a disregarded entity. The IRS took the position that it was able to levy on Littriello's personal property in satisfaction of the outstanding FICA obligations. Littriello received a due process hearing with respect to that levy.[29]

The District Court determined that Littriello, operating his business as an SMLLC that under Check-the-Box was a disregarded entity, was for purposes of Code Sec. 3402 the "employer" responsible for the withholding taxes.[30] Littriello made a trio of arguments as to why he should not be liable for the withholding taxes: (1) the Check-the-Box regulations exceed the authority of the Treasury with respect to the issuance of regulatory interpretations of the Code; (2) the Check-the-Box regulations conflict with *Morrissey*; and (3) Littriello was improperly denied the benefits of limited liability and separate entity treatment afforded by the Kentucky LLC Act.[31] As to the first argument, the Court determined that what constitutes either a "partnership" or a "corporation," as those terms are utilized in the Code, is ambiguous.[32] There existing an ambiguity, the District Court analyzed Check-the-Box under *Chevron*,[33] as applied in the Sixth Circuit, and determined that Check-the-Box did not overstep the regulatory authority of Treasury in that the regulations were a "reasonable response to the changes in the state law industry of business formation," and as such determined that the regulations are a permissible construction of the statute.

Littriello's position that the limited liability shield afforded by the Kentucky LLC Act should protect him from liability likewise was rejected, the Court noting that the impact of the treatment as a disregarded entity related exclusively to federal tax liability.[34]

On a motion for reconsideration, Littriello argued that the Check-the-Box regulations are invalid as violative of the direction provided by the Supreme Court in *Morrissey*, a position argued in a then recently published law review article.[35] This position was rejected because the District Court did "not believe that *Morrissey* forever incorporated in all future Treasury Regulations a particular definition of an 'association.'"[36]

The first step in the analysis undertaken by the Sixth Circuit, similar to that engaged in by the District Court, was determining whether the Code is itself unambiguous as to what business organizations fall within the ambit of "corporations" versus those that are "partnerships." The Court observed that, historically, the *Kintner* regulations had been adequate to the classification task, but went on to observe that the continued application of the *Kintner* classification regulations in a realm of these new business organizations was not an effective application of resources. There then followed Check-the-Box, being a "practical scheme" that was as well a "reasonable interpretation by the IRS of a tax statute ([Code Sec.] 7701) that was otherwise ambiguous."[37]

The Sixth Circuit had no difficulty determining that the definition of a "corporation" under the Code is ambiguous, reciting that "the Court in *Morrissey* observed that the Code's definition of a corporation is less than adequate and that, as a result, the IRS had the authority to supply rules of implementation that could later be changed to meet new situations."[38]

With respect to the argument that Littriello could not be held liable because, under Kentucky law, the LLC afforded him a limited liability shield from its debts and obligations, the Court appeared to feel that an extensive analysis was not required. Rather, the Court simply noted that state law attributes of an entity are not controlling under federal tax law and that, as the single-member LLC would, for tax purposes, be treated as a sole proprietorship, so Littriello would have liability for employment taxes in the same manner as if his business were organized as a sole proprietorship.[39]

With respect to the October 2005 proposed regulations, the Sixth Circuit observed that "Littriello argues that the proposed amendments should be taken as reflecting current Treasury Department policy and applied to his case." The Court observed, however, that these regulations were simply proposed and, citing *Commodity Futures Trading Comm. v. Schor*,[40] held that draft regulations cannot be cited against a regulatory agency prior to the process of receiving comments, considering alternatives and issuing final regulations.[41]

Sean McNamee ("McNamee") was the sole member of a Connecticut single-member LLC, W.F. McNamee & Company LLC. For the third and fourth quarters of 2000 and for all of 2001, the LLC failed to pay: (a) the employee income tax withholding (Code Sec. 3402); (b) employee withheld FICA contributions (Code Secs. 3101 and 3102(b)); (c) employer unemployment taxes (Code Sec. 3301); and (d) employee FICA obligations (Code Sec. 3111).

The unpaid taxes totaled $64,736.18. The LLC, an eligible entity, did not elect to be classified as an association and was by default "disregarded as an entity separate from its owner."[42] The IRS assessed McNamee for the taxes not paid. McNamee filed a timely administrative appeal and asserted that (a) Connecticut law provided that he, as the sole member, was not liable for the debts of the LLC and (b) that the IRS lacked the authority to unilaterally pierce the LLC's veil based upon its tax classification. The administrative appeal rejected McNamee's arguments and concluded that he was "personally liable for the employment tax debt of the LLC."[43]

The District Court, in a rather summary manner, dismissed McNamee's application for summary judgment and granted summary judgment for the IRS.[44] Citing *South Texas Lumber Co.*[45] for the rule that "Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes," it was held that the Check-the-Box regulations "are both reasonable and consistent with the purpose of the revenue statutes." Applying an abuse of discretion standard, the balance of the decision affirmed the Notice of Determination Concerning Collection Actions. From this ruling, McNamee appealed to the Second Circuit.

As he had in the District Court, before the Second Circuit McNamee asserted that the Check-the-Box regulations (a) impermissibly conflate the LLC and its sole member with the effect of imposing liability for taxes of the former upon the latter and (b) otherwise conflict with the Code.

As did the *Littriello* court, the Second Circuit began its analysis by a consideration of whether the statute is ambiguous, thereby opening the door for administrative guidance, and then assessing whether that guidance is reasonable. Determining that the Code definitions for person, partnership and corporation (Code Sec. 7701(a)) are ambiguous, the Court reviewed the prior *Kintner* regulations and the need for a new classification system to address developments in the law including especially LLCs. After then reviewing the operation of the Check-the-Box negotiations, the Court held that it could not be concluded that they, in "providing a flexible response to a novel business form, are arbitrary, capricious, or unreasonable."[46] The Second Circuit went on to note that a SMLLC may elect classification as a corporation or as a disregarded entity, each of which has certain benefits and burdens, and to that extent the regulations "are therefore eminently reasonable."[47]

As to the proposed regulations that would alter the rules as to liability in a SMLLC, regulations that McNamee argued demonstrated that the current position is "wrong,"[48] McNamee's position was described as being "wide of the mark." Citing *Littriello*, it reported the rule that proposed regulations are not binding. The Second Circuit cited as well the October 2005 proposal and its genesis in problems in the "reporting, payment and collection of employment taxes" and the suggestion that the proposal "will improve the administration of the tax laws and simplify compliance."[49] Although not specifically highlighted by the Second Circuit, this language suggests not a problem with the merits of the prior characterization, but one with implementation.[50]

> The issues raised by this trio of cases will remain with us unless and until the IRS alters its position as to who, for employment tax purposes, is the employer.

McNamee asserted as well that the IRS could not ignore the limited liability provided by the Connecticut LLC Act. This argument was dismissed on the grounds that a disregarded entity is just that, and "hence cannot be regarded as the employer."[51] Continuing that train of thought, as the SMLLC is not the employer, it must be the sole member whose business is to be treated as a sole proprietorship that is the employer.[52] Ergo, the tax liability was *ab initio* that of the sole member qua sole member, and the limited liability shield from the debts and obligations of the LLC was never implicated. Adding a belt to these suspenders, the Second Circuit quoted *Littriello* for the rule that "state law cannot abrogate [their owner's] federal tax liability." Most damning to McNamee's position, the Second Circuit closed with:

> We know of no provision, policy, or principle that required the federal government to allow him both to escape personal liability for the taxes owed by his sole proprietorship and to have the proprietorship escape taxation as a separate entity.

E. Kandi,[53] a decision of the Western District of Washington, is now on appeal to the Ninth Circuit Court of Appeals. In *Kandi*, what had originally

been a two-member LLC became, in January 2001, a single-member LLC. A total employment tax liability of $216,250.96 was incurred in the first two quarters of 2001; this obligation was not paid. After a collection due process hearing on the IRS's position that it could collect the liability from Kandi, the matter came before the District Court, which issued its ruling in response to cross-motions for summary judgment. That ruling (a) provides a well-written discussion of the presumption of nonretroactive application of regulations in general and specifically the currently pending regulations on employment tax liability in single-member LLCs, (b) clarifies that as the employment tax liability is that of the owner *ab initio*, the limited liability shield is not implicated[54] and (c) explains that as the member chose to have the LLC classified as a disregarded entity and to the extent such is a waiver of otherwise available limited liability, that was the member's choice to which he is now bound. It should be noted that *Kandi* did not challenge, *ab initio*, the validity of the Check-the-Box regulations. While the District Court's ruling in *Littriello* was mentioned in passing in Kandi's memoranda in support of summary judgment and discussed at length in the Department of Justice's memorandum, it was not cited in the *Kandi* decision.

If Check-the-Box were Invalid?

As has been elsewhere observed,[55] it would be difficult to contemplate the outcome had the Check-the-Box regulations been held invalid. Since January 1, 1997, innumerable LLCs, LPs and LLPs, as well as other unincorporated business organizations, have been organized without concern, as to tax classification, of the presence or absence of the *Kintner/Morrissey* characteristics. Had the Check-the-Box regulations been invalidated, would the *Kintner* regulations have come back into full force and effect? Were that the case, many entities that have for now a decade been classified as partnerships could well find themselves subject to classification as corporations. In that those organizations and their owners did not file corporate tax returns or make reports consistent with corporate classification, what would have been the impact of the running of statutes of limitations with respect to those years? What would be the treatment of the single-member LLCs that have been organized and how would they fit into a *Kintner/Morrissey* analysis that is preconditioned on the presence of "associates."[56] Alternatively, would we simply be governed by the test articulated by the Supreme Court in 1934 in *Morrissey* without the benefit of the weighing analysis of the *Kintner* regulations even as we were forced to deal with the *Morrissey* factor that did not find its way into the *Kintner* regulations, namely the ability of the entity to hold real estate in its own name?[57] Furthermore, this level of confusion would have been played out across the various states that, for purposes of state tax classification, conform to the federal system.

Continuing Questions

While it is possible that a court will hold that the sole member of a SMLLC classified as a disregarded entity is not liable for the employment taxes incurred in the course of its operations, such appears unlikely. Out of three cases we have four extensive written opinions explaining the validity of the imposition of that responsibility on the sole member. Even as this state of affairs is accepted, it is important to keep in mind that *Littriello*/*McNamee*/*Kandi* do not reflect an IRS determination to ignore the SMLLC or selectively to invalidate state granted liability shields. The issue is "who is the employer?" In this instance it is the sole owner. In other instances, the IRS has expressly acknowledged the legal and separate existence of the SMLLC. For example, in CCA 199930003,[58] it was opined that a levy against the sole member of a disregarded entity could not be satisfied from the assets of the disregarded entity, a legal entity distinct from its owner.

State law does not control federal tax law, and federal tax law does not control state law.[59] We can answer the question "who is the employer?" only by knowing the perspective from which the question is asked. For purposes of FICA and other employment taxes, assuming it is a disregarded entity, the employer is the sole member. That conclusion does not, however, alter state law rules such as who has responsibility for maintaining workers' compensation insurance.[60]

There is at least one interesting area of overlap in the application of these rules. Almost all LLC acts provide that no distributions may be made to a member when the LLC is either balance sheet insolvent or cannot meet its obligations as the come due in the ordinary course.[61] Assume that SMLLC, a disregarded entity, is insolvent. FICA taxes are due. May SMLLC assets be distributed either directly to the IRS, thereby satisfying the sole member's liability, or distributed to sole member so that she may remit them to the IRS?[62] Might

a creditor of SMLLC challenge the transfer, no matter which option is utilized, asserting it was to pay a personal obligation of the sole member and was therefore improper?[63] The conflict between the Code and state law is clear and at this time likely irreconcilable.

Conclusion

The issues raised by this trio of cases will remain with us unless and until the IRS alters its position as to who, for employment tax purposes, is the employer. It is entirely possible that any change in that position will be years in the making. For now, the single owners of disregarded entities need to be counseled on the importance of timely remission of all employment tax liabilities and their personal exposure in the event such is not done, and we need to await the outcome of *Kandi* as well as any reconsideration of *Littriello* and/or *McNamee* for additional guidance.[64]

ENDNOTES

1 Reg. §§301.7701-1 to 7701-3.

2 Three administrative due process hearings, three district court rulings, and two rulings from Courts of Appeals. *See generally F.A. Littriello,* CA-6, 2007-1 USTC ¶50,426, 484 F3d 372. *Aff'g,* DC Ky., 2005-1 USTC ¶50,385, *mot. for reconsideration denied,* 2005 U.S. Dist. LEXIS 15950; *S.P. McNamee,* CA-2, 2007-1 USTC ¶50,515. *Aff'g,* DC Conn., 2005 U.S. Dist. LEXIS 25775; *E. Kandi,* DC Wash., 2006 U.S. Dist. LEXIS 2687, UNEMPLOYMENT INS. REP. (CCH) ¶17,786 (Jan. 11, 2006).

3 Code Sec. 3102(a).

4 Code Sec. 3111(a).

5 The equivalent SECA provision is Code Sec. 1401(a).

6 Code Sec. 3101(b).

7 Code Sec. 3111(b).

8 The equivalent SECA provision is Code Sec. 1401(b).

9 Code Sec. 3102(a).

10 Code Sec. 3301. The unemployment tax rate in 2007 is 6.2% with a $7,000 per employee annual cap. Income and FICA taxes are reported on Form 941, while unemployment/FUTA taxes are reported on Form 940.

11 Code Secs. 3402 and 3403.

12 Code Sec. 761(a). *See also* Code Sec. 7701(a)(2).

13 Code Sec. 7701(a)(3). *See also* Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate,* 44 CATH. U. L. REV. 437 (Winter 1995).

14 As noted recently by the Second Circuit, "none of [the 7701(a) definitions] specifies the characteristics of the entity that it 'defin[es].'" *McNamee, supra* note 2.

15 Reg. § 301.7701-2 (1960) (repealed Jan. 1, 1997).

16 *A.R. Kintner,* CA-9, 54-2 USTC ¶9626, 216 F2d 418.

17 *T.A. Morrissey,* SCt, 36-1 USTC ¶9020, 296 US 344, 56 SCt 289.

18 *See P.G. Larson,* 66 TC 159 at 187, Dec. 33,793 (1976), *acq.*, 1979-2 CB 1 (Dawson, J., concurring).

19 Thomas E. Rutledge, *The Place (If Any) of the Special Purpose Professional Structure in Entity Rationalization,* 58 BUS. LAW. 1413 (August 2003).

20 "The *Kintner* regulations, adequate to provide a measure of predictability at the time of their promulgation in 1960 and for several decades afterward, proved less than adequate to deal with the new hybrid business entities—limited liability companies, limited liability partnerships and the like—developed in the last years in the last century under various state laws." *Littriello,* 484 F.3d at 375-76.

21 "The '*Kintner* exercise' required skillful lawyering by business entities and case-by-case review by the IRS; it quickly came to be seen as squandering the resources of both sides of the equation." *Littriello,* 484 F.3d at 376.

22 Where an eligible entity is treated as a disregarded entity, "its activities are treated in the same manner as a sole proprietorship, branch, or division of the owners." Reg. §301.7701-2(a).

23 *See, e.g.*, Ky. Rev. Stat. §275.025 as amended by 1998 Acts ch. 341 §23. Some states, such as New York and Delaware, never had a two-member requirement. All states now permit single-member LLCs.

24 Code Sec. 7805(a).

25 Notice 99-6, IRB 1999-3, 12, 1999-1 CB 321.

26 In CCA 200338013 (Aug. 19, 2003), the IRS considered who may submit a Form 8655 on behalf of a disregarded entity LLC, concluding that it must be the sole owner. "While Notice 99-6 allows a single-member LLC to file employment tax returns, the LLC is not the employer and therefore not the taxpayer; the taxpayer for purposes of designating a reporting agent is the owner of the LLC." *See also* CCA 200216028 (Mar. 20, 2002) ("In substance, a disregarded LLC is a tradename by which the company's sole member conducts business."); FSA 200114006 (Dec. 18, 2000) (same); FSA 200105045 (Nov. 1, 2000) ("Sole Owner was doing business as Single Member Limited Liability Company ….").

27 Under Rev. Rul. 2004-41, IRB 2004-18, 845, 2004-1 CB 845, members in a multi-member LLC are not qua members liable for unpaid unemployment taxes as, under state law, an LLC's members are not liable for its debts and obligations. To the extent the LLC does not satisfy its obligations for unemployment taxes, the members may bear liability for those taxes under Code Sec. 6672.

28 Disregarded Entities: Employment and Excise Taxes, 70 FR 60475 (Oct. 18, 2005). Summaries of the proposed regulations include Howard E. Abrams, Fred T. Witt & Lisa M. Zarlenga, 704 T.M., *Disregarded Entities,* at § I.B. (BNA); *Disregarded Entities Would Pay Their Own Employment and Excise Taxes Under Proposed Regulations,* 8 Bus. Entities (Mar/April 2006); and *Proposed Regs Treat Disregarded Entities as Regarded for Purposes of Employment and Certain Excise Taxes,* 8 Bus. Entities (Jan./Feb. 2006).

29 For a more comprehensive review of the factual background of the dispute through the ruling of the District Court, *see Note, Right Without Reason? The Check-the-Box Corporate or Partnership Election Regulations Correctly Held Valid: Littriello v. United States,* 59 TAX LAW. 913 (Spring 2006).

30 *Littriello, supra* note 2.

31 The first and second of these arguments had been reviewed previously in Staff of the Joint Committee on Taxation, *Review of Selected Entity Classification Partnership Tax Issues,* at 13-17 (JCS-6-97), April 8, 1997. That report did not determine, however, that the Check-the-Box regulations were invalid. *See also* WILLIAM S. MCKEE, ROBERT L. WHITMIRE, WILLIAM F. NELSON, FEDERAL TAXATION OF PARNTERSHIPS AND PARTNERS, ¶ 3.08 (3d Ed. 1997) (discussing the possibility of a challenge to the validity of the Check-the-Box regulations).

32 "A business entity registered in Kentucky as [an LLC] does not fall squarely in either the partnership or corporation category as defined in the [Code]." *Littriello, supra* note 2.

33 *Chevron USA., Inc. v. Natural Res. Def. Counsel, Inc.,* SCt, 467 US 837, 104 SCt 2778 (1984).

34 *Littriello, supra* note 2.

35 *See* Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?,* 84 B.U.L. REV. 185 (Feb. 2004).

36 *Littriello, mot. for reconsideration, supra* note 2.

37 484 F.3d at 375, 376. The Sixth Circuit also observed that:

Endnotes

What was avoided by the resulting "check-the-box" provisions was the necessity of forcing these hybrids to jump through the Kintner regulation "hoops" in order to achieve a desired—and perfectly legal—classification for federal tax purposes. *Id.* at 376

[38] *Citing Morrissey, supra* note 17.

[39] "As courts have repeatedly observed, state laws of the corporation control various aspects of business relations; they may affect, but do not control, federal tax provisions." *Littriello, supra* note 2.

[40] *Commodity Futures Trading Comm. v. Schor*, SCt, 478 U.S. 833, 106 SCt 3245, Comm. Fut. L. Rep. (CCH) ¶23,116 (1986).

[41] Littriello has filed with the Sixth Circuit a petition for an en banc reconsideration of that Court's decision. As could have been predicted, the Department of Justice, on behalf of the Treasury, has replied that reconsideration is not justified. The basis for the requested reconsideration are (a) the erroneous application of *Chevron* under the subsequent guidance of *Gonzales v. Oregon*, SCt, 546 US 243, 126 SCt 904 (2006) and *Rapanos v. United States*, SCt, 126 SCt 2208 (2006), and (b) the distinction under Code Sec. 7805(a) between legislative (entitled to *Chevron* deference) and interpretive (not entitled to *Chevron* deference) regulations. Further, Littriello asks the Sixth Circuit to consider whether check-the-box impermissibly amends Code Secs. 3402 and 3403 and replaces Code Sec. 6672. As this article is written the Sixth Circuit has not acted on the application for rehearing.

[42] Reg. § 301.7701-2(a).

[43] *McNamee, supra* note 2.

[44] *McNamee v. Dept. of Treasury*, DC Conn., 2005 U.S. Dist. LEXIS 25775. Contrast the rather detailed opinions of the District Courts in *Littriello* and *Kandi*.

[45] *South Texas Lumber Co.,* SCt, 48-2 ustc ¶5929, 48-1 ustc ¶5922, 333 US 496, 68 SCt 695.

[46] *McNamee, supra* note 2.

[47] *McNamee, supra* note 2.

[48] *McNamee, supra* note 2. In his brief to the Second Circuit, McNamee wrote:

> While the Treasury is correct in the fact that this will simplify compliance, they are still failing to admit that the change is being made because their initial interpretation was wrong. Because it was wrong, the Treasury does not have the luxury of making this change prospective, they are required to make this regulation change retroactive.

McNamee Brief filed June 6, 2006 at p. 7.

[49] 70 FR 60,475–76.

[50] As noted in *Littriello* "it appears the changes contemplated by the amendments are intended to simplify employment tax collection procedures. . . ." *Littriello, supra* note 2.

[51] *McNamee, supra* note 2.

[52] Where an eligible entity is treated as a disregarded entity, "its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner." Reg. § 301.7701-2(a).

[53] *E. Kandi,* DC Wash., 2006 U.S. Dist. LEXIS 2687, Unemployment Ins. Rep. (CCH) ¶17,786 (Jan. 11, 2006).

[54] *See also* Thomas E. Rutledge, *Limited Liability (or not): Reflections on the Holy Grail,* 51 S.D. L. Rev. 417, 435-36 (2006) (reviewing personal liability for actions notwithstanding status as the owner of a business entity providing limited liability); Allan G. Donn, *Is the Liability of Limited Liability Entities Really Limited?* at §IX (ALI-ABA Feb. 6, 2003).

[55] Thomas E. Rutledge and Scott Ludwig, *The Sixth Circuit Affirms Littriello: "Check-the-Box" Classification Regulations are Upheld,* 106 J. Tax'n 325 (June 2007).

[56] Reg. §301.7701-2(a)(2) (repealed Jan. 1, 1997). It does not necessarily follow, were Check-the-Box to be held invalid, that under either the *Kintner* regulations or the predecessor *Morrissey* test that the SMLLCs at issue in *Littriello, McNamee* or *Kandi* would be classified as corporations and thereby, presumably, shield their sole owners from characterization as the employer. While a single-member LLC does afford its member limited liability, such would not be determinative of the classification test as such would elevate limited liability to a "supercharacteristic," a result contrary to *Larson, supra* note 18, and the subsequently rejected Proposed Reg. §301.7701-2(a), 45 FR 75,709 (1980). The absence of "associates" in a single-member LLC, a pre-condition to classification as an association, would present problems unless reliance could be placed on decisions such as *L.D. Barnette,* 63 TCM 3201, Dec. 48,319(M), TC Memo. 1992-371 (*Kintner* regulations applied to GmbH with a single quota-holder; it was determined that each of the corporate characteristics was present and for that reason the GmbH would be classified as an association taxable as a corporation). *See also* GCM 39395 (June 24, 1983).

[57] *Morrissey, supra* note 17.

[58] CCA 199930003 (Feb. 24, 1999).

[59] This axiom was forgotten in cases such as *Borkowski v. Kentucky,* Ky. CtApp, 139 SW3d 531, Unemployment Ins. Rep. (CCH) ¶8395 (2004), wherein a Kentucky court held that a member of a multi-member LLC was not entitled to unemployment compensation as the LLC in question was, for federal tax purposes, classified as a partnership, and the member in question was therefore for tax purposes treated as a partner. On the basis that Kentucky law does not provide unemployment compensation to "partners," it was denied the member.

[60] This is not the first (or the last) instance in which the SMLLC necessiates a different mind-set than does a multi-member LLC. *See, e.g., In re Albright,* BC-DC Colo., 291 BR 538 (2003) (bankruptcy trustee of sole member of LLC not restricted to "exclusive" remedy of a charging order).

[61] *See, e.g.,* Ky. Rev. Stat. §275.225; Ala. Code §10-12-29(c) (applying only a balance sheet insolvency test).

[62] *See also* Robert R. Keatinge, John R. Maxfield, Thomas E. Yearout, *Compensation Issues in Passthrough Entities: Self-Employment and Employment Tax Issues and Issuances of Interests as Compensation*, §4 (ALI-ABA March 16, 2006) ("There may be a question of whether when the LLC pays the employment tax it is discharging the obligation of the owner, thereby effectively making a distribution to the owner for state law purposes.")

[63] It is even more clear that a distribution to satisfy the sole member's SECA liability is a distribution for the benefit of the member and is therefore subject to characterization as improper. Another theory of exposure would be piercing the veil of the LLC under an alter ego analysis on the basis that company assets are being knowingly disbursed to satisfy the personal obligations of the owner. For example, alter ego piercing has been authorized where "the corporation is not only influenced by the owners, but also that there is such unity of ownership and interest that their separateness has ceased; and that the facts are such that an adherence to the normal attributes, *viz,* treatment as a separate entity, of separate corporate existence would sanction a fraud or promote injustice." *White v. Winchester Land Dev. Corp.,* Ky. CtApp, 584 SW2d 56 (1979).

[64] My thanks to Scott Ludwig, Bob Keatinge and Professor Beth Miller for insights incorporated into this discussion.