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January 5, 2009

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Notice 2008-19 and Segregated Arrangements That Do Not Involve Insurance

Dear Commissioner Shulman:

Enclosed are comments in response to Notice 2008-19 that address segregated arrangements that do not involve insurance. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Wm J Wilkins".

William J. Wilkins
Chair, Section of Taxation

Enclosure

cc: Hon. Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
Eric San Juan, Acting Tax Legislative Counsel, Department of the Treasury
Steven G. Frost, Office of Tax Legislative Counsel, Department of the Treasury
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AMERICAN BAR ASSOCIATION SECTION OF TAXATION

COMMENTS IN RESPONSE TO NOTICE 2008-19

The following comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Thomas E. Yearout of the Section’s Partnerships and LLCs Committee (the “Committee”). Substantive contributions were made by Eliot L. Kaplan, Joseph A. Riley, David J. Clark, R. Brent Clifton, J. Leigh Griffith, Sanford Holo, Robert R. Keatinge, Walter D. Schwidetzky and Jeanne Sullivan. Additional contributions were made by Sheldon I. Banoff, Adam M. Cohen, Jill E. Darrow, Allan G. Donn, Harry T. Lamb, Thomas C. Lenz, Howard J. Levine, Christopher S. McLoon and Carlene Y. Miller. The Comments were reviewed by R. Brent Clifton, Chair of the Committee, Bahar A. Schippel, Vice Chair of the Committee, and Monte A. Jackel, Chair of the Committee’s Subcommittee on Government Submissions. The Comments were further reviewed by James E. Wreggelsworth of the Section’s Committee on Government Submissions and by William H. Caudill, the Section’s Council Director for the Committee.

Although the members of the Section of Taxation who participated in preparing these comments have clients who might be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contact: Thomas E. Yearout
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Date: January 5, 2009

EXECUTIVE SUMMARY

Revenue Ruling 2008-8¹ (the “Revenue Ruling”) addresses whether certain arrangements constitute insurance for federal income tax purposes. The “insurance” coverage in the Revenue Ruling is provided through a “Protected Cell Company” structure utilizing cells which, although not treated as separate entities for state law purposes, separately account for their own income, expense, assets, liabilities and capital. Various states permit the formation of entities that have business units with characteristics like the cells discussed in the Revenue Ruling. For example, some states permit the formation of business or statutory trusts with so-called “series” having separate business purposes or investment objectives. States have also started adopting statutes that permit limited liability companies to be divided into series having separate business purposes or investment objectives. There is no meaningful authority that addresses whether a series of a limited liability company constitutes an entity for federal tax purposes that is separate and apart from the limited liability company and any other series of the limited liability company for purposes of Regulation section 301.7701-2(a).²

Notice 2008-19³ (the “Notice”) proposes guidance that would include a rule to the effect that a cell of a Protected Cell Company would be treated as an insurance company separate from any other entity if:

- a. the assets and liabilities of the cell are segregated from the assets and liabilities of any other cell and from the assets and liabilities of the Protected Cell Company such that no creditor of any other cell or of the Protected Cell Company may look to the assets of the cell for the satisfaction of any liabilities, including insurance claims (except to the extent that any other cell or the Protected Cell Company has a direct creditor claim against such cell); and
- b. based on all the facts and circumstances, the arrangements and other activities of the cell, if conducted by a corporation, would result in its being classified as an insurance company within the meaning of sections 816(a) or 831(c).

The Notice requests comments on guidance concerning segregated arrangements that do not involve insurance. A number of unresolved tax questions exist with respect to series limited liability companies. These Comments respond to the Notice by requesting guidance on the classification of series limited liability companies for federal tax

¹ Rev. Rul. 2008-8, 2008-5 I.R.B. 340.

² All references to “section” herein are to sections of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise expressly stated herein, and references to Regulations are to the Treasury Regulations promulgated under the Code.

³ Notice 2008-19, 2008-5 I.R.B. 366. (February 4, 2008).

purposes and proposing an approach for addressing the classification of series limited liability companies and their respective series for federal tax purposes.

Under the Delaware Limited Liability Company Act (the “Delaware LLC Act”),⁴ a Series⁵ may have the following characteristics:

- a. Each Series may have a separate business purpose or investment objective;
- b. Each Series may have separate members, managers and limited liability company interests;
- c. Each Series may have separate rights, powers or duties with respect to specified property, obligations or profits and losses associated with specified property or obligations;
- d. The debts, liabilities, obligations and expenses of a particular Series may be enforceable only against the assets of such Series; and
- e. Each Series has the power to, in its own name, contract, hold title to assets, and grant liens and security interests.

We recommend that the Treasury Department (“Treasury”) and the Internal Revenue Service (the “Service”) issue guidance confirming that each Series of an LLC is a separate “business entity” for purposes of Regulation section 301.7701-2(a), assuming that certain minimum requirements are met. In order to be treated as a separate business entity, the Series must (i) be formed under a statute having characteristics such as those contained in the Delaware Series Provision of the Delaware LLC Act, and (ii) satisfy applicable record keeping and notice requirements so that the liabilities of a particular Series may only be enforceable against that Series’ assets.

We further recommend that the characterization of the LLC itself for federal tax purposes depend upon whether the LLC satisfies the minimum requirements to be a business entity that is separate from its Series. Unless the LLC has assets and liabilities that are not associated with one or more of its Series, the LLC has no separate existence and should be treated as transparent or as a nominee. If the LLC has separate assets (including holding the economic interest in one or more of its Series) and satisfies applicable record keeping and notice requirements so that the liabilities of the LLC may

⁴ Del. Code Ann. tit. 6, § 18-101 to -1109. The term “LLC” in these Comments refers to a limited liability company within the meaning of the Delaware LLC Act (or other state statute under which series limited liability companies have the same basic characteristics as under the Delaware LLC Act).

⁵ Section 18-215 of the Delaware LLC Act (referred to in these Comments as “Delaware Series Provision”) governs the establishment of series of a limited liability company in Delaware. For purposes of these Comments, the capitalized term “Series” mean a designated series of members, managers, limited liability company interests or assets of a limited liability company pursuant to section 18-215 of the Delaware LLC Act or other state statute under which series limited liability companies have the same basic characteristics as Series under the Delaware LLC Act.

only be enforced against the LLC's assets, the LLC should be characterized as a separate business entity.

By recognizing each Series and the LLC as a separate "business entity" under Regulation section 301.7701-2(a), each Series' and the LLC's classification for federal tax purposes would be independently determined. As long as the LLC is not required to be classified as a corporation under Regulation section 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8), each Series and the LLC would be a separate "eligible entity" within the meaning of Regulation section 301.7701-3(a). If a Series or the LLC has at least two members, such Series or the LLC would be classified as a partnership unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2). If a Series or the LLC has a single member, such Series or the LLC would be disregarded as an entity separate from its single member unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2).

We recognize that the approach we are recommending may not be consistent with how some taxpayers are currently treating series limited liability companies that they are using for their business affairs. We believe that any guidance should be applied prospectively, except that existing series limited liability companies should be allowed to rely on the guidance if they (i) are formed under a statute having characteristics such as those contained in the Delaware Series Provision, (ii) satisfy applicable record keeping and notice requirements, and (iii) have been consistent in their treatment of the arrangement in accordance with the guidance. The classification of other existing series limited liability companies should be based upon the authority that currently exists concerning the classification of series limited liability companies and business trusts and whether taxpayers have been consistent in their treatment of such arrangements for federal tax purposes.

DISCUSSION

I. Background

The Revenue Ruling⁶ addresses whether certain arrangements constitute insurance for federal income tax purposes. The “insurance” coverage in the Revenue Ruling is provided through a “Protected Cell Company” structure. A Protected Cell Company is formed as a legal entity under the laws of a particular jurisdiction. The Protected Cell Company establishes multiple accounts or “cells.” Although a cell is not treated as a legal entity distinct from the Protected Cell Company, each cell has its own name and is identified with a particular participant. Each cell is separately capitalized and responsible for its own obligations. The income, expense, assets, liabilities and capital of each cell are accounted for separately from the income, expense, assets, liabilities and capital of any other cell and the Protected Cell Company. In addition, the assets of each cell are statutorily protected from the creditors of another cell or the Protected Cell Company. The Revenue Ruling does not indicate whether a cell may sue or be sued in its own name. The Revenue Ruling also does not address whether a cell constitutes an entity separate and apart from any other cell or the Protected Cell Company for federal tax purposes.

Various states permit the formation of entities that have business units with characteristics like the cells discussed in the Revenue Ruling. For example, some states permit the formation of business or statutory trusts with so-called “series” having separate business purposes or investment objectives. Such trusts may have series of trustees, beneficial owners or beneficial interests with separate rights, powers or duties with respect to specified trust property, trust obligations or profits and losses associated with specified trust property or obligations.⁷

States have also started adopting statutes that permit limited liability companies to be divided into series having separate business purposes or investment objectives. Delaware was the first state to enact such legislation in 1996.⁸ More recently, Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah have adopted similar legislation.⁹

⁶ Rev. Rul. 2008-8, 2008-5 I.R.B. 340.

⁷ *See, e.g.*, Del. Code Ann. tit. 12, § 3806(b). Although section 3804(a) of the Delaware Statutory Trust Act provides that a statutory trust may sue and be sued, the statute does not specifically state that a series of a statutory trust may sue and be sued in its own name.

⁸ *See* Del. Code Ann. tit. 6, § 18-215. In addition to series limited liability companies and series trusts, Delaware also permits the formation of series limited partnerships. *See* Del. Code Ann. tit. 6, § 17-218.

⁹ *See* 805 Ill. Comp. Stat. § 180/37-40; Iowa Code § 490A.305; Nev. Rev. Stat. § 86.296; Okla. Stat. tit. 18, § 18-2054.4B; Tenn. Code Ann. § 48-249-309; and Utah Code Ann. § 48-2c-606. A handful of other states (*e.g.*, Wisconsin, Minnesota and North Dakota) have provided for “series” or “classes” of membership interests in limited liability companies, but have not enacted legislation permitting series limited liability companies.

The Delaware Series Provision provides that:

1. Each Series may have a separate business purpose or investment objective;
2. Each Series may have separate members, managers and limited liability company interests;
3. Each Series may have separate rights, powers or duties with respect to specified property, obligations or profits and losses associated with specified property or obligations;
4. The debts, liabilities, obligations and expenses of a particular Series may be enforceable only against the assets of such Series and the debts, liabilities, obligations and expenses of the LLC or any other Series may not be enforceable against the particular Series; and
5. Each Series may have the power to, in its own name, contract, hold title to assets, and grant liens and security interests.¹⁰

Generally, as long as certain record-keeping requirements and other prerequisites are met, the debts, liabilities, obligations and expenses of a particular Series are enforceable only against the assets of that Series and, unless otherwise provided in the limited liability company agreement, none of the debts, liabilities, obligations and expenses of the LLC or any other Series are enforceable against the assets of the particular Series.

As in the case of the cells in the Revenue Ruling, there is no meaningful authority that addresses whether a series of a limited liability company constitutes an entity for federal tax purposes that is separate and apart from any other series of the limited liability company for purposes of Regulation section 301.7701-2(a).¹¹

II. Notice 2008-19

Treasury and the Service issued the Notice in connection with the Revenue Ruling. The Notice requests comments on proposed guidance addressing the entity classification issues related to cells and Protected Cell Companies. More specifically, the Notice proposes guidance that would include a rule to the effect that a cell of a Protected

¹⁰ See Del. Code Ann. tit. 6, § 18-215. A Series is not treated as a separate entity for state law purposes under the Delaware LLC Act. Appendix A to these Comments compares the characteristics of Series under the Delaware LLC Act with the characteristics of series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah. In general, series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah share the same characteristics as Series under the Delaware LLC Act except for: (i) only Delaware and Illinois specifically permit series to contract and hold assets in the series' name; and (ii) only Illinois permits series to be treated as separate entities for state law purposes.

¹¹ See Part IV (Applicable Authorities) of these Comments for a discussion of those authorities on which commentators and the Service have relied as bearing on the classification of series limited liability companies for federal income tax purposes.

Cell Company would be treated as an insurance company separate from any other entity if:

1. the assets and liabilities of the cell are segregated from the assets and liabilities of any other cell and from the assets and liabilities of the Protected Cell Company such that no creditor of any other cell or of the Protected Cell Company may look to the assets of the cell for the satisfaction of any liabilities, including insurance claims (except to the extent that any other cell or the Protected Cell Company has a direct creditor claim against such cell); and
2. based on all the facts and circumstances, the arrangements and other activities of the cell, if conducted by a corporation, would result in its being classified as an insurance company within the meaning of sections 816(a) or 831(c).

The Notice requests comments on the proposed guidance to ensure that entity classification and federal tax elections for Protected Cell Companies are both legally correct and administrable. In addition, the Notice “requests comments on what guidance, if any, would be appropriate concerning similar segregated arrangements that do not involve insurance.”

III. Statement of Need for Guidance

We request that Treasury and the Service issue guidance that recognizes each Series of an LLC, and the LLC itself, as a separate “business entity” for purposes of Regulation section 301.7701-2(a). By recognizing each Series and the LLC as a separate “business entity” under Regulation section 301.7701-2(a), the federal tax classification of each Series and the LLC would be determined independent of each other. Provided that the LLC is not required to be classified as a corporation under Regulation section 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8), each Series and the LLC would be an “eligible entity” within the meaning of Regulation section 301.7701-3(a). If a Series or the LLC has at least two members it would be classified as a partnership unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2). If a Series or the LLC has a single member it would be disregarded as an entity separate from its single member unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2).

As discussed above, the Revenue Ruling does not address the entity classification of cells or Protected Cell Companies. The Notice proposes guidance that would include a rule governing only the entity classification of cells and Protected Cell Companies. Consequently, the Revenue Ruling and the Notice do not provide any basis for determining the federal tax classification of segregated arrangements outside the context of Protected Cell Companies.

The Service has issued at least one private letter ruling in which it concluded that each series of a limited liability company should be treated as a separate eligible entity for federal income tax purposes.¹² Also, the Service has issued a number of private letter

¹² PLR 200803004 (Oct. 15, 2007).

rulings holding that each series of a business trust is treated as a separate business entity for federal income tax purposes.¹³ However, because those rulings contain very little or no legal analysis, it is not possible to apply those rulings in determining the proper entity classification of a series of a limited liability company in other contexts.¹⁴

A number of commentators have written on the topic of series limited liability companies.¹⁵ This commentary is helpful in understanding how series limited liability companies are organized and operate under the laws of different states, and is also helpful in understanding various similarities and differences in the laws of states that allow series limited liability companies.

As a general matter, commentators have noted that the federal income tax consequences of investing in series limited liability companies are unresolved and uncertain.¹⁶ In fact, in the face of the uncertainty surrounding series limited liability companies, one commentator has asserted that “[t]he series LLC has the potential of a tax planning H bomb.”¹⁷ In the light of such uncertainty, different commentators have discussed the unresolved tax questions surrounding series limited liability companies, including:¹⁸

1. Is each series a separate “business entity” within the meaning of Regulation section 301.7701-2(a)?
2. Is each series responsible for filing its own tax return or is the limited liability company responsible for filing a tax return that includes all of the series?

¹³ See, e.g., PLR 200809012 (Nov. 28, 2007), PLR 9703002 (Sept. 5, 1996) and PLR 9703016 (Oct. 11, 1996).

¹⁴ We acknowledge that private letter rulings may not be relied upon other than by the taxpayer to which the ruling was issued. Section 6110(k)(3). See Part IV (Applicable Authorities) of these Comments for a discussion of those authorities on which commentators and the Service have cited as bearing on the classification of series limited liability companies for federal tax purposes.

¹⁵ Appendix B to these Comments includes a bibliography of select articles that commentators have written on series limited liability companies.

¹⁶ See, e.g., Donn, *et al.*, *Limited Liability Entities – 2008: New Developments in Limited Liability Companies and Limited Liability Partnerships, Exploring the New World of Series LLCs*, § IX.A. (ALI-ABA Video Law Review) (Mar. 19, 2008). Carter Bishop’s and Daniel Kleinberger’s treatise on limited liability companies includes a thoughtful analysis on the classification of series limited liability companies for federal income tax purposes. Bishop and Kleinberger, *Limited Liability Companies: Tax and Business Law* ¶ 2.11 (Warren, Gorham & Lamont ed. 2006) (1994).

¹⁷ Cuff, *Series LLCs and the Abolition of the Tax System*, 2 Business Entities 26 (Warren, Gorham & Lamont ed.) (Jan./Feb. 2000).

¹⁸ See, e.g., Cuff, *supra*; Donn, *supra*, § IX.A.5; Frost, *Musings on Series LLCs*, J. Passthrough Entities 15 (May-June 2007).

3. What are the tax consequences if one series of a limited liability company is terminated while other series of the same limited liability company remain in existence?
4. What are the tax consequences if one series of a limited liability company transfers property to a different series of the same limited liability company?
5. What are the tax consequences if a person contributes property to one series of a limited liability company in exchange for an interest in a different series of the same limited liability company?
6. What are the tax consequences if a person exchanges an interest in a series of a limited liability company for an interest in a different series of the same limited liability company?

The questions set forth above represent a small sample of the tax issues raised by series limited liability companies. One does not need to review all of the various articles on this subject to appreciate the importance of the need for guidance regarding the federal tax classification of series limited liability companies.

Series limited liability companies are a valuable tool for business enterprises. The value of series limited liability companies is based on the wide acceptance among the legal community of limited liability companies. Considering the widespread use of limited liability companies, series limited liability companies are particularly important to the business community because they can facilitate differentiation of ownership and management and segregation of assets and liabilities while avoiding the complexity and costs associated with forming separate entities for state law purposes.

Nevertheless, series limited liability companies are not yet being widely used today. Aside from the fact that, to date, many states have not adopted legislation that would permit the organization of series limited liability companies, the lack of certainty in how series limited liability companies should be classified for federal tax purposes is a very significant impediment to their increased use.¹⁹ In fact, this uncertainty may be a reason why more states have not adopted legislation permitting the organization of series limited liability companies.

Guidance on the proper federal tax classification of series limited liability companies would (i) encourage more states to adopt legislation permitting the

¹⁹ The evolution of limited liability companies illustrates the need for guidance on the classification of series of limited liability companies. States were slow to adopt legislation permitting the organization of limited liability companies until the Service issued Revenue Ruling 88-76, 1988-2 C.B. 360, holding that a limited liability company organized under the Wyoming statute was classified as a partnership for federal income tax purposes. Although more states began to adopt limited liability company legislation and more people began to use limited liability companies after Revenue Ruling 88-76 was issued, the most significant increase in the use of limited liability companies occurred after Regulation sections 301.7701-2 and 301.7701-3 (frequently referred to as the “Check-the-Box Regulations”) were issued in 1996.

organization of series limited liability companies, (ii) facilitate the use of series limited liability companies by taxpayers, and (iii) make more manageable the administration of series limited liability companies by the Service.

IV. Applicable Authorities

As with other state law entities, the classification of a series limited liability company for federal tax purposes depends upon whether the limited liability company itself and each of its series is treated as (i) a “business entity” under Regulation section 301.7701-2(a), and (ii) an “eligible entity” under Regulation section 301.7701-3(a).

As indicated above, there is no meaningful authority that addresses whether a series of a limited liability company constitutes an entity for federal tax purposes that is separate and apart from the limited liability company itself or any other series of that limited liability company. Nevertheless, there are certain authorities that commentators and the Service have relied upon as supporting the conclusion that each series should be treated as a separate entity for federal tax purposes.

Classification of an organization as an entity separate from its owners for federal tax purposes is a matter of federal tax law.²⁰ The classification of a series limited liability company as an entity for federal tax purposes depends generally on facts and circumstances. The Supreme Court has held that, in determining whether there is a partnership for federal tax purposes, the test is “whether, considering all the facts – the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent – the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.”²¹

In the context of determining the classification of a Delaware statutory trust for federal tax purposes, the Service considered a number of factors in concluding that the trust was a separate entity.²² Such factors included:²³

²⁰ Reg. § 301.7701-1(a)(1).

²¹ *Commissioner v. Culbertson*, 337 U.S. 733, 742 (1949).

²² Rev. Rul. 2004-86, 2004-2 C.B. 191.

²³ Revenue Ruling 2004-86 concluded that the Delaware statutory trust at issue should be classified as a trust for federal tax purposes. This conclusion was based upon the finding that there was no power under the trust agreement to vary the investments of the certificate holders. Nevertheless, the Service stated that if the trustee had certain additional powers, the trust would be classified as a business entity for federal tax purposes. Such additional powers included the power to: (i) dispose of property and acquire new property; (ii) renegotiate leases with the current tenant or enter into leases with new tenants; (iii) renegotiate or refinance the obligation used to purchase the property; (iv) invest cash received to profit

1. Recognition of the trust as an entity separate from its owners under state law;
2. Whether creditors of the owners may assert claims directly against the trust's assets;
3. The trust's ability to sue and be sued, and whether the trust's assets are subject to attachment and execution;
4. Whether the trust's owners have limited personal liability for the trust's actions;
5. Whether the trust may merge or consolidate with or into other entities; and
6. Whether the trust was formed for investment purposes.²⁴

*National Securities Series – Industrial Stock Series, et al. v. Commissioner*²⁵ has been cited in support of the proposition that each series of a business trust or limited liability company should be treated as a separate entity for federal tax purposes. The taxpayers in *National Securities* were unincorporated investment trusts that were created under a single trust agreement and which differed only in the nature of their assets. Each trust regularly issued certificates representing shares in the property held in the trust and regularly redeemed such certificates pursuant to the terms of the trust agreement. For purposes of the Court's analysis of the issues²⁶ presented in *National Securities*, the Court stated, without explaining the support or basis for the statement, that each trust was taxable as a separate regulated investment company.²⁷ Certain of the series business trust rulings²⁸ cite *National Securities* as an analogous situation that lends support to the conclusion that each series should be treated as a separate entity for federal tax purposes. Similarly, commentators have cited *National Securities* as bearing on how series limited liability companies should be classified for federal tax purposes.²⁹

from market fluctuations; or (v) make more than minor non-structural modifications to the property not required by law.

²⁴ See Part VI (Recommendations) of these Comments for a comparison of the factors considered in Revenue Ruling 2004-86 to the characteristics of Series under the Delaware LLC Act.

²⁵ 13 T.C. 884 (1949), *acq.* 1950-1 C.B. 4.

²⁶ The issue decided by the Court in *National Securities* was whether earnings paid by a trust to its shareholders in connection with a redemption of their shares constituted preferential dividends within the meaning of section 27(h) of the Internal Revenue Code (1939).

²⁷ 13 T.C. at 885.

²⁸ See, e.g., PLR 9703002 (Sept. 5, 1996); PLR 9703016 (Oct. 11, 1996).

²⁹ See, e.g., Donn, *supra*, § IX.A.1.b.

The Service applied the principles set forth in *National Securities* in Revenue Ruling 55-416.³⁰ Revenue Ruling 55-416 also dealt with unincorporated investment trusts created under a single trust agreement. Like *National Securities*, Revenue Ruling 55-416 treated each trust as a separate regulated investment company. It has also been cited in support of the proposition that each series of a limited liability company should be treated as a separate entity for federal tax purposes.³¹

Revenue Ruling 55-39³² has also been cited as bearing on how series of a limited liability company should be classified for federal tax purposes.³³ The taxpayer in Revenue Ruling 55-39 was a general partner of a partnership comprised of both limited and general partners. Under the partnership agreement, the taxpayer was permitted to direct that the amount in his capital account be invested, in whole or in part, in securities selected and controlled by the taxpayer and held by the partnership for the taxpayer's account. Revenue Ruling 55-39 holds that securities purchased at the taxpayer's direction become the taxpayer's property at the time the securities are acquired by the partnership. Revenue Ruling 55-39 also concludes that treating the securities as the taxpayer's property at the time the securities are acquired by the partnership is not affected by the fact that the securities would be treated as partnership property with respect to the claims of partnership creditors. Commentators have asserted that the principles of Revenue Ruling 55-39 support treating each series of a limited liability company as a separate entity for federal tax purposes.³⁴

As noted previously, Private Letter Ruling 200803004 (Oct. 15, 2007) holds that each series of a limited liability company should be classified as a separate business entity for federal tax purposes. The Service relied on certain representations made by the taxpayer in support of this holding. The representations on which the Service relied included the following:

1. Each series had its own investment objectives, policies and restrictions;
2. Each series consisted of a separate pool of assets, liabilities and stream of earnings;
3. The owners of a series could share in the income only of that series;

³⁰ Rev. Rul. 55-416, 1955-1 C.B. 416.

³¹ See, e.g., Mass. Ltr. Rul. 08-2: *Separate Entity Status and Federal Classification for Each Series of an LLC* (Feb. 15, 2008).

³² Rev. Rul. 55-39, 1955-1 C.B. 403.

³³ See, e.g., Donn, *supra*, § IX.A.1.c.; Bishop, *supra*, ¶ 2.11[4].

³⁴ See Bishop, *supra*, ¶ 2.11[4] (“Revenue Ruling 55-39 emphasizes ‘investment control’ over segregated assets within a partnership to suggest that the segregated funds create a separate taxpayer – even when those assets are subject to cross-over liability to partnership creditors.”).

4. The ownership interest in a series was limited to the assets of that series upon redemption, liquidation or termination of such series;
5. The payment of the expenses, charges and liabilities of a series was limited to that series' assets; and
6. The creditors of a series were limited to the assets of that series for recovery of expenses, charges and liabilities.

Although states typically follow the federal rules in classifying business entities for state tax purposes, certain states have addressed the classification of series limited liability companies in the absence of formal guidance at the federal level. For example, Massachusetts has issued a letter ruling³⁵ that concludes that each series of a Delaware limited liability company will be classified as a separate entity for Massachusetts income and corporate excise tax purposes. The Massachusetts letter ruling cited various authorities in support of this conclusion, including *National Securities*, Revenue Ruling 55-416, various private letter rulings dealing with series trusts, and a private letter ruling issued by the Service to the same taxpayers with respect to which the Massachusetts letter ruling was directed.³⁶

Similarly, the California Franchise Tax Board has asserted that each series of a series limited liability company will be treated as a separate entity for California filing and tax purposes.³⁷ The California Franchise Tax Board's position is premised on series possessing the following characteristics: (i) the holders of the interests in each series are limited to the assets of that series upon redemption, liquidation, or termination, and may share only in the income of that series; and (ii) under state law, the payment of expenses, charges, and liabilities is limited to the assets of that series.

In addition, in Illinois a "limited liability company and any of its series may elect to consolidate their operations as a single taxpayer to the extent permitted under applicable law."³⁸ This provision appears to presume that each series and the limited

³⁵ Mass. Ltr. Rul. 08-2: *Separate Entity Status and Federal Classification for Each Series of an LLC* (Feb. 15, 2008). Notwithstanding the conclusion that each series will be classified as a separate entity for Massachusetts income and corporate excise tax purposes, the Massachusetts ruling also concludes that, subject to any future changes in federal law, each series will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

³⁶ Based upon a comparison of the facts in the Massachusetts letter ruling and the facts in PLR 200803004 (Oct. 15, 2007), it appears that PLR 200803004 may be the private letter ruling that the Massachusetts letter ruling references as having been issued by the Service to the taxpayers.

³⁷ California 2007 Limited Liability Company Tax Booklet, p. 5, Section F. By treating each series as a separate entity for California filing and tax purposes, a series of a limited liability company that is registered or doing business in California must file its own tax return and pay its own separate annual tax and fee in California.

³⁸ 805 Ill. Comp. Stat. 180/37-40(b).

liability company is, by default, a separate entity for tax purposes unless an election is made to consolidate operations for tax purposes.³⁹

Finally, although the Code does not address the federal tax classification of series limited liability companies, by analogy certain provisions of the Code have a bearing on this issue. In particular, in defining the term “regulated investment company,” section 851(g)(1) provides that “[i]n the case of a regulated investment company . . . having more than one fund, each fund of such regulated investment company shall be treated as a separate corporation”⁴⁰ One could infer from section 851(g)(1) that, by analogizing multiple series of a limited liability company to multiple funds of a regulated investment company, each series should be treated as a separate entity for federal tax purposes.

V. Basis for Recommendations

The Revenue Ruling notes that a Protected Cell Company may be referred to sometimes as a “segregated account company” or “segregated portfolio company.” The Notice similarly observes that “[s]tatutes under which Protected Cell Companies are chartered differ among various jurisdictions, and cell arrangements differ among taxpayers due to variations in contractual terms.” These observations reflect the variety of segregated arrangements from which taxpayers may choose in organizing their business affairs.

As discussed above, a number of states have statutes that permit limited liability companies to be divided into series. Although the different states’ limited liability company statutes share various common traits, each state’s statute has certain unique characteristics. It follows that the different states’ statutes do not completely conform to one another. The fact that the different states’ statutes are not completely consistent is understandable considering the relative newness of series limited liability companies.

Because of the differences in states’ series limited liability company statutes, we have based our recommendations in these Comments on the Delaware LLC Act. Delaware was the first state to adopt series limited liability company legislation in 1996. It is not uncommon for practitioners to form an entity as a Delaware LLC even when it is not engaged in business in the state of Delaware. To the extent that practitioners are using series limited liability companies, we believe that it is more common for such series to be formed under the Delaware LLC Act than under the statutes of other states.

³⁹ The election in Illinois to consolidate the limited liability company’s and series’ operations for tax purposes appears to be separate and distinct from the election that Illinois permits for each series to be a separate state law entity.

⁴⁰ Section 851(g)(2) defines the term “fund” to mean “a segregated portfolio of assets, the beneficial interests in which are owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series in respect of such portfolio of assets.” Private Letter Ruling 200809012 (Feb. 29, 2008) cited section 851(g) as supporting the proposition that each series of a business trust should be treated as a separate business entity for federal income tax purposes.

By selecting the Delaware LLC Act as the basis for our recommendations, we do not intend that the guidance be limited to Series formed under the Delaware Series Provision. Rather, we suggest that the characteristics in the Delaware Series Provision that are essential to separate entity status be identified. Series limited liability companies formed in other states that contain these essential features should then receive the same treatment as series limited liability companies formed in Delaware. We discuss below the features in the Delaware LLC Act that we believe are essential to separate entity status.

As discussed previously, the Delaware Series Provision provides that:

1. Each Series may have a separate business purpose or investment objective;
2. Each Series may have separate members, managers and limited liability company interests;
3. Each Series may have separate rights, powers or duties with respect to specified property, obligations or profits and losses associated with specified property or obligations;
4. The debts, liabilities, obligations and expenses of a particular Series may be enforceable only against the assets of such Series and the debts, liabilities, obligations and expenses of the LLC or any other Series may not be enforceable against the particular Series; and
5. Each Series may have the power to, in its own name, contract, hold title to assets, and grant liens and security interests.

In addition, in order for the debts, liabilities, obligations and expenses of a particular Series to be enforceable against the assets of that Series only, and not against the assets of the LLC or any other Series, and in order for the debts, liabilities, obligations and expenses of the LLC or any other Series not to be enforceable against the assets of the particular Series: (i) the records maintained for the particular Series must account for the assets associated with that Series separately from the other assets of the LLC or any other Series of the LLC; (ii) the limited liability company agreement must provide that (x) the debts, liabilities, obligations and expenses of a particular Series are enforceable only against the assets of that Series, and (y) the debts, liabilities, obligations and expenses of the LLC or any other Series are not enforceable against the particular Series; and (iii) the LLC's certificate of formation must include a notice of the limitation on liabilities of a Series as provided in the Delaware Series Provision (collectively, the "Record Keeping and Notice Requirements").⁴¹

Although a Series is not a separate legal entity from the LLC, the characteristics of a Series under the Delaware Series Provision are the attributes that are commonly associated with a separate state law entity. A Series also has considerable autonomy

⁴¹ See Del. Code Ann. tit. 6, § 18-215(b).

from the LLC and the other Series.⁴² Assets associated with a Series may be held in the name of the Series, the LLC or a nominee.⁴³ In addition, an event that causes a member to cease to be associated with a Series does not cause the member to cease to be associated with the LLC or any other Series of that LLC.⁴⁴

The extent to which the limited liability company agreement may modify the Series' terms is not entirely clear under the Delaware Series Provision. The Delaware Series Provision only specifically states that the limited liability company agreement may: (i) establish one or more designated series of members, managers, limited liability company interests or assets; (ii) provide that the debts, liabilities, obligations and expenses of a particular Series are enforceable only against the assets of such Series; (iii) vary a Series' power to contract, hold title to assets, grant liens and security interests, and sue and be sued in its own name; (iv) provide that a member or manager is obligated personally for the Series' debts, obligations and liabilities; (v) provide for classes or groups of members or managers; (vi) provide for the taking of an action without the vote or approval of any member or manager or class or group of members or managers; (vii) provide that any member or class or group of members associated with a Series shall have no voting rights; (viii) grant to all or certain members or managers or a specified class or group of members or managers associated with a Series the right to vote separately or with all or any class or group of the members or managers associated with the Series; (ix) determine management for the Series; (x) vary the members' rights with respect to distributions declared by the Series; (xi) determine a member's rights upon an assignment of their limited liability company interest in a Series; and (xii) provide for the termination of a Series.⁴⁵

As previously indicated, the basis for our recommendations is limited generally to series limited liability companies and, more particularly, Series under the Delaware LLC Act. Nevertheless, we note that there are a number of state law business entities with respect to which segregation is permitted without the formation of a separate entity. Protected Cell Companies and cells are an example of such segregated arrangements. In addition, as discussed previously, some states permit the formation of series business trusts.⁴⁶ Furthermore, some foreign jurisdictions permit the formation of entities with series or other segregated arrangements having separate business purposes or investment

⁴² A Series is not completely autonomous of the LLC. For example, a dissolution of the LLC causes the termination and winding up of all of the LLC's Series. Del. Code Ann. tit. 6, § 18-215(k). However, the termination and winding up of a Series does not cause a dissolution of the LLC or any other Series. *Id.*

⁴³ See Del. Code Ann. tit. 6, § 18-215(b).

⁴⁴ See Del. Code Ann. tit. 6, § 18-215(j).

⁴⁵ See Del. Code Ann. tit. 6, § 18-215.

⁴⁶ See, e.g., Del. Code Ann. tit. 12, § 3806(b). Delaware also permits the formation of series limited partnerships. See Del. Code Ann. tit. 6, § 17-218.

objectives.⁴⁷ Such other segregated arrangements are not the subject of these Comments. We request that guidance be issued concerning the federal tax classification of series limited liability companies in light of the importance of series limited liability companies to the business community and the impact that the lack of certainty in how series limited liability companies should be classified for federal tax purposes has on the increased use of series.

VI. Recommendations

We recommend that Treasury and the Service issue guidance holding that each series of an LLC, and the LLC itself,⁴⁸ is a separate “business entity” for purposes of Regulation section 301.7701-2(a). By recognizing each Series and the LLC as a separate “business entity” under Regulation section 301.7701-2(a), each Series’ and the LLC’s classification for federal income tax purposes would be independently determined. Provided the LLC is not required to be classified as a corporation under Regulation section 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8), each Series and the LLC would be a separate “eligible entity” within the meaning of Regulation section 301.7701-3(a). If a Series or the LLC has at least two members, such Series or the LLC would be classified as a partnership unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2). If a Series or the LLC has a single member, such Series or the LLC would be disregarded as an entity separate from its single member unless it elects to be classified as an association taxable as a corporation under Regulation section 301.7701-2(b)(2).

To the extent that authority exists which bears on the federal tax classification of series limited liability companies, treating each Series and the LLC as a separate business entity is consistent with that authority. Accordingly, we believe that the rule we are recommending would (i) be consistent with the authority that does exist concerning the classification of series limited liability companies and business trusts, (ii) facilitate the use of series limited liability companies by taxpayers, and (iii) make more manageable the administration of series limited liability companies by the Service.

⁴⁷ For example, St. Vincent and the Grenadines (“SVG”) permits the formation of protected cell companies and series limited liability companies. SVG’s limited liability company statute is modeled after the Delaware LLC Act (including the Delaware Series Provision). Similarly, the Cayman Islands permits the formation of segregated portfolio companies.

⁴⁸ Although it is common for the business and affairs of the LLC to be conducted completely through Series, the Delaware Series Provision contemplates that the LLC may have its own separate assets, debts, liabilities, obligations and expenses that are not associated with any particular Series. *See* Del. Code Ann. tit. 6, § 18-215(b). We recommend that the characterization of the LLC itself depend upon whether the LLC satisfies the minimal requirements to be a business entity that is separate from its Series. Unless the LLC has assets and liabilities that are not associated with one or more of its Series, the LLC has no separate existence and should be treated as transparent or as a nominee. *See* Rev. Rul. 2004-86, 2004-2 C.B. 191; Rev. Rul. 92-105, 1992-2 C.B. 204. If the LLC has separate assets (including holding the economic interest in one or more of its Series) and satisfies the Record Keeping and Notice Requirements so that the liabilities of the LLC may only be enforced against the LLC’s assets, the LLC should be characterized as a separate business entity.

The guidance we are recommending would require that applicable state law contain provisions that allow Series to have the characteristics described in the Delaware Series Provision. In addition, we believe the guidance should require that the Record Keeping and Notice Requirements be satisfied so that, pursuant to the Delaware Series Provision, (i) the debts, liabilities, obligations and expenses of a particular Series are enforceable against the assets of that Series only, and not against the assets of the LLC or any other Series, and (ii) the debts, liabilities, obligations and expenses of the LLC or any other Series are not enforceable against the assets of the particular Series.⁴⁹ If those requirements are met each Series would be treated as a separate “business entity” for purposes of Regulation section 301.7701-2(a).

If applicable state law allows each Series to have the characteristics described in the Delaware Series Provision and the applicable Record Keeping and Notice Requirements are satisfied, we do not believe that any guidance should require that each Series possess the described characteristics (*e.g.*, separate business purposes, members and managers) or that the liabilities of a particular Series be enforceable only against the assets of that Series. It is not uncommon for separate, but affiliated, state law entities to have common business purposes, ownership or management. It is also permissible for one state law entity to assume the risk associated with another entity’s liabilities (*e.g.*, by contract between the entities, giving a guarantee to third-party creditors, or by cross-collateralizing debt). It is for those reasons that, for the guidance we are recommending, we believe it is sufficient if applicable state law allows each Series to have the described characteristics (without regard to whether each Series possesses such characteristics) and if the applicable Record Keeping and Notice Requirements are satisfied (without regard to whether the liabilities of a particular Series may only be enforced against the assets of that Series).

As noted above, we believe that the characteristics of Series under the Delaware Series Provision (including satisfaction of the Record Keeping and Notice Requirements) should be the foundation for the guidance we are recommending. In general, series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah share the same characteristics as Series under the Delaware LLC Act, except that only the Delaware and Illinois statutes specifically permit series to contract, hold assets, and grant liens and security interests in the series’ name. Basing the guidance on the characteristics of Series under the Delaware Series Provision would: (i) give states that have already adopted legislation direction on how to conform their statutes; and (ii) encourage more states to adopt legislation permitting the organization of series limited liability

⁴⁹ We do not believe any guidance should require that applicable state law allow a Series to sue and be sued in its own name. We view the ability to sue and be sued in the Series’ name as a procedural aspect of enforcing the rights of or the claims against a particular Series. We note that not requiring a Series to be able to sue and be sued in its own name is consistent with the proposed guidance in the Notice. Appendix A to these Comments compares the characteristics of Series under the Delaware LLC Act with the characteristics of series limited liability companies in Illinois, Iowa, Nevada, Oklahoma, Tennessee and Utah.

companies.⁵⁰ In the case of a series limited liability company organized under a statute that does not possess all of the relevant characteristics of Series under the Delaware Series Provision, we believe that classification should depend upon the authority that currently exists concerning the classification of series limited liability companies and business trusts.

As discussed previously, in Revenue Ruling 2004-86 the Service considered a number of factors in concluding that a Delaware statutory trust was a separate entity for federal income tax purposes. Such factors included:

1. Recognition of the trust as an entity separate from its owners under state law;
2. Whether creditors of the owners may assert claims directly against the trust's assets;
3. The trust's ability to sue and be sued, and whether the trust's assets are subject to attachment and execution;
4. Whether the trust's owners have limited personal liability for the trust's actions;
5. Whether the trust may merge or consolidate with or into other entities; and
6. Whether the trust was formed for investment purposes.

The characteristics of Series under the Delaware Series Provision compare favorably to the factors considered by the Service in Revenue Ruling 2004-86. The factors considered in Revenue Ruling 2004-86 support treating a Series as a separate entity for federal income tax purposes except that: (i) although a Series is separate from its members, a Series is not recognized as a separate legal entity from the LLC under state law; (ii) we do not believe that a Series must be able to sue and be sued in its own name; and (iii) a Series may not merge or consolidate with or into other entities separate and apart from the LLC or other Series.⁵¹ Although a Series is not recognized as a separate legal entity under state law, a Series' characteristics under the Delaware Series Provision⁵² are attributes of a separate state law entity. As noted previously, we view the

⁵⁰ Basing any guidance on the fundamental characteristics of the Delaware Series Provision would also be consistent with the Notice's suggested approach for classifying cells for federal income tax purposes. Section 3.01 of the Notice proposes treating a cell as a separate entity for federal income tax purposes if "the assets and liabilities of the cell are segregated from the assets and liabilities of any other cell and from the assets and liabilities of the Protected Cell Company such that no creditor of any other cell or of the Protected Cell Company may look to the assets of the cell for the satisfaction of any liabilities, including insurance claims (except to the extent that any other cell or the Protected Cell Company has a direct creditor claim against such cell)"

⁵¹ In order for a cell to be treated as an insurance company separate from any other entity, the Notice does not require that a cell (i) be recognized as a separate entity under state law, (ii) be able to sue or be sued in the cell's name, or (iii) be able to merge or consolidate with or into other entities.

⁵² For example, having a separate business purpose and separate owners, management, equity interests, assets and liabilities are common attributes of a business entity under state law.

ability to sue and be sued in the Series' name as a procedural aspect of enforcing the rights of or the claims against a particular Series. Further, although a Series may not merge or consolidate with or into other entities pursuant to a merger statute, a Series could effectively combine its operations with other entities by entering into joint ventures or transferring its assets in exchange for equity in another entity.

We considered various approaches in concluding that any guidance should adopt a blanket rule that classifies each Series and the LLC as a separate business entity for federal income tax purposes. As discussed above, the classification of a series of a limited liability company for federal tax purposes depends generally on facts and circumstances.⁵³ Accordingly, we considered whether the classification of Series and the LLC should depend upon a balancing of factors similar, for example, to the approach used by the *Kintner* Regulations in classifying an organization as a corporation or a partnership for federal income tax purposes by considering whether the organization possessed a preponderance of the corporate characteristics of (i) continuity of life, (ii) centralized management, (iii) limited liability, and (iv) free transferability of interests.⁵⁴

An approach based upon a balancing of factors could effectively establish a *de facto* elective regime that would favor taxpayers with sophisticated tax counsel. Such an approach could also create significant administrative complexity. Although the authority concerning the classification of series of a limited liability company for federal tax purposes is relatively sparse, because our recommended approach is consistent with the authority that does exist we do not believe that a balancing approach is warranted under the circumstances. Additionally, as discussed above, if guidance is based on the characteristics of Series under the Delaware Series Provision as set forth above (including satisfaction of the Record Keeping and Notice Requirements), that approach will inherently incorporate those characteristics as a foundation for classifying series limited liability companies for federal tax purposes. It is for those reasons that we concluded that a balancing approach is not appropriate.

We also considered whether it might be appropriate to allow taxpayers to elect to treat one or more Series and the LLC as a single business entity for federal tax purposes. Although Series are attractive because they allow taxpayers to segregate assets and liabilities while avoiding the complexity and costs associated with forming separate state law entities, taxpayers may not always want to treat Series separately for federal tax purposes. For example, although taxpayers may want to segregate the assets and liabilities associated with different businesses, they may nevertheless want to treat the businesses collectively as a single business entity for tax reporting purposes in order to achieve tax reporting and compliance efficiencies.

⁵³ See *Culbertson*, 337 U.S. 733; Rev. Rul. 2004-86.

⁵⁴ The *Kintner* Regulations, which were adopted in 1960, took their name from the case of *Kintner v. United States*, 216 F.2d 418 (9th Cir. 1954). The *Kintner* Regulations were replaced with the Check-the-Box Regulations in 1996.

We believe that taxpayers who desire to aggregate Series into a single business entity for federal tax purposes should be able to adopt a structure that accomplishes the desired result under the existing entity classification regulations. We also believe that a structure in which a multi-member Series owns all of the limited liability company interests in other Series should yield the same result for federal tax purposes as a structure in which a multi-member LLC owns all of the limited liability company interests in other LLCs. The flexibility to effectively aggregate eligible entities for federal income tax purposes is inherent in the entity classification regulations because, through ownership of the Series and the LLC, the Series and the LLC can be structured so that there is effectively a parent tax partnership that is the sole owner of each of the Series which are disregarded for tax purposes.⁵⁵ We recommend that any guidance governing the classification of Series for federal tax purposes include appropriate examples that illustrate both (i) operation of the basic rule, and (ii) the ability to effectively aggregate Series for federal tax purposes under the existing entity classification regulations.

We recognize that the approach we are recommending may not be consistent with how some taxpayers are currently treating series limited liability companies that they are using for their business affairs. Consequently, we believe that any guidance should be applied prospectively and not govern series limited liability companies created before such guidance is issued, except that existing series limited liability companies should be allowed to rely on the guidance if they (i) are formed under a statute having characteristics such as those contained in the Delaware Series Provision, (ii) satisfy applicable Record Keeping and Notice Requirements, and (iii) have been consistent in their treatment of the arrangement in accordance with the guidance. The classification of other existing series limited liability companies would be based upon the authority that currently exists concerning the classification of series limited liability companies and business trusts and whether taxpayers have been consistent in their treatment of such arrangements for federal tax purposes.

Finally, we recognize that the issue of how series limited liability companies should be classified for federal tax purposes is a subset of the larger issue of what is a “business entity” for federal tax purposes. The Regulations are not clear in defining what is a “business entity” for federal tax purposes – any entity that is recognized for federal tax purposes is a “business entity.”⁵⁶ We appreciate that issuing guidance regarding the classification of series limited liability companies necessarily raises the question of whether the larger issue must also be addressed.

⁵⁵ Regulation section 301.7701-2(a). *See* Example 2 of Part VII (Examples) of these Comments for an illustration of how the entity classification regulations could be used to aggregate Series into a single entity for federal tax purposes.

⁵⁶ The Regulations define a “business entity” as “any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under section 301.7701-3) that is not properly classified as a trust under section 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code.” Regulation section 301.7701-2(a).

We believe, however, that the larger issue does not lend itself as readily to being answered as the more specific question of how series limited liability companies should be classified for federal tax purposes.⁵⁷ Consequently, an approach targeted at resolving the larger issue for purposes of answering the more specific question would unnecessarily delay guidance on series limited liability companies. Considering the popularity of limited liability companies and the value of series limited liability companies, any substantial delay in addressing the classification of series would have significant consequences in terms of the administration of series limited liability companies for federal tax purposes. We believe that, notwithstanding the larger issue, developing guidance for the efficient administration of series limited liability companies is in the best interests of both taxpayers and the government. It is for that reason that we ask that the issuance of guidance concerning series limited liability companies not be delayed by concerns related to the broader question of what is a “business entity” generally for federal tax purposes.

VII. Examples

The following examples illustrate how Series would be classified under our recommendation and how the existing entity classification regulations could be used to effectively aggregate Series for federal tax purposes.⁵⁸

⁵⁷ For example, determining what is a “business entity” may require consideration of: (i) when two or more separate state law entities should be treated as one business entity for federal tax purposes; and (ii) when one state law entity (*e.g.*, other than in the context of series limited liability companies) should be treated as multiple business entities for federal tax purposes.

⁵⁸ The examples in this Part VII assume that (i) the LLC is organized under the Delaware LLC Act, (ii) the Record Keeping and Notice Requirements are satisfied, (iii) all of the assets, debts, liabilities, obligations and expenses are associated with the different Series and not the LLC, (iv) the LLC has none of its own members, managers, assets, debts, liabilities, obligations, expenses or business activities or any ownership interest in any of the Series, (v) pursuant to the Delaware Series Provision, the assets and liabilities of each Series will be separate and protected from the claims of creditors and members of the other Series, and (vi) the limited liability company agreement governing the LLC and the Series provides that the members’ capital accounts with respect to each Series will be determined and maintained in accordance with Regulation section 1.704-1(b)(2)(iv). Because the LLC does not have assets and liabilities that are not associated with any Series, the LLC has no separate existence and should be treated as transparent or as a nominee. *See* Rev. Rul. 2004-86, 2004-2 C.B. 191; Rev. Rul. 92-105, 1992-2 C.B. 204.

Example 1 (Investment Fund)

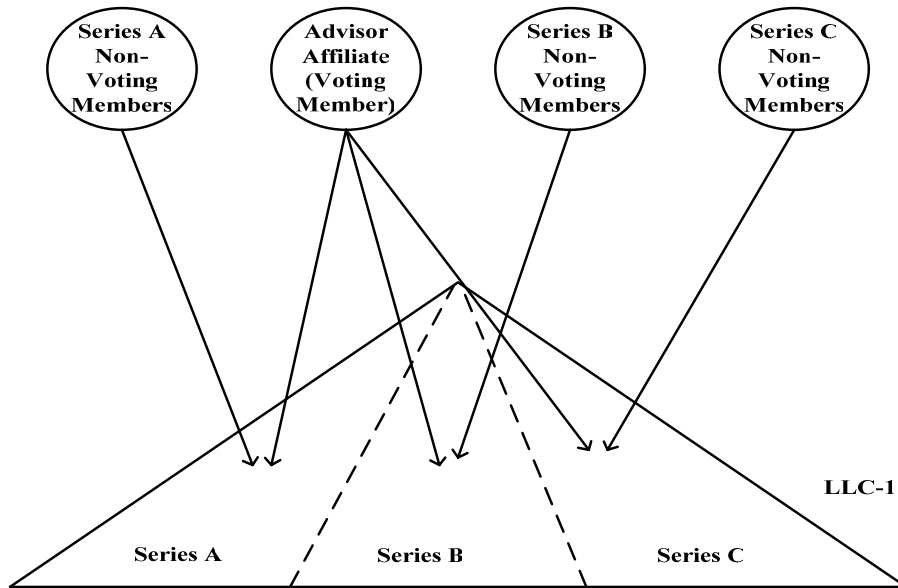
Background

Investment advisor (“Advisor”) creates LLC-1 for the purpose of establishing multiple investment funds. Upon formation, LLC-1 will have three Series (Series A, Series B and Series C). Each Series will have a unique investment strategy. Series A will invest principally in equity securities of U.S. companies. Series B will invest principally in equity securities of companies in emerging markets. Series C will invest principally in debt securities. Series A, Series B and Series C will each have separate and distinct nonvoting members (*i.e.*, investors). An affiliate of Advisor will be a member of each Series and will hold the voting limited liability company interest in each Series. There will be nothing to prevent a member of Series A, Series B or Series C from investing in another Series. LLC-1 will have the ability to establish additional Series in the future. The members will generally share in the profits, losses and distributions of each Series in accordance with their ownership of the Series’ limited liability company interests.

Analysis

The structure of LLC-1 and Series A, Series B and Series C can be depicted as follows:

Example 1



Each of Series A, Series B and Series C will be classified as a separate business entity for purposes of Regulation section 301.7701-2(a). Each of Series A, Series B and Series C will be an eligible entity treated as (i) a partnership if the Series has two or more members, (ii) a disregarded entity if the Series has one member, or (iii) a corporation if the Series elects to be treated as an association within the meaning of Regulation

section 301.7701-2(b)(2).⁵⁹ If a Series has two or more members, the members will have a capital account in and be treated as partners of the Series for federal tax purposes (assuming the Series does not elect to be treated as an association). If a Series has only one member, the member will be treated as directly holding the Series' assets and liabilities for federal tax purposes (assuming the Series does not elect to be treated as an association).

⁵⁹ Because each of Series A, Series B and Series C is classified as a separate eligible entity, each series may elect its classification for federal tax purposes without regard to the classification election made by the other series.

Example 2 (Operating Company)

Background

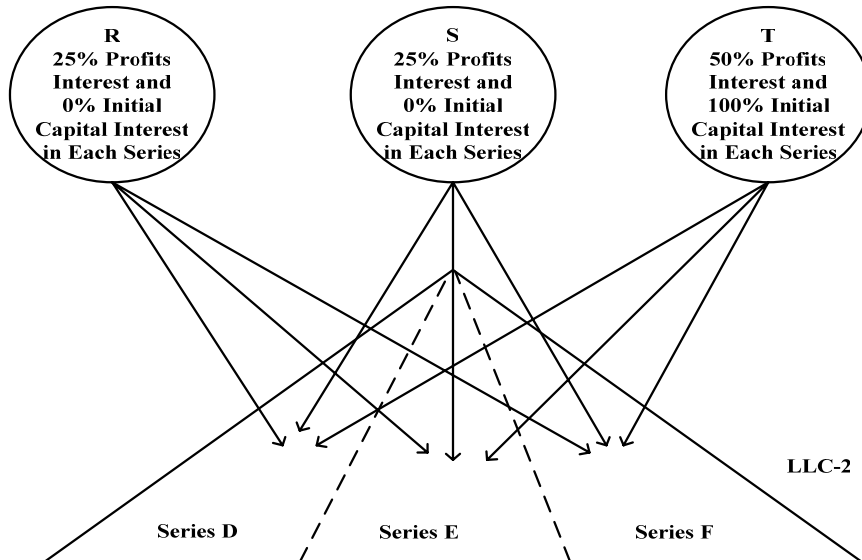
R and S have substantial experience in the automotive industry. T is a wealthy individual with substantial financial resources. R, S and T would like to form a company that will own and operate three separate but related businesses. The first line of business will be a dealership engaged in the sale of new and used automobiles (the “Sale Business”). The second line of business will focus on the servicing and maintenance of automobiles (including automobiles sold by the Sale Business and by third parties) (the “Service Business”). The third line of business will provide financing to people purchasing automobiles (including automobiles sold by the Sale Business and by third parties) (the “Finance Business”). Because of differences in the types of risks associated with the different lines of business, R, S and T would like for each line of business to be insulated from the liabilities associated with the other business lines.

R, S and T form LLC-2 with three Series (Series D, Series E and Series F). Series D will engage in the Sale Business. Series E will engage in the Service Business. Series F will engage in the Finance Business. Each Series will hold the assets and be responsible for the obligations related to that Series’ business. Except for certain extraordinary financial transactions, R and S will have equal responsibility for managing the day-to-day operations of all three Series. Extraordinary financial transactions for each Series will require T’s approval. T will make cash contributions directly to each of Series D, Series E and Series F as required to fund each Series’ business operations. Each of R and S will own a 25% profits interest in each Series and T will own the remaining 50% profits interest (and all of the initial capital interest). R, S and T will generally share in the profits, losses and distributions of each Series in accordance with their ownership of the profits interests in that Series. Each Series will make liquidating distributions in accordance with R’s, S’s and T’s positive capital account balances.

Primary Analysis

The structure of LLC-2 and Series D, Series E and Series F can be depicted as follows:

Example 2—Primary Analysis



Each of Series D, Series E and Series F will be classified as a separate business entity for purposes of Regulation section 301.7701-2(a) and a separate eligible entity for purposes of Regulation section 301.7701-3(a). Because each Series has more than two members, each Series will be treated as (i) a partnership or (ii) a corporation if the Series elects to be treated as an association within the meaning of Regulation section 301.7701-2(b)(2). Assuming the Series do not elect to be treated as associations, R, S and T will have capital accounts in and be treated as partners of each Series for federal tax purposes.

Alternative Analysis

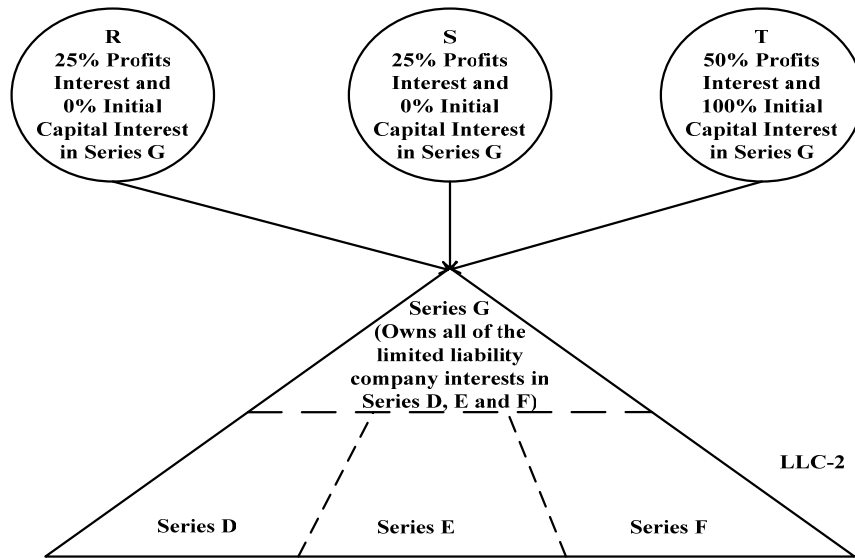
Alternatively, R, S and T could effectively aggregate the Series for federal tax purposes under the existing entity classification regulations. In order to aggregate the Series for federal tax purposes, LLC-2 would form a fourth Series (Series G). Each of R and S would own 25% of the profits interests of Series G and T would own the remaining 50% profits interest (and all of the initial capital interest). T will make cash contributions directly to Series G as required to fund each of Series D's, Series E's and Series F's business operations. Series G would own all of the limited liability company interests in Series D, Series E and Series F.⁶⁰ R, S and T will generally share in the profits, losses

⁶⁰ Under the Delaware LLC Act (including the Delaware Series Provision), it is permissible for one Series to own limited liability company interests in another Series (whether of the same or a different LLC). Based upon discussions with Delaware corporate counsel, although the Delaware Series Provision is drafted in a manner that would appear to permit LLC-2 to own limited liability company interests in Series

and distributions of Series G in accordance with their ownership of the profits interests. Series G will make liquidating distributions in accordance with R's, S's and T's positive capital account balances.

The structure of LLC-2 and Series D, Series E, Series F and Series G can be depicted as follows:

Example 2—Alternative Analysis



Assuming that none of Series D, Series E, Series F or Series G elects to be treated as an association within the meaning of Regulation section 301.7701-2(b)(2), for federal tax purposes (i) Series G would be treated as a partnership because it has more than two members, and (ii) each of Series D, Series E and Series F would be treated as a disregarded entity because all of their limited liability company interests are owned by Series G. Accordingly, Series D, Series E and Series F would be treated as branches or divisions of Series G for federal tax purposes.

D, Series E and Series F, it is our understanding that practitioners typically form a new Series of an LLC to hold limited liability company interests in other Series of that same LLC.

Example 3 (Real Estate Development Company)

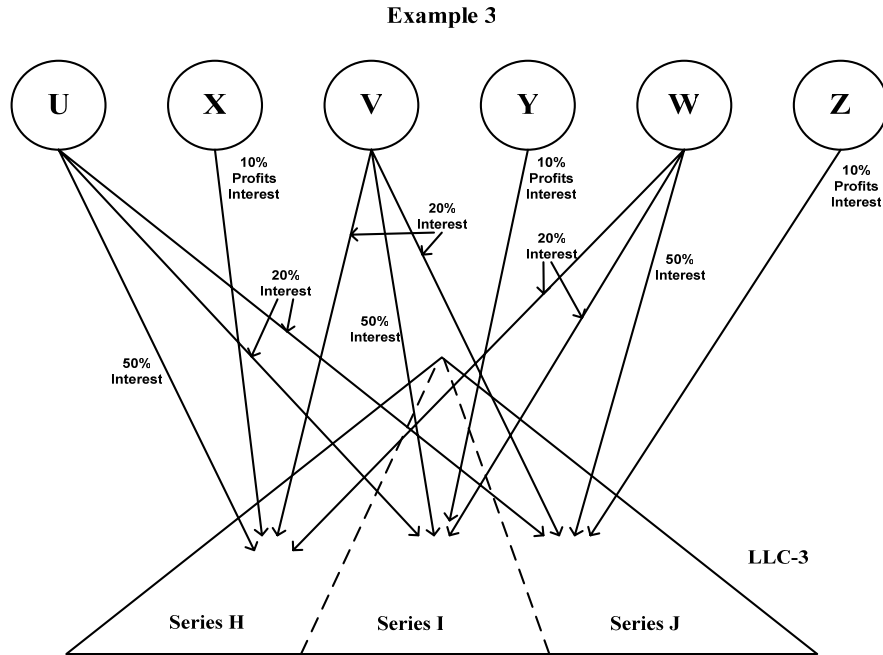
Background

U owns the fee interest in Blackacre. V owns the fee interest in Whiteacre. W owns the fee interest in Greenacre. The properties are of equal value. U, V and W form LLC-3 with three Series (Series H, Series I and Series J). The purpose of LLC-3 and the Series is to acquire and develop real estate on an ongoing basis. U transfers Blackacre to Series H in exchange for 50% of the limited liability company interests in Series H. Each of V and W makes a pro rata cash contribution to Series H in exchange for 20% of the limited liability company interests in Series H. V transfers Whiteacre to Series I in exchange for 50% of the limited liability company interests in Series I. Each of U and W makes a pro rata cash contribution to Series I in exchange for 20% of the limited liability company interests in Series I. W transfers Greenacre to Series J in exchange for 50% of the limited liability company interests in Series J. Each of U and V makes a pro rata cash contribution to Series J in exchange for 20% of the limited liability company interests in Series J.

Each of Blackacre, Whiteacre and Greenacre will be separately developed under the guidance of X, Y and Z, respectively. X, Y and Z are unrelated to U, V and W. In connection with services performed and to be performed (i) X is issued a 10% profits interest in, and is responsible for managing, Series H (which owns Blackacre), (ii) Y is issued a 10% profits interest in, and is responsible for managing, Series I (which owns Whiteacre), and (iii) Z is issued a 10% profits interest in, and is responsible for managing, Series J (which owns Greenacre). U, V, W, X, Y and Z will generally share in the profits, losses and distributions of each Series in accordance with their ownership of the profits interests in that Series. Each Series will make liquidating distributions in accordance with U's, V's, W's, X's, Y's and Z's positive capital account balances.

Analysis

The structure of LLC-3 and Series H, Series I and Series J can be depicted as follows:



Each of Series H, Series I and Series J will be classified as a separate business entity for purposes of Regulation section 301.7701-2(a) and a separate eligible entity for purposes of Regulation section 301.7701-3(a). Because each Series has more than two members, each Series will be treated as (i) a partnership, or (ii) a corporation if the Series elects to be treated as an association within the meaning of Regulation section 301.7701-2(b)(2). Assuming the Series do not elect to be treated as associations, U, V, W, X, Y and Z will have capital accounts in and be treated as partners for federal tax purposes of each Series in which they hold an ownership interest.

APPENDIX A

Comparison of Series Limited Liability Company Statutes

	<u>Delaware</u>	<u>Illinois</u>	<u>Iowa</u>	<u>Nevada</u>	<u>Oklahoma</u>	<u>Tennessee</u>	<u>Utah</u>
Each series may have a separate business purpose or investment objective	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Each series may have separate members, managers and limited liability company interests	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Each series may have separate rights, powers or duties with respect to specified property, obligations or profits and losses associated with specified property or obligations	Yes	Yes	Yes	Yes	Yes	Yes	Yes
The debts, liabilities, obligations and expenses of a particular series are enforceable only against the assets of such series	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Each series has the power to contract, hold title to assets, and grant liens and security interests in its own name	Yes	Yes	No	No	No	No	A Series may only contract in its own name
Each series is a separate state law entity	No	Elective	No	No	No	No	No
State law imposes record keeping and notice requirements	Yes	Yes	Yes	Yes	Yes	Yes	Yes

APPENDIX B

Selective Bibliography of Articles on Series Limited Liability Companies

Banoff and Lipton, *California Refines Its Tax Treatment of Series LLCs*, 106 J. Tax'n 316 (2007).

Bishop and Kleinberger, *Limited Liability Companies: Tax and Business Law* ¶ 2.11 (Warren, Gorham & Lamont ed. 2006) (1994).

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Cuff, *Series LLCs and the Abolition of the Tax System*, 2 Bus. Entities 26 (Warren, Gorham & Lamont ed.) (Jan./Feb. 2000).

Donn, *et al.*, *Limited Liability Entities – 2008: New Developments in Limited Liability Companies and Limited Liability Partnerships, Exploring the New World of Series LLCs* (ALI-ABA Video Law Review) (Mar. 19, 2008).

Frost, *Musings on Series LLCs*, J. Passthrough Entities 15 (May-June 2007).

Gattuso, *Let's Give the Frog a Little Love*, Bus. L. Today, Vol. 17, No. 6 (July/Aug. 2008).

Harding, *Series LLCs: A Wave of the Future or Not*, 27 Mich. Bus. L.J. 19 (Spring 2007).

Marsico, *Current Status of the Series LLC: Illinois Series Improves Upon Delaware Series LLC But Many Open Issues Remain*, J. Passthrough Entities, Vol. 6, No. 6 (Nov.-Dec. 2006).

McLoughlin and Ely, *The Series LLC Raises Serious State Tax Questions but Few Answers are Yet Available*, 16 J. Multistate Tax'n 6 (Jan. 2007).

Mooney, *Series LLCs: The Loaves and Fishes of Subchapter K*, 116 Tax Notes 663 (Aug. 20, 2007).

Murray, *A Real estate Practitioners' Guide to Delaware Series LLCs (With Form)* (2007), available at <http://www.firstam.com/listReference.cfm?id=5574>.

Stephens and Schultz, *Segregating Assets Within a Single Partnership: Delaware Series Partnerships and LLCs*, 78 Taxes 3 (Mar. 2000).

Terry and Samz, *An Initial Inquiry into the Federal Tax Classification of Series Limited Liability Companies*, 110 Tax Notes 1093 (Mar. 6, 2006).

APPENDIX C

Delaware Series Provision

Section 18-215: Series of Members, Managers, Limited Liability Company Interests or Assets

(a) A limited liability company agreement may establish or provide for the establishment of 1 or more designated series of members, managers, limited liability company interests or assets. Any such series may have separate rights, powers or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations, and any such series may have a separate business purpose or investment objective.

(b) Notwithstanding anything to the contrary set forth in this chapter or under other applicable law, in the event that a limited liability company agreement establishes or provides for the establishment of 1 or more series, and if the records maintained for any such series account for the assets associated with such series separately from the other assets of the limited liability company, or any other series thereof, and if the limited liability company agreement so provides, and if notice of the limitation on liabilities of a series as referenced in this subsection is set forth in the certificate of formation of the limited liability company, then the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof, and, unless otherwise provided in the limited liability company agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series. Assets associated with a series may be held directly or indirectly, including in the name of such series, in the name of the limited liability company, through a nominee or otherwise. Records maintained for a series that reasonably identify its assets, including by specific listing, category, type, quantity, computational or allocational formula or procedure (including a percentage or share of any asset or assets) or by any other method where the identity of such assets is objectively determinable, will be deemed to account for the assets associated with such series separately from the other assets of the limited liability company, or any other series thereof. Notice in a certificate of formation of the limitation on liabilities of a series as referenced in this subsection shall be sufficient for all purposes of this subsection whether or not the limited liability company has established any series when such notice is included in the certificate of formation, and there shall be no requirement that any specific series of the limited liability company be referenced in such notice. The fact that a certificate of formation that contains the foregoing notice of the limitation on liabilities of a series is on file in the office of the Secretary of State shall constitute notice of such limitation on liabilities of a series.

(c) A series established in accordance with subsection (b) of this section may carry on any lawful business, purpose or activity, whether or not for profit, with the exception of the business of banking as defined in § 126 of Title 8. Unless otherwise provided in a limited liability company agreement, a series established in accordance with subsection (b) of this section shall have the power and capacity to, in its own name, contract, hold title to assets (including real, personal and intangible property), grant liens and security interests, and sue and be sued.

(d) Notwithstanding § 18-303(a) of this title, under a limited liability company agreement or under another agreement, a member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of one or more series.

(e) A limited liability company agreement may provide for classes or groups of members or managers associated with a series having such relative rights, powers and duties as the limited liability company agreement may provide, and may make provision for the future creation in the manner provided in the limited liability company agreement of additional classes or groups of members or managers associated with the series having such relative rights, powers and duties as may from time to time be established, including rights, powers and duties senior to existing classes and groups of members or managers associated with the series. A limited liability company agreement may provide for the taking of an action, including the amendment of the limited liability company agreement, without the vote or approval of any member or manager or class or group of members or managers, including an action to create under the provisions of the limited liability company agreement a class or group of the series of limited liability company interests that was not previously outstanding. A limited liability company agreement may provide that any member or class or group of members associated with a series shall have no voting rights.

(f) A limited liability company agreement may grant to all or certain identified members or managers or a specified class or group of the members or managers associated with a series the right to vote separately or with all or any class or group of the members or managers associated with the series, on any matter. Voting by members or managers associated with a series may be on a per capita, number, financial interest, class, group or any other basis.

(g) Unless otherwise provided in a limited liability company agreement, the management of a series shall be vested in the members associated with such series in proportion to the then current percentage or other interest of members in the profits of the series owned by all of the members associated with such series, the decision of members owning more than 50% of the said percentage or other interest in the profits controlling; provided, however, that if a limited liability company agreement provides for the management of the series, in whole or in part, by a manager, the management of the series, to the extent so provided, shall be vested in the manager who shall be chosen in the manner provided in the limited liability company agreement. The manager of the series shall also hold the offices and have the responsibilities accorded to the manager as set forth in a limited liability company agreement. A series may have more than 1

manager. Subject to § 18-602 of this title, a manager shall cease to be a manager with respect to a series as provided in a limited liability company agreement. Except as otherwise provided in a limited liability company agreement, any event under this chapter or in a limited liability company agreement that causes a manager to cease to be a manager with respect to a series shall not, in itself, cause such manager to cease to be a manager of the limited liability company or with respect to any other series thereof.

(h) Notwithstanding § 18-606 of this title, but subject to subsections (i) and (l) of this section, and unless otherwise provided in a limited liability company agreement, at the time a member associated with a series that has been established in accordance with subsection (b) of this section becomes entitled to receive a distribution with respect to such series, the member has the status of, and is entitled to all remedies available to, a creditor of the series, with respect to the distribution. A limited liability company agreement may provide for the establishment of a record date with respect to allocations and distributions with respect to a series.

(i) Notwithstanding § 18-607(a) of this title, a limited liability company may make a distribution with respect to a series that has been established in accordance with subsection (b) of this section. A limited liability company shall not make a distribution with respect to a series that has been established in accordance with subsection (b) of this section to a member to the extent that at the time of the distribution, after giving effect to the distribution, all liabilities of such series, other than liabilities to members on account of their limited liability company interests with respect to such series and liabilities for which the recourse of creditors is limited to specified property of such series, exceed the fair value of the assets associated with such series, except that the fair value of property of the series that is subject to a liability for which the recourse of creditors is limited shall be included in the assets associated with such series only to the extent that the fair value of that property exceeds that liability. For purposes of the immediately preceding sentence, the term “distribution” shall not include amounts constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business pursuant to a bona fide retirement plan or other benefits program. A member who receives a distribution in violation of this subsection, and who knew at the time of the distribution that the distribution violated this subsection, shall be liable to a series for the amount of the distribution. A member who receives a distribution in violation of this subsection, and who did not know at the time of the distribution that the distribution violated this subsection, shall not be liable for the amount of the distribution. Subject to § 18-607(c) of this title, which shall apply to any distribution made with respect to a series under this subsection, this subsection shall not affect any obligation or liability of a member under an agreement or other applicable law for the amount of a distribution.

(j) Unless otherwise provided in the limited liability company agreement, a member shall cease to be associated with a series and to have the power to exercise any rights or powers of a member with respect to such series upon the assignment of all of the member’s limited liability company interest with respect to such series. Except as otherwise provided in a limited liability company agreement, any event under this chapter or a limited liability company agreement that causes a member to cease to be associated

with a series shall not, in itself, cause such member to cease to be associated with any other series or terminate the continued membership of a member in the limited liability company or cause the termination of the series, regardless of whether such member was the last remaining member associated with such series.

(k) Subject to § 18-801 of this title, except to the extent otherwise provided in the limited liability company agreement, a series may be terminated and its affairs wound up without causing the dissolution of the limited liability company. The termination of a series established in accordance with subsection (b) of this section shall not affect the limitation on liabilities of such series provided by subsection (b) of this section. A series is terminated and its affairs shall be wound up upon the dissolution of the limited liability company under § 18-801 of this title or otherwise upon the first to occur of the following:

- (1) At the time specified in the limited liability company agreement;
- (2) Upon the happening of events specified in the limited liability company agreement;
- (3) Unless otherwise provided in the limited liability company agreement, upon the affirmative vote or written consent of the members of the limited liability company associated with such series or, if there is more than 1 class or group of members associated with such series, then by each class or group of members associated with such series, in either case, by members associated with such series who own more than two-thirds of the then-current percentage or other interest in the profits of the series of the limited liability company owned by all of the members associated with such series or by the members in each class or group of such series, as appropriate; or
- (4) The termination of such series under subsection (m) of this section.

(l) Notwithstanding § 18-803(a) of this title, unless otherwise provided in the limited liability company agreement, a manager associated with a series who has not wrongfully terminated the series or, if none, the members associated with the series or a person approved by the members associated with the series or, if there is more than 1 class or group of members associated with the series, then by each class or group of members associated with the series, in either case, by members who own more than 50% of the then current percentage or other interest in the profits of the series owned by all of the members associated with the series or by the members in each class or group associated with the series, as appropriate, may wind up the affairs of the series; but, if the series has been established in accordance with subsection (b) of this section, the Court of Chancery, upon cause shown, may wind up the affairs of the series upon application of any member associated with the series, the member's personal representative or assignee, and in connection therewith, may appoint a liquidating trustee. The persons winding up the affairs of a series may, in the name of the limited liability company and for and on behalf of the limited liability company and such series, take all actions with respect to the series as are permitted under § 18-803(b) of this title. The persons winding up the affairs of a series shall provide for the claims and obligations of the series and distribute the assets of the series as provided in § 18-804 of this title, which section shall apply to the

winding up and distribution of assets of a series. Actions taken in accordance with this subsection shall not affect the liability of members and shall not impose liability on a liquidating trustee.

(m) On application by or for a member or manager associated with a series established in accordance with subsection (b) of this section, the Court of Chancery may decree termination of such series whenever it is not reasonably practicable to carry on the business of the series in conformity with a limited liability company agreement.

(n) If a foreign limited liability company that is registering to do business in the State of Delaware in accordance with § 18-902 of this title is governed by a limited liability company agreement that establishes or provides for the establishment of designated series of members, managers, limited liability company interests or assets having separate rights, powers or duties with respect to specified property or obligations of the foreign limited liability company or profits and losses associated with specified property or obligations, that fact shall be so stated on the application for registration as a foreign limited liability company. In addition, the foreign limited liability company shall state on such application whether the debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a particular series, if any, shall be enforceable against the assets of such series only, and not against the assets of the foreign limited liability company generally or any other series thereof, and whether any of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the foreign limited liability company generally or any other series thereof shall be enforceable against the assets of such series.