Single Member LLCs - The Complexities of a Simple Idea

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Single Member LLCs in Hallowed Antiquity (*i.e.*, before January 1, 1997)

- *Morrissey v. Comm'r*, 296 U.S. 344 (1935)
- *U.S. v. Kintner*, 216 F.2d 418 (9th Cir. 1954)
- Kintner Classification Regs, Treas. Reg. § 301.7701-2 (1960)
- Rev. Rule 77-214 (separate interest test)
- *MCA Inc. v U.S.*, 685 F.2d 1099 (9th Cir. 1982)
- Rev. Rule 88-76
- GCM 39395 (Aug. 5, 1985)
- *E.g.*, Wirtz & Harris, *Tax Classification of the One-Member Limited Liability Company*, TAX NOTES TODAY (June 28, 1993) (Westlaw, 93 TNT 140-53)

The Check the Box Regulations and the "Disregarded Entity"

- Internal Revenue Service Notice of Proposed Rulemaking and Hearing on Simplification of Entity Classification Rules, P.S. 43-95 (May 9, 1996.)

- The final Check-the-Box regulations were released on December 17, 1996 with an effective date of January 1, 1997. T.D. 8967.

- Breaking important new ground in classification, the Check-the-Box regulations addressed the classification of single member unincorporated associations.

- While disregarded entity treatment may seem entirely logical, its adoption in the Check-the-Box regulations was a momentous development that reversed the Service's position as set forth in the so-called "branch letters." Therein, the Service had determined that five wholly owned foreign subsidiaries of a U.S. parent, each organized as a GmbH, lacked associates and anyone with whom to divide profits. Therefore, it was concluded that each venture was neither a corporation nor a partnership nor a trust, but rather nothing more than "an integral part" of the U.S. parent corporation. In other words, the ventures were not separate entities with their own tax identities but rather nothing more than branches of the U.S. corporations. However, these letters were each withdrawn shortly thereafter, the Service stating in each case that the earlier letter "is not in accord with the views of the Service concerning the proper tax classification of foreign organizations that have only one beneficial owner."

The Check the Box Regulations and the "Disregarded Entity"

- Single member LLCs now have the option of either being classified as a corporation or, in the alternative, treated as either a sole proprietorship, where the sole member is an individual, or as a branch/division, where the owner is a corporation or other business entity. Reg. § 301.7701-3(a). *See also* Reg. § 301.7701-2(c)(2).

- Such organizations are sometimes referred to as "Tax-Nothings."

- If disregarded, the separate entity, while existing for purposes of state law, will be afforded no separate income tax identity. Reg. § 301.7701-2(a).

- Under the default rule, a single member unincorporated entity is treated as having no separate income tax identity. Reg. § 7701-3(b)(ii).

- Federal Taxpayer Identification Number.

The Check the Box Regulations and the "Disregarded Entity"

- It is doubtful that it is possible to overstate the importance of the Service's effort in this area.
- Revenue Ruling 88-76 signified the acceptance of the multiple-member LLC as a viable business structure with a predictable tax classification.
- ***BUT*** Rev. Proc. 95-10, 1995-1 C.B. 501, § 4.01 acknowledged that single member LLCs, under certain statutes, could be formed, it also provided that such an entity could not request an advance classification ruling.
- The Check-the-Box regulations initiated the practical use of the single member LLC.

Bad Information is Widely Available on the Internet
(I know you are shocked)

Limited-Liability Companies are traditionally just partnerships, with added liability protection. Because of their partnership origins, operating an LLC with only one owner (called a Single-Member LLC) can cause some hiccups.

In fact, some states don't even allow the formation of single-member LLCs and the IRS considers single member LLCs to be "disregarded entities" and taxes them as they would a sole-proprietorship. You see, because LLCs were designed to be partnerships, the IRS only agreed to recognize the new entity type under the condition that you adhere to some basic partnership rules – namely that you have a partner! And no, your dog doesn't count…

http://www.myllc.com/single-Member-LLC.aspx

The best and easiest way to avoid operating as a single member LLC is to take on a partner. Even if you only give two percent of the company away to a close family member, you'll still be in the clear. Keep in mind, though, that if you choose your spouse as your only partner, the IRS (and most likely, the courts!) will still consider you as one member. However you can choose a child or another relative with no problem.

If you choose your spouse as your only other partner in your LLC, the IRS, and in most cases, the courts, will still consider you as one member.

http://www.myllc.com/single-Member-LLC.aspx

Except When They Are the Same, the SMLLC Disregarded Entity and The Sole Member Are Not the Same

- Ky. Rev. Stat. Ann. ("KRS") § 275.010(2); 805 ILCS 180/5-1(c) – "a [LLC] is a legal entity distinct from its members."

- KRS § 275.015(11) – "'Limited liability company'" or 'domestic limited liability company' means a [LLC] formed under this chapter having (1) or more members."; 805 ILCS 180/5-1(b) – "A limited liability company shall have one or more members."

- KRS § 275.240(1) – "Property transferred to or otherwise acquired by a [LLC] shall be the property of the [LLC] and not of the members individually."; 805 ILCS 180/30-1(a) – "A member is not a co-owner of, and has no transferable interest in, property of a [LLC]."

- KRS § 275.250 – "a [LLC] interest shall be personal property."; 805 ILCS 180/30-1(b) – "A distributional interest in a [LLC] is personal property…"

So Which Is It?

- That is, ultimately, the question. The answer is contextual. In certain circumstances the SMLLC and its sole member are treated as one. Alternatively, in other circumstances, the SMLLC and its sole member are treated as distinct legal actors.

- Ergo, it depends

Not All SMLLCs Are Disregarded Entities
Nor Are All Disregarded Entities SMLLCs

- While a SMLLC has a default federal tax classification as a disregarded entity, it may elect to be taxed as a corporation and, presuming the other requirements are satisfied, even elect to be taxed as an S corporation.

- A SMLLC may be a QSUB.

- A Grantor Trust is not exactly a disregarded entity

Bad Information is Widely Available on the Internet
(I know you are shocked)

A single-member limited liability company ("SMLLC") is a business entity similar to a limited liability company ("LLC"), except that a SMLLC only has one member. …. Now, all states and the District of Columbia either allow LLC'S to have one member or permit the formation of a SMLLC.

http://www.nolo.com/legal-encyclopedia/single-member-llcs.html

To form a SMLLC, you submit your articles of incorporation and the required fees to your secretary of state's office. The process is similar to what's required for LLCs.

http://www.nolo.com/legal-encyclopedia/single-member-llcs.html

The Internal Revenue Code states that the SMLLC will be treated as a disregarded entity if it is taxed like a sole proprietorship.

http://www.nolo.com/legal-encyclopedia/single-member-llcs.html

Pro Se Representation

- Bob, the sole member of SMLLC, files pleadings in court to effect the eviction of a tenant from the property owned by his SMLLC.

- Bob's pleadings are stricken under Rule 11; Bob is not an attorney and does not have the capacity to file pleadings on behalf of the SMLLC.

- *Lattanzio LLC v. Comta*, 481 F.3d 137 (2nd Cir. 2007); *Bobbett v. Russellville Mobile Park, LLC*, No. 2007-CA-000684-DG (Ky. App. Sept. 12, 2008; modified Oct. 17, 2008).

Real Party In Interest

- Property used in the business of an LLC is damaged in an accident. Larry, sole member of the LLC, brings in his own name an action for damages to that property.

- Which suit is then dismissed on the basis that Larry is not the "real party in interest"

- *Turner v. Andrew*, 413 S.W.3d 272 (Ky. 2013).

- "The LLC and its solitary member, Andrew, are not legally interchangeable. Moreover, an LLC is not a legal coat that one slips on to protect the owner from liability but then discards or ignores altogether when it is time to pursue a damage claim."

- At least one court has taken the "real party in interest" concept to heart, imposing Rule 11 sanctions against counsel who named an individual member as a party in a suit against an LLC. *See Page v. Roscoe, LLC*, 497 S.E.2d 422 (N.C. Ct. App., 1998).

Federal Income Tax ≠ State Income Tax

- The states are not required to conform their tax classification system to the federal system.

- Numerous states impose an entity level tax on SMLLCs that are, for federal purposes, disregarded entities.

- Bruce P. Ely *et al.*, *An Update on the State Tax Treatment of LLCs and LLP's*, STATE TAX NOTES (Feb. 2, 2015).

- *See, e.g.*, CAL. REV. & TAX CD §§ 17941, 17942; KRS §§ 141.010(24), 141.040(5); ILCS 35, § 5/205(b).

Some "Multiple Member LLCs" Are Actually Disregarded Entities

- Many LLC acts allow for a "member" who has no economic interest in the company.

- *See, e.g.*, COLO. REV. STAT. § 7-80-702; KRS § 275.195(3) – "[A] person may be admitted to a [LLC] as a member without acquiring a [LLC] interest."

- An LLC with two members, one with no rights in the economics of the venture, is for tax purposes a SMLLC with a disregarded entity default classification.

- *Historic Boardwalk Hall, LLC*, CA-3, 2012-2 USTC ¶50,538, 694 F.3d 425; Field Attorney Advice 20124002F (March 1, 2013); PLR 199911033 (Dec. 18, 1998).

- LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 19:2 (2d ed. December 2014) ("Thus, even if a person is a member under state law, that person will be disregarded if the person has no interest in the economics of the LLC.").

The Sole Member is Not an "Employee"

- Assuming that the LLC member is treated as a partner for tax purposes, he or she cannot be treated as an employee of the LLC.

- *See* Rev. Rul. 69-184, 1969-1 C.B. 256; I.R.S. Gen. Couns. Mem. 34001 (Dec. 23, 1969); I.R.S. Gen. Couns. Mem. 34173 (July 25, 1969).

- *Borkowski v. Commonwealth*, 139 S.W.3d 531 (Ky. App. 2004) (member of LLC is not an "employee" for purposes of unemployment insurance benefits); KRS § 342.012 (absent special endorsement, member of LLC not covered by workers compensation insurance).

- *Bowers v. Ophthalmology Group, LLP*, 2012 U.S. Dist. LEXIS 118761 (W.D. Ky. 2012) ("One's status does not change from partner to employee simply because the partner is out-numbered and finds herself in a minority position among the other partners . . . Bowers was a partner in Ophthalmology Group, not an employee.").

The Sole Member is Not an "Employee"

- RESTATEMENT OF THE LAW (3RD) EMPLOYMENT LAW (tentative draft No. 2 (April 3, 2009)) § 1.03 ("Unless otherwise provided by law, an individual is not an employee of an enterprise if the individual through an ownership interest controls all or part of the enterprise.").

- 54 Alan J. Tarr, USC Law School Institute on Major Tax Planning ¶ 606.1(c) (2012) ("A partner rendering services in his capacity as a partner is not an employee of the partnership. This mutual exclusivity characterization is made clear in various provisions, especially in the context of employment taxes.").

- *Paying Yourself*, IRS (May 31, 2013), http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Paying-Yourself ("Partners are not employees and should not be issued a Form W-2 in lieu of Form 1065, Schedule K-1, for distributions or guaranteed payments from the partnership.").

The Sole Member is Not an "Employee"

- The same rule would apply if the LLC were classified for tax purposes as a disregarded entity; the sole member cannot be that sole member's employee.

- *See, e.g., Kentucky Employers' Mutual Insurance v. Ellington*, ___ S.W.3d ___, No. 2013-SC-000802-WC, 2015 WL 2340284 (Ky. May 14, 2015) (sole proprietor is not an employee of the sole proprietorship).

- Assuming the LLC is taxed as a partnership, agreed compensatory payments to a member will be treated as guaranteed payments under Code § 708.

- *Model LLC Operating Agreement Organizational Checklist*, 69 BUS. LAW. 1251, 1264-65 (Aug. 2014).

Miscellaneous Tax Rules

"The single member LLC (absent an association election) is a ghost for income tax purposes – except where there is a limited consideration that reifies the single member LLC. (Partnership practitioners all know about the special Section 752 rules for single member LLC's that are partners.) I do not see a consideration in the transaction that Bill describes that should cause the tax law to reify the single member LLC. I am willing to disregard the single member LLC in this context without either something more specific than the Section 7701 regulations or a proton backpack. I cannot recall any authority that directly addresses Bill's issue (other than the Section 7701 regulations)."

Terence Floyd Cuff

- Treas. Reg. § 1.752-3(a) (Allocation of liability)
- Rev. Rul. 2004-86, 2004-2 CB 191 (Delaware Statutory Trust and like-kind exchange)
- Rev. Ruls. 99-5 (disregarded entity to partnership), 99-6 (partnership to disregarded entity)
- Banks and nonprofit organizations

Local Occupational Taxes

- The Louisville/Jefferson County (Ky.) Metro Revenue Commission administers a local occupational license tax.

- For property owned by an individual, rental income of less than $50,000 does not trigger the occupational license tax.

- An SMLLC, being treated de jure as a business engaged in licensed activities, is subject to the occupational license tax on the first dollar of rental income.

Homestead Property Tax Exemptions

- Certain states provide a homestead tax exemption for an owner occupied principal residence.
- Different states have adopted different rules for LLC owned property.
- Kentucky allows the homestead exemption for property, otherwise qualifying, owned by an LLC. KRS § 132.810(2)(f).
- Alabama does not allow the homestead exemption for LLC owned property. Alabama A.G. Opinion 2007-043.

The Bankruptcy Homestead Exemption

- If you put your house in a single member LLC, have you lost homestead exemption upon bankruptcy?
- You might have.
- *See, e.g.*, *In re Hecker*, 414 B.R. 499 (Bankr. D. Minn. 2009).

Simple Partnerships, TEFRA and the Tax Matters Partner

- "Small partnerships" are exempt from TEFRA and the requirement that the partnership maintain a tax matters partner.
- A "small partnership" has no more than 10 partners, and may only have natural persons, estates or C corporations as partners.
- When a partnership has a disregarded entity as a partner, it is no longer a small partnership and is therefore subject to TEFRA.

The No Member Anymore LLC

- Sole member of LLC is an individual
- Sole member dies
- "No member anymore LLC"
- Some states provide for springing member (*e.g.*, KRS § 275.285(4)(b); COLO. REV. STAT. §§ 7-80-701; 7-80-801(c)(l); 805 ILCS 180/35-3(c))
- If no springing member, who has authority to bind, wind-up the LLC?

Rights of Occupancy

- Under New Jersey law, notwithstanding otherwise applicable tenant protections, the owner of a multi-unit residence of three or fewer units may compel a tenant to vacate if the owner "seeks to personally occupy a unit." N.J.S.A. § 2A:18-61.1(d)(3).

- When the sole member of an SMLLC owner sought to expel a tenant, they were refused because the owner, the LLC, was not going to occupy the unit. *3519-3513 Realty, LLC v. Law*, 967 A.2d 954 (N.J. Super. 2009).

Some Multiple Member Entities Are Disregarded Entities

- Whether a particular organization has a single or multiple members is, for tax purposes, determined under tax law.

- A limited partnership comprised of Beth, as the sole general partner, and Beth's disregarded entity LLC, while a valid limited partnership from the perspective of state law, is for tax purposes a disregarded entity.

- Rev. Rul. 2004-77, 2004-31 IRB 119; FSA 200035006 (May 16, 2000).

Can You Have a Disregarded Entity in a Community Property State?

- In community property states, each spouse is deemed to hold a 50% undivided ownership in all marital property. IRM 25.18.1.1.2.(3), *Basic Principles of Community Property Law*.

- Does that mean that in a community property state is not possible to organize a disregarded entity SMLLC owned by a married person as the spouse would be automatically deemed as a co-owner?

- Nope. Rev. Proc. 2002-69, 2002-2 CB 831, allows the treatment of the SMLLC as either a partnership or a disregarded entity.

Assignees Are Not Members, But They Are Partners

- An assignee of an interest in an LLC is not a member unless and until some required threshold of the incumbent members elect the assignee to that status. Del. Code Ann. tit. 6, § 18-702(b)(1); REV. PROTOTYPE LLC ACT § 502(a)(4).

- Assume a two member LLC in which one member has assigned her entire interest to a third party, the assignor member has been dissociated, and there is no election to admit the assignee as a member.

- For state law purposes, the LLC has a single member.

- For tax law purposes, the assignee is treated as a "partner" with the result that the LLC, for tax purposes, is a multiple member, and not a single member, LLC. *See*, *e.g.*, Rev. Rul. 77-137, 1977-1 CB 178; 1 WILLIAM S. MCKEE, FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS ¶3.01[2] (3d ed.).

Piercing The Veil

- A SMLLC may be pierced under the same theories as may be a multiple member LLC.

- SMLLCs may be more subject to piercing consequent to informality (sloppiness?) in their operation. RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 12:3.

But That Does Not Mean It Should Be Easy

- *Rednour Properties, LLC v. Spangler Roof Services, LLC* (Ky. App. 2011) (ordered not to be published by the Kentucky Supreme Court) - piercing of SMLLC justified for reasons including it had only a single member and that he had "set up the LLCs for tax purposes."

- *Greenhunter Energy, Inc. v. Western Ecosystems Technology, Inc.*, 2014 WL 5794332 (Wyo. Nov. 7, 2014) - piercing of LLC justified in part on the basis that it was for tax purposes a "disregarded entity."

- *Martin v. Freeman*, 272 P.3d 1182 (Colo. Ct. App. 2012) - Among the factors on which the court based its conclusion that the LLC was the sole member's alter-ego was "the fact that a single individual served as the entity's sole member and manager facilitated misuse."

Some Statutory Reactions

- VA. STAT. ANN. § 13.1-1019 – "Except as otherwise provided by this Code or as expressly provided in the articles of organization, no member, manager, organizer or other agent of a limited liability company, *regardless of whether the [LLC] has a single member or multiple members*, shall have any personal obligation for any liabilities of a limited liability company, whether such liabilities arise in contract, tort or otherwise, solely by reason of being a member, manager, organizer or agent of a [LLC]."

- KRS § 275.150(1) – "That a [LLC] has a single-member or single manager is not a basis for setting aside the rule otherwise recited in this subsection."

IRS Assertion of Alter Ego

- Normally the IRS has the burden of proof in claiming alter ego treatment of a business organization and its owners.

- But in a SMLLC the sole member must object to the IRS' lien filed on the basis of alter ego.

- *Little Italy Oceanside Inc., LLC v. IRS*, Case No. 14-cv-10217 (E.D. Mich. Aug. 14, 2015).

SMLLCs, Asset Protection and *Olmstead v. F.T.C.*

- Three approaches to Charging Orders
    - Silence (most states)
    - Explicit statement that charging order is exclusive remedy for single-member LLC (*e.g.*, De, Nv, Ut, Wy)
    - Different charging order rule for single-member LLC (*e.g.*, Fl, Nh, ULLCA (2013))
- Then there are the weird states like Kentucky

LLCs and Bankruptcy

- There are inconsistent decisions as to whether, in the context of a multiple member LLC, a bankruptcy trustee succeeds to the management rights therein.

- It is clear that the bankruptcy trustee does succeed to management of a single-member LLC when that single-member files for bankruptcy. *In re Ashley Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003).

- The bankruptcy of the sole member does not give rise to an automatic stay against the LLC. *In re Penn*, 2010 WL 9445533 (Bankr. N.D. Ga. April 2, 2010).

Discharge of Indebtedness; Code § 108

- Background – Under general principles of tax law, the amount of discharge of indebtedness ("DOI") is treated as income and includable in the gross income of the debtor. (IRC § 61(a)(12).) There is an exception to this rule for any DOI if the discharge occurs in a Title 11 case or to the extent the taxpayer is insolvent when the discharge occurs. (IRC § 108(a)(1)(A) and (B).) Under current law, there is a "look-through" such that the insolvency or bankruptcy is determined at the partner rather than the partnership level, i.e., these exceptions with respect to discharge of partnership debt will only apply if the partner is either insolvent or in bankruptcy. (IRC § 108(d)(6) (insolvency and bankruptcy exceptions applied at the partner level).)

- The Proposed Regulations – In 2011, the Treasury released guidance concerning the exclusion of DOI of a disregarded entity. (Prop. Reg. § 1.108-9, Fed. Reg. Vol. 76 No. 71 p. 20593 (April 13, 2011) ("The activities of an entity that is a disregarded entity are treated in the same manner as a sole proprietorship, branch, or division of the owner (except for certain employment and excise tax rules). Accordingly, for Federal income tax purposes, all assets, liabilities, and items of income, deduction, and credit of a disregarded entity are treated as assets, liabilities, and such items (as the case may be) of the owner of the disregarded entity."). *See also* Amy S. Elliott, *Disregarded Entity Reg. May Not Further Bankrupt's Rehabilitation*, TAX NOTE TODAY (Oct. 21, 2014).) The Proposed Regulation will provide a "look-through" for the definition of "insolvency" and the bankruptcy exception to disregarded entities. Thus, a disregarded entity's DOI will be included in the income of the owner except to the extent that the owner is also insolvent or in bankruptcy. (Prop. Treas. Reg § 1.108-9(a).)

New York Treatment of SMLLCS and the New York Inheritance Tax

In an estate tax advisory opinion (TSB-A-15(1)M (May 29, 2015) Petition No. M141121A.), Counsel for the New York Department of Taxation and Finance ruled that an interest in a single-member LLC that owns New York real property that is disregarded for federal and New York income tax purposes is not "intangible property" for New York estate tax purposes. Where real property in New York, including condominiums, is held by a corporation, partnership or trust, interest in such entity has been held to constitute intangible property (Citing *Estate of Havemeyer* 17 N.Y.2d 216 (1966)), which, if owned by a non-resident, is not subject to New York estate tax. Because a non-electing single-member LLC is disregarded and not deemed to be an entity separate from its owner, the activities of the owner and the real property owned by the LLC would be treated as owned by the member of the LLC.

Employment Trust Fund Taxes, Treatment of SMLLC as a Corporation

- 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 their employment. A similar tax is imposed on self-employment income under the Self-Employment Contribution Act ("SECA").
- FICA tax itself has two components. For old-age, survivors and disability insurance ("OASDI"), the taxes are assessed at the rate of 6.2% on the employee (Code § 3102(a)) and 6.2% on the employer (Code § 3111(a)), both of which are subject to an annually adjusted cap. The equivalent SECA provision is Code § 1401(a).
- The second component is the hospital insurance ("HI"), determined at a rate of 1.45% imposed upon the employee (Code § 3101(b)) and 1.45% imposed upon the employer (Code § 3111(b)); the HI tax is not subject to a wage cap. The equivalent SECA provision is Code § 1401(b). The employee portion of OASDI and HI is withheld by the employer. Code § 3102(a).
- Unemployment taxes ("FUTA") are assessed only against the employer. Code § 3301. The unemployment tax rate in 2007 is 6.2% with a $7000 per employee annual cap. Income and FICA taxes are reported on Form 941, while unemployment/FUTA taxes are reported on Form 940. Employers as well act as withholding agents for employee income tax liabilities. Code §§ 3402, 3403.

Employment Trust Fund Taxes, Treatment of SMLLC as a Corporation

- *Littriello v. U.S.*, 484 F.3d 372 (6th Cir. 2007)
- *McNamee v. Dept. of the Treas.*, 2007 WL 1487686 (2nd Cir. 2007)
- Scott E. Ludwig and Thomas E. Rutledge, *The Sixth Circuit Affirms Littriello: "Check-the-Box" Classification Regulations Are Upheld*, 106 J. TAX'N 325 (June 2007); Ludwig and Rutledge, *Second Circuit Affirms McNamee: Validity of Check the Box Regulations Again Confirmed*, 107 J. TAX'N 32 (July 2007).

Employment Trust Fund Taxes, Treatment of SMLLC as a Corporation

- In October 2005, the Service gave notice of proposed rulemaking under the Check-the-Box regulations and their application to unsatisfied employment taxes.

- *Disregarded Entities: Employment and Excise Taxes*, 70 Fed. Reg. 60475 (proposed October 18, 2005).

- These proposed regulations, with respect to disregarded entities, treat them as separate from their owners for employment tax purposes and related reporting obligations.

- Regulations were adopted July 25, 2007 (TD 9356 (Aug. 15, 2007)) effective January 1, 2009.

Employment Trust Fund Taxes, Treatment of SMLLC as a Corporation

- For employment tax purposes, a disregarded SMLLC is treated as a corporation for purposes of trust fund taxs.

- Treas. Reg. § 301.7701-2(c)(2)(iv) - Except with respect to backup withholding under IRC § 3406 [under which the owner rather than the SMLLC is responsible for withholding], the SMLLC is treated as a corporation with respect to employment taxes.

- Notwithstanding the rule that, as to employees, a disregarded SMLLC is treated as a corporation, as to the sole member, they are self-employed and subject to self-employment income taxes.

- Treas. Reg. § 301.7701-2(c)(2)(iv)(C)(2) - "[T]he owner of an entity that is treated in the same manner as a sole proprietorship under paragraph (a) of this section is subject to tax on self-employment income."

Can The Sole Member of a Disregarded LLC That Is Hired By a Corporation Treat Themselves As An Employee?

- In its May 1, 2015 recommendation for the 2015-2016 guidance plan, the AICPA recommended including the issue in the guidance. ("Provide guidance on the treatment of partnership employees working for a single member limited liability company (SMLLC) or other disregarded entity owned by an upper tier partnership (after the SMLLC employment tax reporting rules change, effective in 2009). Specifically provide guidance on whether an owner of the upper tier entity is treated as a partner or an employee if he or she provides service to the lower tier SMLLC or other disregarded entity.").

- This item was not included in the 2015-2016 Priority Guidance Plan released on July 31, 2015.

Circular Entities

- Circular ownership occurs when one entity owns all or a portion of a second entity, and at the same time, the second entity owns all or a portion of the first entity.

- Partial circular ownership that "works" for state law purposes can result in what are likely unintended consequences for federal tax purposes. For instance, partial circular ownership involving state law partnerships could result in the partnerships being treated as entities with one owner that are therefore disregarded for federal tax purposes.

- In the case of complete circular ownership, there are myriad questions regarding the proper tax characterization of the transactions creating the circular ownership as well as the ongoing operations of the entities.

- *See* Sheldon I. Banoff, *What Goes Around Comes Around: Circular Ownership of Passthrough Entities*, 77 TAXES 189 (1999).

Drop Kicks

- Seller wants to sell, and Buyer wants to buy, assets that are subject to federal, state and/or local taxation upon sale.
- Neither Buyer nor Seller are anxious to pay any tax.
- Under applicable law, while the sale of assets is subject to taxation, the sale of an intangible interest in a business organization is not.
- Ergo, Seller contributes assets on the eve of the sale to newly formed SMLLC and sells SMLLC to Buyer.

SMLLCs v. Series LLC

- E.g., should owner of multiple rental properties (i) put each property in a SMLLC or (ii) put each property in a series of a series LLC
- "Yes use a series, avoid all those filing fees"
- Does state in which property is located provide for series?
- *Alphonse v. Arch Bay Holdings, L.L.C.*, No. 13-30154, 2013 WL 6490229 (5th Cir. Dec. 11, 2013).

"Wolde You Bothe Eate Your Cake and Have Your Cake?"

- John Haywood, *A Dialogue Conteinying the Nomber in Effect of All Prouerbes in the Englishe Tongue*.

- There are entirely legitimate reasons, including but not restricted to limited liability, for holding property and engaging in business through a SMLLC.

- It must be recognized, however, that doing so changes the legal relationship between the sole owner, the LLC's property, and those third-parties with whom the LLC does business.