

## **DELAWARE SERIES LLC – WHERE ARE WE TODAY?**

by

Leo J. Cushing, Esq., CPA, LL.M.  
Cushing & Dolan, P.C.  
Attorneys at Law  
Ten Tremont Street  
Third Floor, Suite 9  
Boston, MA 02108

375 Totten Pond Road, Suite 200  
Waltham, MA 02451

Tel: (617) 523-1555

Fax: (617) 523-5653

*lcushing@cushingdolan.com*  
*www.cushingdolan.com*

April 4, 2012

### **1. Introduction**

- In 1996, Delaware introduced a concept known as a Delaware Series LLC. Del. Code Title 6, §18-215.
- Since then, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico have enacted Series/Cell LLC Statutes.

### **2. Goal of Series LLC**

To create a single entity that would be a partnership for federal income tax purposes that could set up numerous cells known as “Separate Series” to hold various properties and/or businesses. This would eliminate the need to form numerous limited liability companies and eliminate the cost of formation, maintaining and income tax return preparation.

#### Example:

Husband and wife own 10 real estate properties, mostly in Massachusetts, but the titles are held either individually or in so-called Massachusetts realty trusts. Some of the realty trusts provide usual language as follows:

“The Trustees shall have no power to deal in or with the Trust estate except as directed by all of the beneficiaries.”

Other properties held in a document entitled Realty Trust that provides that the Trustee shall have essentially full power of ownership so the Trustee owns the property individually.

### 3. Liability of Owners

It is well settled that the trustee of a true nominee trust is an agent for the principal and therefore is liable. Similarly, the principals are liable, both jointly and severally, on the assumption that the relationship between the beneficiaries of a Massachusetts nominee trust is that of a general partnership.

Remember, a nominee trust is an entity that could file for bankruptcy, but the liability of the principal would be determined by state law. *Medallion Realty Trust*, 150 B.R. 495 (D. Mass. 1990)

### 4. Solution to Liability Problem

- Option 1: Transfer all 10 properties to 1 LLC.  
Problem: There is no firewall between the properties so all properties are at risk assuming there is a problem at 1 property.
- Option 2: Transfer each property to a separate LLC.  
Problem: 10 annual fees, 10 formation fees, and 10 partnership Returns will be required annually.

Annual Fees:	\$ 5,000 (\$500 x 10)
Partnership Returns:	\$25,000 (\$2,500 each x 10)
Total Fees:	\$30,000

- Option 3:  
Create LLC to be owned equally by husband and wife and then LLC will form 10 separate single member LLCs.

Annual Fees:	\$ 5,500 (\$ 500 x 11)
Partnership return:	\$ 2,500 (\$2,500 x 1)
Total Fees:	\$ 8,000

### PLANNING NOTE:

*Each single member LLC is owned by the parent LLC so that, pursuant to Treas. Regs. 301.7701-3, it will be taxed as a disregarded entity separate from its owner for federal income tax purposes.*

## **5. The Delaware Series LLC Solution**

Establish one Delaware Series LLC to be owned by husband and wife which will own each of the separate properties as a Separate Series pursuant to 6 Del. Code. §18-215. By statute, if each property is separately titled, each property will be treated as owned by a separate LLC.

## **6. Statutory Provisions/Authority**

§18-215 Series of Members, Managers or Limited Liability Company Interests

- (a) A limited liability company agreement may establish or provide for the establishment of designated series of members, managers, or limited liability company interest having 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, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.
- (b) Notwithstanding anything to the contrary set forth in the chapter or under other applicable law, in the event that a limited liability company agreement creates one or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held and accounted for 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 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 and obligations 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 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 and generally or any other series thereof shall be enforceable against the assets of such series. 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) 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.

## **7. How to Separately Title Property**

- Form Delaware Series LLC
- Delaware Series LLC establishes single member Massachusetts LLC to be a trustee of a Massachusetts realty trust (let's call this ABC Title, LLC)

### **PLANNING NOTE:**

*The Massachusetts LLC will be a disregarded entity for income tax purposes as it is a wholly-owned subsidiary of the Delaware Series LLC. By formation documents, it is established solely for the purpose of holding title to properties as a trustee of a Massachusetts nominee trust to separately hold title to real estate as required by the Delaware Separate Series LLC.*

## **8. Realty Trust – Sample Language**

WHEREAS, this FIRST AMENDED AND RESTATED 265 FRANKLIN STREET REALTY TRUST has been authorized by the sole Beneficiary and is intended to be such instrument and shall set forth the terms of such amendment;

WHEREAS, the Trustee and its Successors in Trust, will hold all real estate and any and all other property, whether real, personal or mixed, that may at any time be conveyed, assigned, transferred or delivered to said Trustee or its Successors in Trust for the sole benefit of a separate Series of a Delaware Series Limited Liability Company as nominee for the purpose of holding such property separately from the other assets of the Delaware Series Limited Liability Company or any Series thereof pursuant to 6 Del. Code Sec. 18-215, as identified in the Schedule of Beneficiaries, which Schedule has this day been executed by the Beneficiaries and filed with the Trustee with receipt and acknowledged by at least one Trustee (hereafter, as it may be amended, "Schedule of Beneficiaries"); and

WHEREAS, the Trustee desires to amend and restate said Trust in its entirety and upon the following terms and conditions.

## **9. Delaware Certificate of Formation – Sample Language**

The Certificate of Formation must state:

“Notice is hereby given pursuant to Section 18.215(b) of the LLC Act that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of the LLC, shall be enforceable against the assets of such series only and not against the assets of the LLC generally, or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the LLC generally, or any other series thereof, shall be enforceable against the assets of such series.”

#### 10. Series LLC – Sample Language in Operating Agreement

“The debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a Series shall be enforceable against the assets of such Series only and not against any other assets of the Company generally or other Series or none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the Company generally or any other Series shall be enforceable against the assets of such Series. Separate and distinct records shall be maintained for each and every series, and assets associated with any such Series shall be accounted for separately from other assets of the Company, or any other Series of the Company. The Members shall not commingle the assets of one Series with the assets of any other Series. The Certificate of Formation shall contain notice of the limitation of liabilities of a Series as to other Series in conformity with Section 18-215 of the Act.”

#### 11. Sounds Great But Questions Remain

- a) Massachusetts entity status and federal classification for each Series of an LLC. Letter Ruling 08-2 dated February 15, 2008.

##### **PLANNING NOTE:**

*The taxpayer, having received a Private Letter Ruling from the Internal Revenue Service relative to the establishment of a Delaware Series LLC and the establishment of Separate Series with respect to the taxpayer’s various businesses (PLR 200803004 discussed below) sought guidance from the Department of Revenue.*

##### **b) Facts of DOR LR. 08-2**

- Taxpayer was a Massachusetts business trust operating an open-end management investment company, also known as a mutual fund, registered under the Investment Company Act of 1940.
- The beneficial interests in the trusts were divided into transferable shares.
- Trustees of the trust divides its shares into several portfolios.
- Each trust portfolio is separate from each other’s trust portfolio.

- Each trust portfolio is currently taxed as a separate regulated investment company (RIC) under IRC § 851.
- The trust proposed to reorganize its business into a Delaware Series LLC.
- Each LLC Series will be separate from each other LLC Series.
- Each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings.
- The shareholders of an LLC Series may share in the income only of that LLC Series.
- The ownership interest of the shareholders of an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series.
- The payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC's Series' assets.
- The creditors of an LLC Series will be limited to the assets of that LLC Series for recovery or expenses, charges, and liabilities.
- The reorganization consists of the following:
  - (1) a transfer by each Trust Portfolio of its assets to a corresponding LLC Series in exchange for the LLC Series' assumption of its liabilities, if any, and the Trust Portfolio's receipt of LLC Series membership interests, followed by
  - (2) a distribution of the LLC Series membership interests to each of the Trust Portfolio's shareholders in complete liquidation of the Trust Portfolio.
- After the Reorganization, LLC proposes that certain LLC Series, each of which will have only one shareholder, collectively the D Series, will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than a disregarded entity as an entity separate from its owner for federal income tax purposes.
- LLC proposes that certain LLC Series, each of which currently has more than one shareholder (type P Series), will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than as a partnership and will not be treated as a publicly traded partnership taxable as a corporation under IRC § 7704 for federal income tax purposes.

- LLC proposes that certain LLC Series will elect pursuant to Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal income tax purposes, effective from the date of formation of such LLC Portfolio (collectively, "Type C Series").

**c) Requested Rulings**

- The Taxpayers request a ruling that (1) each LLC Series is treated for Massachusetts income and corporate excise tax purposes as a separate entity (or part of a separate entity in the case of a Type D disregarded entity treated as part of its sole owner); (2) each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income tax purposes as a separate LLC; and consequently, each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**PLANNING NOTE:**

*The LLC will have no assets, liabilities, or income because everything will be allocated among the Series and the function of the LLC is to make it easier to file amendments and other documents with the SEC.*

**d) Ruling**

- Each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.
- Each LLC Series and any additional Series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**e) Refusal to Rule**

- The Department of Revenue refused to rule on whether each Series of the LLC is itself a separate LLC.

- 12. Question:** Does the Delaware Series LLC file one partnership income tax return reporting the income and expenses of all the subsidiaries or does each Separate Series have to file a separate partnership income tax return?

Based on the Letter Ruling, it appears that, to the extent that the husband and wife, in this case, share equally with respect to each subsidiary, then each subsidiary Series LLC, although not a separate entity under state law, will be treated as a partnership for federal and state income tax purposes and require a separate income tax return for each Series.

### 13. **IRS in the Proposed Regulations dated October 13, 2010**

On October 13, 2010, the IRS issued Proposed Regulations regarding the tax treatment of Series LLCs.

#### Example 1: Domestic Series LLC:

(i) Facts:

Series LLC is a Series Organization (Series LLC). Series LLC has 3 members, 1, 2 and 3. Series LLC establishes 2 Series (A and B) pursuant to the LLC statute of state Y, a Series Statute within the meaning of the Regulations. Under general tax principles, Member 1 and 2 are the owners of Series A and Member 3 is the owner of Series B. Series A and B are not described in Section 301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of Section 301.7701-4.

(ii) Analysis:

Under these Regulations, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under 301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

#### **PLANNING NOTE:**

*(1) The Regulations look through the Delaware Series LLC entity and assume that each Member of the Series LLC owns a pro rata share of each applicable Separate Series thereby making each a partnership, unless there is only 1 Member with respect to a Series, in which case it is a disregarded entity.*

*(2) This treatment may only be applicable to the extent that the Separate Series is not a "Separate Entity" under state law capable of suing and being sued. Compare the Medallion Realty Trust case in which the Massachusetts realty trust which holds title to the property and which is a single member of the Delaware Series LLC, in such a case, the Regulations may not be applicable since the Regulations are premised upon the fact that, under state series law, a separate legal entity does not exist, at least insofar as the Regulations and its analysis are concerned.*

### 14. **Litigation and Liability**

G&G Management, LLC v. Young Brothers & Company, Inc., United States District Court, District of Maine, Civil Action No. 05-162 BK, dated February 21, 2007.

(i) Facts:

- G&G Management, LLC, a limited liability company organized in Delaware with a principal place of business in New York, New York.
- G&G existed to manage the household affairs and the financial investments of the Goelet Family, including the family residence on Gardiner Island in Long Island Sound and the vessel M-V Captain Kidd Ford IV used to transport the family and household supplies between East Hampton, New York and Gardiner Island, New York.
- In 2002, G&G contracted with Young Brothers & Company to build a new boat to replace Captain Kidd III, which was 40 feet long with a 350 horsepower engine and the new boat would be 45 feet long with an 800 horsepower engine at a cost of approximately \$265,000.
- At some point in time, G&G formed 2 separate interests under Delaware law, Series A and Series B, and gave Series B the purpose of holding the assets' liabilities associated with the Captain Kidd IV, including the boat itself as evidenced by a new Certification of Documentation issued on March 25, 2004.
- The boat was delivered but turned out to be defective and G&G Management, LLC commenced a lawsuit against Young Brothers & Company.
- After a trial, it was determined that Young Brothers & Company, Inc. would be liable to the Plaintiff for \$54,923.70, plus interest.

(ii) Issues in case relating to LLC:

- Just prior to trial, G&G Management, LLC filed a Motion to Join a Real Party in Interest, namely G&G Management, LLC (Series B), a series of limited liability company interests in "certified by G&G Management, LLC" pursuant to Delaware Statute that authorizes Delaware LLCs to establish one or more "Series" of "Limited Liability Company" interests having separate rights, powers or duties with respect to specified property or obligations of the Limited Liability Company, citing 6 Del. Code Ann. Section 18-215(A).
- The Court noted that the Delaware Statute does not indicate what capacity an LLC has to pursue litigation on behalf of its Series, see, Fed. R. Civ. P. 17-B, nor does the Statute indicate what capacity the Series of an LLC has, if any, to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved.

- Although G&G Management, LLC contracted for the construction of the vessel and purchased the vessel, it subsequently identified G&G Management, LLC (Series B) as the owner and G&G Management, LLC as the Managing Owner on the Certificate of Documentation for the vessel.
- The Motion was denied with the Court finding that G&G has a sufficient interest in the boat to maintain the action and that it has a unity of interest with the Series B, such that, under Maine law, Series B could not obtain judgment against Young Brothers & Company for the same events and concluded that G&G can maintain this action as the real party in interest even if it had transferred nominal interest to Series B.

#### **15. Other Matters Uncertain**

- Some attorneys do not create realty trusts to hold separate title. This appears to create a significant problem in terms of securing a particular property in exchange for a Note since the Series LLC will need to be the maker of the Note.
- How should the deed into the Series LLC read? Do not put the name of the particular Series into the Grantee line lest you will have a title defect not easily cured. Use a parenthetical notation at the bottom of the deed stating that this property will be held as a Separate Series with the following language:

\_\_\_\_\_ is held in the \_\_\_\_\_ Series, a separate series of the \_\_\_\_\_ Series, LLC. Pursuant to Section 18-215(b) of the Delaware Limited Liability Company Act the debts, liabilities, and obligations incurred, contracted for or otherwise existing with respect to such series of the Company shall be enforceable against the assets of such series only and not against the assets of the Company generally or any other series thereof, and none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series.

#### **16. Employment Tax & Employee Benefit Issues**

The Regulations expressed concern about whether a Series or a Series Organization is the employer under relevant employment law noting “the

domestic statute authorizing the creation of Series contemplates that a Series may operate a business.” If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans.

Application of the employment tax requirements will depend principally on whether the workers are employees and, if so, who is considered the employer for federal income and employment tax purposes “which the employer is identified additionally may arise, including but limited to the following: (1) how would the wage be determined from employees, particularly if they work for more than one Series in a common line of business; (2) how would the common paymaster rules apply; (3) who would be authorized to designate an agent under Section 3504 for reporting and payment of employment taxes and how would the authorization be accomplished; (5) how would the statutory exceptions from the definition of employment and wages apply given that they may be based on the identity of the employer.

If the Series organization handles payroll for a Series and also is the nominal owner of the Series’ assets, would the owners or the managers of the Series organization be responsible for the trust fund recovering penalty under Section 6672?

## **17. Questions asked in the IRS Proposed Regulations**

Comments were requested on the following issues:

- (1) Whether a Series Organization should be recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its Series;
- (2) The appropriate treatment of a Series does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for federal tax purposes are foreign cells that do not conduct insurance business and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How a Series and Series Organization will be treated for state employment tax purposes and other state employment related purposes and how that treatment should affect the federal employment tax treatment of Series or Series Organizations (comments from the State should be particularly helpful);

- (6) What issues could arise with respect to the Division of Employee Benefits by a Series Organization or Series; and
- (7) The requirement for Series Organization and each Series of the Series Organization to file a statement and what information should be included on the statement.

## **18. Other Matters**

- In California, the Franchise Tax Board in California takes the position that each Series counts as its own LLC for fee purposes.
- Apparently the American Bar Association conducted a review of a Series LLC and declined to endorse them. Illinois and Iowa provides specifically that “Each Series shall be treated as a separate entity to the extent set forth in the Articles of Organization” and, further “Each Series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company.”
- The drafters of the 2006 Revised Uniform Limited Company Act (RE-ULLCA) considered but rejected the idea of including Series provisions in the Act.
- In composite returns, most states allow or require the filing of composite returns for pass-through entities with non-resident owners and is generally filed on behalf of all non-resident members of the entity with the tax being computed at the highest marginal rate.
- If a state determines that each share of an LLC is a separate entity, presumably a composite return would be filed and taxes paid, by each series rather than one return being returned by the LLC as an umbrella entity if the series were treated as disregarded entities.
- If an LLC were to have numerous series with activities in a state where owners were non-residence, a compliance burden would be created as compared to the filing of one composite return if the various Series were disregarded as entities apart from the LLC.

## **19. Bankruptcy Law**

Only a “person” is entitled to file for bankruptcy protection. An LLC generally is considered a person even though an LLC is not within the framework of a “person” in the Bankruptcy Code. As a result, it is uncertain whether a Separate

Series that is not a “Separate Entity,” such as under Illinois law, would be eligible to file for bankruptcy.

Compare, however, the *Medallion Realty Trust* case in which the realty trust was entitled to file for bankruptcy. 11 USC 101, Section 41 provides, “The term person includes individual, partnership, incorporation, but does not include governmental unit...”

## **20. Conclusion**

Proceed with Caution!

## **DELAWARE SERIES LLC – WHERE ARE WE TODAY?**

by

Leo J. Cushing, Esq., CPA, LL.M.  
Cushing & Dolan, P.C.  
Attorneys at Law  
Ten Tremont Street  
Third Floor, Suite 9  
Boston, MA 02108

375 Totten Pond Road, Suite 200  
Waltham, MA 02451

Tel: (617) 523-1555

Fax: (617) 523-5653

*lcushing@cushingdolan.com*  
*www.cushingdolan.com*

April 4, 2012

### **1. Introduction**

- In 1996, Delaware introduced a concept known as a Delaware Series LLC. Del. Code Title 6, §18-215.
- Since then, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico have enacted Series/Cell LLC Statutes.

### **2. Goal of Series LLC**

To create a single entity that would be a partnership for federal income tax purposes that could set up numerous cells known as “Separate Series” to hold various properties and/or businesses. This would eliminate the need to form numerous limited liability companies and eliminate the cost of formation, maintaining and income tax return preparation.

#### Example:

Husband and wife own 10 real estate properties, mostly in Massachusetts, but the titles are held either individually or in so-called Massachusetts realty trusts. Some of the realty trusts provide usual language as follows:

“The Trustees shall have no power to deal in or with the Trust estate except as directed by all of the beneficiaries.”

Other properties held in a document entitled Realty Trust that provides that the Trustee shall have essentially full power of ownership so the Trustee owns the property individually.

### 3. Liability of Owners

It is well settled that the trustee of a true nominee trust is an agent for the principal and therefore is liable. Similarly, the principals are liable, both jointly and severally, on the assumption that the relationship between the beneficiaries of a Massachusetts nominee trust is that of a general partnership.

Remember, a nominee trust is an entity that could file for bankruptcy, but the liability of the principal would be determined by state law. *Medallion Realty Trust*, 150 B.R. 495 (D. Mass. 1990)

### 4. Solution to Liability Problem

- Option 1: Transfer all 10 properties to 1 LLC.  
Problem: There is no firewall between the properties so all properties are at risk assuming there is a problem at 1 property.
- Option 2: Transfer each property to a separate LLC.  
Problem: 10 annual fees, 10 formation fees, and 10 partnership Returns will be required annually.

Annual Fees:	\$ 5,000 (\$500 x 10)
Partnership Returns:	\$25,000 (\$2,500 each x 10)
Total Fees:	\$30,000

- Option 3:  
Create LLC to be owned equally by husband and wife and then LLC will form 10 separate single member LLCs.

Annual Fees:	\$ 5,500 (\$ 500 x 11)
Partnership return:	\$ 2,500 (\$2,500 x 1)
Total Fees:	\$ 8,000

### **PLANNING NOTE:**

*Each single member LLC is owned by the parent LLC so that, pursuant to Treas. Regs. 301.7701-3, it will be taxed as a disregarded entity separate from its owner for federal income tax purposes.*

## **5. The Delaware Series LLC Solution**

Establish one Delaware Series LLC to be owned by husband and wife which will own each of the separate properties as a Separate Series pursuant to 6 Del. Code. §18-215. By statute, if each property is separately titled, each property will be treated as owned by a separate LLC.

## **6. Statutory Provisions/Authority**

§18-215 Series of Members, Managers or Limited Liability Company Interests

- (a) A limited liability company agreement may establish or provide for the establishment of designated series of members, managers, or limited liability company interest having 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, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.
- (b) Notwithstanding anything to the contrary set forth in the chapter or under other applicable law, in the event that a limited liability company agreement creates one or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held and accounted for 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 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 and obligations 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 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 and generally or any other series thereof shall be enforceable against the assets of such series. 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) 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.

## **7. How to Separately Title Property**

- Form Delaware Series LLC
- Delaware Series LLC establishes single member Massachusetts LLC to be a trustee of a Massachusetts realty trust (let's call this ABC Title, LLC)

### **PLANNING NOTE:**

*The Massachusetts LLC will be a disregarded entity for income tax purposes as it is a wholly-owned subsidiary of the Delaware Series LLC. By formation documents, it is established solely for the purpose of holding title to properties as a trustee of a Massachusetts nominee trust to separately hold title to real estate as required by the Delaware Separate Series LLC.*

## **8. Realty Trust – Sample Language**

WHEREAS, this FIRST AMENDED AND RESTATED 265 FRANKLIN STREET REALTY TRUST has been authorized by the sole Beneficiary and is intended to be such instrument and shall set forth the terms of such amendment;

WHEREAS, the Trustee and its Successors in Trust, will hold all real estate and any and all other property, whether real, personal or mixed, that may at any time be conveyed, assigned, transferred or delivered to said Trustee or its Successors in Trust for the sole benefit of a separate Series of a Delaware Series Limited Liability Company as nominee for the purpose of holding such property separately from the other assets of the Delaware Series Limited Liability Company or any Series thereof pursuant to 6 Del. Code Sec. 18-215, as identified in the Schedule of Beneficiaries, which Schedule has this day been executed by the Beneficiaries and filed with the Trustee with receipt and acknowledged by at least one Trustee (hereafter, as it may be amended, "Schedule of Beneficiaries"); and

WHEREAS, the Trustee desires to amend and restate said Trust in its entirety and upon the following terms and conditions.

## **9. Delaware Certificate of Formation – Sample Language**

The Certificate of Formation must state:

“Notice is hereby given pursuant to Section 18.215(b) of the LLC Act that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of the LLC, shall be enforceable against the assets of such series only and not against the assets of the LLC generally, or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the LLC generally, or any other series thereof, shall be enforceable against the assets of such series.”

#### 10. Series LLC – Sample Language in Operating Agreement

“The debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a Series shall be enforceable against the assets of such Series only and not against any other assets of the Company generally or other Series or none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the Company generally or any other Series shall be enforceable against the assets of such Series. Separate and distinct records shall be maintained for each and every series, and assets associated with any such Series shall be accounted for separately from other assets of the Company, or any other Series of the Company. The Members shall not commingle the assets of one Series with the assets of any other Series. The Certificate of Formation shall contain notice of the limitation of liabilities of a Series as to other Series in conformity with Section 18-215 of the Act.”

#### 11. Sounds Great But Questions Remain

- a) Massachusetts entity status and federal classification for each Series of an LLC. Letter Ruling 08-2 dated February 15, 2008.

##### **PLANNING NOTE:**

*The taxpayer, having received a Private Letter Ruling from the Internal Revenue Service relative to the establishment of a Delaware Series LLC and the establishment of Separate Series with respect to the taxpayer’s various businesses (PLR 200803004 discussed below) sought guidance from the Department of Revenue.*

##### **b) Facts of DOR LR. 08-2**

- Taxpayer was a Massachusetts business trust operating an open-end management investment company, also known as a mutual fund, registered under the Investment Company Act of 1940.
- The beneficial interests in the trusts were divided into transferable shares.
- Trustees of the trust divides its shares into several portfolios.
- Each trust portfolio is separate from each other’s trust portfolio.

- Each trust portfolio is currently taxed as a separate regulated investment company (RIC) under IRC § 851.
- The trust proposed to reorganize its business into a Delaware Series LLC.
- Each LLC Series will be separate from each other LLC Series.
- Each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings.
- The shareholders of an LLC Series may share in the income only of that LLC Series.
- The ownership interest of the shareholders of an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series.
- The payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC's Series' assets.
- The creditors of an LLC Series will be limited to the assets of that LLC Series for recovery or expenses, charges, and liabilities.
- The reorganization consists of the following:
  - (1) a transfer by each Trust Portfolio of its assets to a corresponding LLC Series in exchange for the LLC Series' assumption of its liabilities, if any, and the Trust Portfolio's receipt of LLC Series membership interests, followed by
  - (2) a distribution of the LLC Series membership interests to each of the Trust Portfolio's shareholders in complete liquidation of the Trust Portfolio.
- After the Reorganization, LLC proposes that certain LLC Series, each of which will have only one shareholder, collectively the D Series, will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than a disregarded entity as an entity separate from its owner for federal income tax purposes.
- LLC proposes that certain LLC Series, each of which currently has more than one shareholder (type P Series), will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than as a partnership and will not be treated as a publicly traded partnership taxable as a corporation under IRC § 7704 for federal income tax purposes.

- LLC proposes that certain LLC Series will elect pursuant to Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal income tax purposes, effective from the date of formation of such LLC Portfolio (collectively, "Type C Series").

**c) Requested Rulings**

- The Taxpayers request a ruling that (1) each LLC Series is treated for Massachusetts income and corporate excise tax purposes as a separate entity (or part of a separate entity in the case of a Type D disregarded entity treated as part of its sole owner); (2) each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income tax purposes as a separate LLC; and consequently, each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**PLANNING NOTE:**

*The LLC will have no assets, liabilities, or income because everything will be allocated among the Series and the function of the LLC is to make it easier to file amendments and other documents with the SEC.*

**d) Ruling**

- Each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.
- Each LLC Series and any additional Series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**e) Refusal to Rule**

- The Department of Revenue refused to rule on whether each Series of the LLC is itself a separate LLC.

- 12. Question:** Does the Delaware Series LLC file one partnership income tax return reporting the income and expenses of all the subsidiaries or does each Separate Series have to file a separate partnership income tax return?

Based on the Letter Ruling, it appears that, to the extent that the husband and wife, in this case, share equally with respect to each subsidiary, then each subsidiary Series LLC, although not a separate entity under state law, will be treated as a partnership for federal and state income tax purposes and require a separate income tax return for each Series.

### 13. **IRS in the Proposed Regulations dated October 13, 2010**

On October 13, 2010, the IRS issued Proposed Regulations regarding the tax treatment of Series LLCs.

#### Example 1: Domestic Series LLC:

(i) Facts:

Series LLC is a Series Organization (Series LLC). Series LLC has 3 members, 1, 2 and 3. Series LLC establishes 2 Series (A and B) pursuant to the LLC statute of state Y, a Series Statute within the meaning of the Regulations. Under general tax principles, Member 1 and 2 are the owners of Series A and Member 3 is the owner of Series B. Series A and B are not described in Section 301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of Section 301.7701-4.

(ii) Analysis:

Under these Regulations, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under 301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

#### **PLANNING NOTE:**

*(1) The Regulations look through the Delaware Series LLC entity and assume that each Member of the Series LLC owns a pro rata share of each applicable Separate Series thereby making each a partnership, unless there is only 1 Member with respect to a Series, in which case it is a disregarded entity.*

*(2) This treatment may only be applicable to the extent that the Separate Series is not a "Separate Entity" under state law capable of suing and being sued. Compare the Medallion Realty Trust case in which the Massachusetts realty trust which holds title to the property and which is a single member of the Delaware Series LLC, in such a case, the Regulations may not be applicable since the Regulations are premised upon the fact that, under state series law, a separate legal entity does not exist, at least insofar as the Regulations and its analysis are concerned.*

### 14. **Litigation and Liability**

G&G Management, LLC v. Young Brothers & Company, Inc., United States District Court, District of Maine, Civil Action No. 05-162 BK, dated February 21, 2007.

(i) Facts:

- G&G Management, LLC, a limited liability company organized in Delaware with a principal place of business in New York, New York.
- G&G existed to manage the household affairs and the financial investments of the Goelet Family, including the family residence on Gardiner Island in Long Island Sound and the vessel M-V Captain Kidd Ford IV used to transport the family and household supplies between East Hampton, New York and Gardiner Island, New York.
- In 2002, G&G contracted with Young Brothers & Company to build a new boat to replace Captain Kidd III, which was 40 feet long with a 350 horsepower engine and the new boat would be 45 feet long with an 800 horsepower engine at a cost of approximately \$265,000.
- At some point in time, G&G formed 2 separate interests under Delaware law, Series A and Series B, and gave Series B the purpose of holding the assets' liabilities associated with the Captain Kidd IV, including the boat itself as evidenced by a new Certification of Documentation issued on March 25, 2004.
- The boat was delivered but turned out to be defective and G&G Management, LLC commenced a lawsuit against Young Brothers & Company.
- After a trial, it was determined that Young Brothers & Company, Inc. would be liable to the Plaintiff for \$54,923.70, plus interest.

(ii) Issues in case relating to LLC:

- Just prior to trial, G&G Management, LLC filed a Motion to Join a Real Party in Interest, namely G&G Management, LLC (Series B), a series of limited liability company interests in "certified by G&G Management, LLC" pursuant to Delaware Statute that authorizes Delaware LLCs to establish one or more "Series" of "Limited Liability Company" interests having separate rights, powers or duties with respect to specified property or obligations of the Limited Liability Company, citing 6 Del. Code Ann. Section 18-215(A).
- The Court noted that the Delaware Statute does not indicate what capacity an LLC has to pursue litigation on behalf of its Series, see, Fed. R. Civ. P. 17-B, nor does the Statute indicate what capacity the Series of an LLC has, if any, to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved.

- Although G&G Management, LLC contracted for the construction of the vessel and purchased the vessel, it subsequently identified G&G Management, LLC (Series B) as the owner and G&G Management, LLC as the Managing Owner on the Certificate of Documentation for the vessel.
- The Motion was denied with the Court finding that G&G has a sufficient interest in the boat to maintain the action and that it has a unity of interest with the Series B, such that, under Maine law, Series B could not obtain judgment against Young Brothers & Company for the same events and concluded that G&G can maintain this action as the real party in interest even if it had transferred nominal interest to Series B.

#### **15. Other Matters Uncertain**

- Some attorneys do not create realty trusts to hold separate title. This appears to create a significant problem in terms of securing a particular property in exchange for a Note since the Series LLC will need to be the maker of the Note.
- How should the deed into the Series LLC read? Do not put the name of the particular Series into the Grantee line lest you will have a title defect not easily cured. Use a parenthetical notation at the bottom of the deed stating that this property will be held as a Separate Series with the following language:

\_\_\_\_\_ is held in the \_\_\_\_\_ Series, a separate series of the \_\_\_\_\_ Series, LLC. Pursuant to Section 18-215(b) of the Delaware Limited Liability Company Act the debts, liabilities, and obligations incurred, contracted for or otherwise existing with respect to such series of the Company shall be enforceable against the assets of such series only and not against the assets of the Company generally or any other series thereof, and none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series.

#### **16. Employment Tax & Employee Benefit Issues**

The Regulations expressed concern about whether a Series or a Series Organization is the employer under relevant employment law noting “the

domestic statute authorizing the creation of Series contemplates that a Series may operate a business.” If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans.

Application of the employment tax requirements will depend principally on whether the workers are employees and, if so, who is considered the employer for federal income and employment tax purposes “which the employer is identified additionally may arise, including but limited to the following: (1) how would the wage be determined from employees, particularly if they work for more than one Series in a common line of business; (2) how would the common paymaster rules apply; (3) who would be authorized to designate an agent under Section 3504 for reporting and payment of employment taxes and how would the authorization be accomplished; (5) how would the statutory exceptions from the definition of employment and wages apply given that they may be based on the identity of the employer.

If the Series organization handles payroll for a Series and also is the nominal owner of the Series’ assets, would the owners or the managers of the Series organization be responsible for the trust fund recovering penalty under Section 6672?

## **17. Questions asked in the IRS Proposed Regulations**

Comments were requested on the following issues:

- (1) Whether a Series Organization should be recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its Series;
- (2) The appropriate treatment of a Series does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for federal tax purposes are foreign cells that do not conduct insurance business and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How a Series and Series Organization will be treated for state employment tax purposes and other state employment related purposes and how that treatment should affect the federal employment tax treatment of Series or Series Organizations (comments from the State should be particularly helpful);

- (6) What issues could arise with respect to the Division of Employee Benefits by a Series Organization or Series; and
- (7) The requirement for Series Organization and each Series of the Series Organization to file a statement and what information should be included on the statement.

## **18. Other Matters**

- In California, the Franchise Tax Board in California takes the position that each Series counts as its own LLC for fee purposes.
- Apparently the American Bar Association conducted a review of a Series LLC and declined to endorse them. Illinois and Iowa provides specifically that “Each Series shall be treated as a separate entity to the extent set forth in the Articles of Organization” and, further “Each Series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company.”
- The drafters of the 2006 Revised Uniform Limited Company Act (RE-ULLCA) considered but rejected the idea of including Series provisions in the Act.
- In composite returns, most states allow or require the filing of composite returns for pass-through entities with non-resident owners and is generally filed on behalf of all non-resident members of the entity with the tax being computed at the highest marginal rate.
- If a state determines that each share of an LLC is a separate entity, presumably a composite return would be filed and taxes paid, by each series rather than one return being returned by the LLC as an umbrella entity if the series were treated as disregarded entities.
- If an LLC were to have numerous series with activities in a state where owners were non-residence, a compliance burden would be created as compared to the filing of one composite return if the various Series were disregarded as entities apart from the LLC.

## **19. Bankruptcy Law**

Only a “person” is entitled to file for bankruptcy protection. An LLC generally is considered a person even though an LLC is not within the framework of a “person” in the Bankruptcy Code. As a result, it is uncertain whether a Separate

Series that is not a “Separate Entity,” such as under Illinois law, would be eligible to file for bankruptcy.

Compare, however, the *Medallion Realty Trust* case in which the realty trust was entitled to file for bankruptcy. 11 USC 101, Section 41 provides, “The term person includes individual, partnership, incorporation, but does not include governmental unit...”

## **20. Conclusion**

Proceed with Caution!

## **DELAWARE SERIES LLC – WHERE ARE WE TODAY?**

by

Leo J. Cushing, Esq., CPA, LL.M.  
Cushing & Dolan, P.C.  
Attorneys at Law  
Ten Tremont Street  
Third Floor, Suite 9  
Boston, MA 02108

375 Totten Pond Road, Suite 200  
Waltham, MA 02451

Tel: (617) 523-1555

Fax: (617) 523-5653

*lcushing@cushingdolan.com*  
*www.cushingdolan.com*

April 4, 2012

### **1. Introduction**

- In 1996, Delaware introduced a concept known as a Delaware Series LLC. Del. Code Title 6, §18-215.
- Since then, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico have enacted Series/Cell LLC Statutes.

### **2. Goal of Series LLC**

To create a single entity that would be a partnership for federal income tax purposes that could set up numerous cells known as “Separate Series” to hold various properties and/or businesses. This would eliminate the need to form numerous limited liability companies and eliminate the cost of formation, maintaining and income tax return preparation.

#### Example:

Husband and wife own 10 real estate properties, mostly in Massachusetts, but the titles are held either individually or in so-called Massachusetts realty trusts. Some of the realty trusts provide usual language as follows:

“The Trustees shall have no power to deal in or with the Trust estate except as directed by all of the beneficiaries.”

Other properties held in a document entitled Realty Trust that provides that the Trustee shall have essentially full power of ownership so the Trustee owns the property individually.

### 3. Liability of Owners

It is well settled that the trustee of a true nominee trust is an agent for the principal and therefore is liable. Similarly, the principals are liable, both jointly and severally, on the assumption that the relationship between the beneficiaries of a Massachusetts nominee trust is that of a general partnership.

Remember, a nominee trust is an entity that could file for bankruptcy, but the liability of the principal would be determined by state law. *Medallion Realty Trust*, 150 B.R. 495 (D. Mass. 1990)

### 4. Solution to Liability Problem

- Option 1: Transfer all 10 properties to 1 LLC.  
Problem: There is no firewall between the properties so all properties are at risk assuming there is a problem at 1 property.
- Option 2: Transfer each property to a separate LLC.  
Problem: 10 annual fees, 10 formation fees, and 10 partnership Returns will be required annually.

Annual Fees:	\$ 5,000 (\$500 x 10)
Partnership Returns:	\$25,000 (\$2,500 each x 10)
Total Fees:	\$30,000

- Option 3:  
Create LLC to be owned equally by husband and wife and then LLC will form 10 separate single member LLCs.

Annual Fees:	\$ 5,500 (\$ 500 x 11)
Partnership return:	\$ 2,500 (\$2,500 x 1)
Total Fees:	\$ 8,000

### **PLANNING NOTE:**

*Each single member LLC is owned by the parent LLC so that, pursuant to Treas. Regs. 301.7701-3, it will be taxed as a disregarded entity separate from its owner for federal income tax purposes.*

## **5. The Delaware Series LLC Solution**

Establish one Delaware Series LLC to be owned by husband and wife which will own each of the separate properties as a Separate Series pursuant to 6 Del. Code. §18-215. By statute, if each property is separately titled, each property will be treated as owned by a separate LLC.

## **6. Statutory Provisions/Authority**

§18-215 Series of Members, Managers or Limited Liability Company Interests

- (a) A limited liability company agreement may establish or provide for the establishment of designated series of members, managers, or limited liability company interest having 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, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.
- (b) Notwithstanding anything to the contrary set forth in the chapter or under other applicable law, in the event that a limited liability company agreement creates one or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held and accounted for 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 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 and obligations 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 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 and generally or any other series thereof shall be enforceable against the assets of such series. 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) 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.

## **7. How to Separately Title Property**

- Form Delaware Series LLC
- Delaware Series LLC establishes single member Massachusetts LLC to be a trustee of a Massachusetts realty trust (let's call this ABC Title, LLC)

### **PLANNING NOTE:**

*The Massachusetts LLC will be a disregarded entity for income tax purposes as it is a wholly-owned subsidiary of the Delaware Series LLC. By formation documents, it is established solely for the purpose of holding title to properties as a trustee of a Massachusetts nominee trust to separately hold title to real estate as required by the Delaware Separate Series LLC.*

## **8. Realty Trust – Sample Language**

WHEREAS, this FIRST AMENDED AND RESTATED 265 FRANKLIN STREET REALTY TRUST has been authorized by the sole Beneficiary and is intended to be such instrument and shall set forth the terms of such amendment;

WHEREAS, the Trustee and its Successors in Trust, will hold all real estate and any and all other property, whether real, personal or mixed, that may at any time be conveyed, assigned, transferred or delivered to said Trustee or its Successors in Trust for the sole benefit of a separate Series of a Delaware Series Limited Liability Company as nominee for the purpose of holding such property separately from the other assets of the Delaware Series Limited Liability Company or any Series thereof pursuant to 6 Del. Code Sec. 18-215, as identified in the Schedule of Beneficiaries, which Schedule has this day been executed by the Beneficiaries and filed with the Trustee with receipt and acknowledged by at least one Trustee (hereafter, as it may be amended, "Schedule of Beneficiaries"); and

WHEREAS, the Trustee desires to amend and restate said Trust in its entirety and upon the following terms and conditions.

## **9. Delaware Certificate of Formation – Sample Language**

The Certificate of Formation must state:

“Notice is hereby given pursuant to Section 18.215(b) of the LLC Act that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of the LLC, shall be enforceable against the assets of such series only and not against the assets of the LLC generally, or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the LLC generally, or any other series thereof, shall be enforceable against the assets of such series.”

#### 10. Series LLC – Sample Language in Operating Agreement

“The debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a Series shall be enforceable against the assets of such Series only and not against any other assets of the Company generally or other Series or none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the Company generally or any other Series shall be enforceable against the assets of such Series. Separate and distinct records shall be maintained for each and every series, and assets associated with any such Series shall be accounted for separately from other assets of the Company, or any other Series of the Company. The Members shall not commingle the assets of one Series with the assets of any other Series. The Certificate of Formation shall contain notice of the limitation of liabilities of a Series as to other Series in conformity with Section 18-215 of the Act.”

#### 11. Sounds Great But Questions Remain

- a) Massachusetts entity status and federal classification for each Series of an LLC. Letter Ruling 08-2 dated February 15, 2008.

##### **PLANNING NOTE:**

*The taxpayer, having received a Private Letter Ruling from the Internal Revenue Service relative to the establishment of a Delaware Series LLC and the establishment of Separate Series with respect to the taxpayer's various businesses (PLR 200803004 discussed below) sought guidance from the Department of Revenue.*

##### **b) Facts of DOR LR. 08-2**

- Taxpayer was a Massachusetts business trust operating an open-end management investment company, also known as a mutual fund, registered under the Investment Company Act of 1940.
- The beneficial interests in the trusts were divided into transferable shares.
- Trustees of the trust divides its shares into several portfolios.
- Each trust portfolio is separate from each other's trust portfolio.

- Each trust portfolio is currently taxed as a separate regulated investment company (RIC) under IRC § 851.
- The trust proposed to reorganize its business into a Delaware Series LLC.
- Each LLC Series will be separate from each other LLC Series.
- Each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings.
- The shareholders of an LLC Series may share in the income only of that LLC Series.
- The ownership interest of the shareholders of an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series.
- The payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC's Series' assets.
- The creditors of an LLC Series will be limited to the assets of that LLC Series for recovery or expenses, charges, and liabilities.
- The reorganization consists of the following:
  - (1) a transfer by each Trust Portfolio of its assets to a corresponding LLC Series in exchange for the LLC Series' assumption of its liabilities, if any, and the Trust Portfolio's receipt of LLC Series membership interests, followed by
  - (2) a distribution of the LLC Series membership interests to each of the Trust Portfolio's shareholders in complete liquidation of the Trust Portfolio.
- After the Reorganization, LLC proposes that certain LLC Series, each of which will have only one shareholder, collectively the D Series, will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than a disregarded entity as an entity separate from its owner for federal income tax purposes.
- LLC proposes that certain LLC Series, each of which currently has more than one shareholder (type P Series), will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than as a partnership and will not be treated as a publicly traded partnership taxable as a corporation under IRC § 7704 for federal income tax purposes.

- LLC proposes that certain LLC Series will elect pursuant to Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal income tax purposes, effective from the date of formation of such LLC Portfolio (collectively, "Type C Series").

**c) Requested Rulings**

- The Taxpayers request a ruling that (1) each LLC Series is treated for Massachusetts income and corporate excise tax purposes as a separate entity (or part of a separate entity in the case of a Type D disregarded entity treated as part of its sole owner); (2) each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income tax purposes as a separate LLC; and consequently, each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**PLANNING NOTE:**

*The LLC will have no assets, liabilities, or income because everything will be allocated among the Series and the function of the LLC is to make it easier to file amendments and other documents with the SEC.*

**d) Ruling**

- Each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.
- Each LLC Series and any additional Series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**e) Refusal to Rule**

- The Department of Revenue refused to rule on whether each Series of the LLC is itself a separate LLC.

- 12. Question:** Does the Delaware Series LLC file one partnership income tax return reporting the income and expenses of all the subsidiaries or does each Separate Series have to file a separate partnership income tax return?

Based on the Letter Ruling, it appears that, to the extent that the husband and wife, in this case, share equally with respect to each subsidiary, then each subsidiary Series LLC, although not a separate entity under state law, will be treated as a partnership for federal and state income tax purposes and require a separate income tax return for each Series.

### 13. **IRS in the Proposed Regulations dated October 13, 2010**

On October 13, 2010, the IRS issued Proposed Regulations regarding the tax treatment of Series LLCs.

#### Example 1: Domestic Series LLC:

(i) Facts:

Series LLC is a Series Organization (Series LLC). Series LLC has 3 members, 1, 2 and 3. Series LLC establishes 2 Series (A and B) pursuant to the LLC statute of state Y, a Series Statute within the meaning of the Regulations. Under general tax principles, Member 1 and 2 are the owners of Series A and Member 3 is the owner of Series B. Series A and B are not described in Section 301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of Section 301.7701-4.

(ii) Analysis:

Under these Regulations, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under 301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

#### **PLANNING NOTE:**

*(1) The Regulations look through the Delaware Series LLC entity and assume that each Member of the Series LLC owns a pro rata share of each applicable Separate Series thereby making each a partnership, unless there is only 1 Member with respect to a Series, in which case it is a disregarded entity.*

*(2) This treatment may only be applicable to the extent that the Separate Series is not a "Separate Entity" under state law capable of suing and being sued. Compare the Medallion Realty Trust case in which the Massachusetts realty trust which holds title to the property and which is a single member of the Delaware Series LLC, in such a case, the Regulations may not be applicable since the Regulations are premised upon the fact that, under state series law, a separate legal entity does not exist, at least insofar as the Regulations and its analysis are concerned.*

### 14. **Litigation and Liability**

G&G Management, LLC v. Young Brothers & Company, Inc., United States District Court, District of Maine, Civil Action No. 05-162 BK, dated February 21, 2007.

(i) Facts:

- G&G Management, LLC, a limited liability company organized in Delaware with a principal place of business in New York, New York.
- G&G existed to manage the household affairs and the financial investments of the Goelet Family, including the family residence on Gardiner Island in Long Island Sound and the vessel M-V Captain Kidd Ford IV used to transport the family and household supplies between East Hampton, New York and Gardiner Island, New York.
- In 2002, G&G contracted with Young Brothers & Company to build a new boat to replace Captain Kidd III, which was 40 feet long with a 350 horsepower engine and the new boat would be 45 feet long with an 800 horsepower engine at a cost of approximately \$265,000.
- At some point in time, G&G formed 2 separate interests under Delaware law, Series A and Series B, and gave Series B the purpose of holding the assets' liabilities associated with the Captain Kidd IV, including the boat itself as evidenced by a new Certification of Documentation issued on March 25, 2004.
- The boat was delivered but turned out to be defective and G&G Management, LLC commenced a lawsuit against Young Brothers & Company.
- After a trial, it was determined that Young Brothers & Company, Inc. would be liable to the Plaintiff for \$54,923.70, plus interest.

(ii) Issues in case relating to LLC:

- Just prior to trial, G&G Management, LLC filed a Motion to Join a Real Party in Interest, namely G&G Management, LLC (Series B), a series of limited liability company interests in "certified by G&G Management, LLC" pursuant to Delaware Statute that authorizes Delaware LLCs to establish one or more "Series" of "Limited Liability Company" interests having separate rights, powers or duties with respect to specified property or obligations of the Limited Liability Company, citing 6 Del. Code Ann. Section 18-215(A).
- The Court noted that the Delaware Statute does not indicate what capacity an LLC has to pursue litigation on behalf of its Series, see, Fed. R. Civ. P. 17-B, nor does the Statute indicate what capacity the Series of an LLC has, if any, to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved.

- Although G&G Management, LLC contracted for the construction of the vessel and purchased the vessel, it subsequently identified G&G Management, LLC (Series B) as the owner and G&G Management, LLC as the Managing Owner on the Certificate of Documentation for the vessel.
- The Motion was denied with the Court finding that G&G has a sufficient interest in the boat to maintain the action and that it has a unity of interest with the Series B, such that, under Maine law, Series B could not obtain judgment against Young Brothers & Company for the same events and concluded that G&G can maintain this action as the real party in interest even if it had transferred nominal interest to Series B.

#### **15. Other Matters Uncertain**

- Some attorneys do not create realty trusts to hold separate title. This appears to create a significant problem in terms of securing a particular property in exchange for a Note since the Series LLC will need to be the maker of the Note.
- How should the deed into the Series LLC read? Do not put the name of the particular Series into the Grantee line lest you will have a title defect not easily cured. Use a parenthetical notation at the bottom of the deed stating that this property will be held as a Separate Series with the following language:

\_\_\_\_\_ is held in the \_\_\_\_\_ Series, a separate series of the \_\_\_\_\_ Series, LLC. Pursuant to Section 18-215(b) of the Delaware Limited Liability Company Act the debts, liabilities, and obligations incurred, contracted for or otherwise existing with respect to such series of the Company shall be enforceable against the assets of such series only and not against the assets of the Company generally or any other series thereof, and none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series.

#### **16. Employment Tax & Employee Benefit Issues**

The Regulations expressed concern about whether a Series or a Series Organization is the employer under relevant employment law noting “the

domestic statute authorizing the creation of Series contemplates that a Series may operate a business.” If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans.

Application of the employment tax requirements will depend principally on whether the workers are employees and, if so, who is considered the employer for federal income and employment tax purposes “which the employer is identified additionally may arise, including but limited to the following: (1) how would the wage be determined from employees, particularly if they work for more than one Series in a common line of business; (2) how would the common paymaster rules apply; (3) who would be authorized to designate an agent under Section 3504 for reporting and payment of employment taxes and how would the authorization be accomplished; (5) how would the statutory exceptions from the definition of employment and wages apply given that they may be based on the identity of the employer.

If the Series organization handles payroll for a Series and also is the nominal owner of the Series’ assets, would the owners or the managers of the Series organization be responsible for the trust fund recovering penalty under Section 6672?

## **17. Questions asked in the IRS Proposed Regulations**

Comments were requested on the following issues:

- (1) Whether a Series Organization should be recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its Series;
- (2) The appropriate treatment of a Series does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for federal tax purposes are foreign cells that do not conduct insurance business and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How a Series and Series Organization will be treated for state employment tax purposes and other state employment related purposes and how that treatment should affect the federal employment tax treatment of Series or Series Organizations (comments from the State should be particularly helpful);

- (6) What issues could arise with respect to the Division of Employee Benefits by a Series Organization or Series; and
- (7) The requirement for Series Organization and each Series of the Series Organization to file a statement and what information should be included on the statement.

## **18. Other Matters**

- In California, the Franchise Tax Board in California takes the position that each Series counts as its own LLC for fee purposes.
- Apparently the American Bar Association conducted a review of a Series LLC and declined to endorse them. Illinois and Iowa provides specifically that “Each Series shall be treated as a separate entity to the extent set forth in the Articles of Organization” and, further “Each Series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company.”
- The drafters of the 2006 Revised Uniform Limited Company Act (RE-ULLCA) considered but rejected the idea of including Series provisions in the Act.
- In composite returns, most states allow or require the filing of composite returns for pass-through entities with non-resident owners and is generally filed on behalf of all non-resident members of the entity with the tax being computed at the highest marginal rate.
- If a state determines that each share of an LLC is a separate entity, presumably a composite return would be filed and taxes paid, by each series rather than one return being returned by the LLC as an umbrella entity if the series were treated as disregarded entities.
- If an LLC were to have numerous series with activities in a state where owners were non-residence, a compliance burden would be created as compared to the filing of one composite return if the various Series were disregarded as entities apart from the LLC.

## **19. Bankruptcy Law**

Only a “person” is entitled to file for bankruptcy protection. An LLC generally is considered a person even though an LLC is not within the framework of a “person” in the Bankruptcy Code. As a result, it is uncertain whether a Separate

Series that is not a “Separate Entity,” such as under Illinois law, would be eligible to file for bankruptcy.

Compare, however, the *Medallion Realty Trust* case in which the realty trust was entitled to file for bankruptcy. 11 USC 101, Section 41 provides, “The term person includes individual, partnership, incorporation, but does not include governmental unit...”

## **20. Conclusion**

Proceed with Caution!

## **DELAWARE SERIES LLC – WHERE ARE WE TODAY?**

by

Leo J. Cushing, Esq., CPA, LL.M.  
Cushing & Dolan, P.C.  
Attorneys at Law  
Ten Tremont Street  
Third Floor, Suite 9  
Boston, MA 02108

375 Totten Pond Road, Suite 200  
Waltham, MA 02451

Tel: (617) 523-1555

Fax: (617) 523-5653

*lcushing@cushingdolan.com*  
*www.cushingdolan.com*

April 4, 2012

### **1. Introduction**

- In 1996, Delaware introduced a concept known as a Delaware Series LLC. Del. Code Title 6, §18-215.
- Since then, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico have enacted Series/Cell LLC Statutes.

### **2. Goal of Series LLC**

To create a single entity that would be a partnership for federal income tax purposes that could set up numerous cells known as “Separate Series” to hold various properties and/or businesses. This would eliminate the need to form numerous limited liability companies and eliminate the cost of formation, maintaining and income tax return preparation.

#### Example:

Husband and wife own 10 real estate properties, mostly in Massachusetts, but the titles are held either individually or in so-called Massachusetts realty trusts. Some of the realty trusts provide usual language as follows:

“The Trustees shall have no power to deal in or with the Trust estate except as directed by all of the beneficiaries.”

Other properties held in a document entitled Realty Trust that provides that the Trustee shall have essentially full power of ownership so the Trustee owns the property individually.

### 3. Liability of Owners

It is well settled that the trustee of a true nominee trust is an agent for the principal and therefore is liable. Similarly, the principals are liable, both jointly and severally, on the assumption that the relationship between the beneficiaries of a Massachusetts nominee trust is that of a general partnership.

Remember, a nominee trust is an entity that could file for bankruptcy, but the liability of the principal would be determined by state law. *Medallion Realty Trust*, 150 B.R. 495 (D. Mass. 1990)

### 4. Solution to Liability Problem

- Option 1: Transfer all 10 properties to 1 LLC.  
Problem: There is no firewall between the properties so all properties are at risk assuming there is a problem at 1 property.
- Option 2: Transfer each property to a separate LLC.  
Problem: 10 annual fees, 10 formation fees, and 10 partnership Returns will be required annually.

Annual Fees:	\$ 5,000 (\$500 x 10)
Partnership Returns:	\$25,000 (\$2,500 each x 10)
Total Fees:	\$30,000

- Option 3:  
Create LLC to be owned equally by husband and wife and then LLC will form 10 separate single member LLCs.

Annual Fees:	\$ 5,500 (\$ 500 x 11)
Partnership return:	\$ 2,500 (\$2,500 x 1)
Total Fees:	\$ 8,000

### **PLANNING NOTE:**

*Each single member LLC is owned by the parent LLC so that, pursuant to Treas. Regs. 301.7701-3, it will be taxed as a disregarded entity separate from its owner for federal income tax purposes.*

## **5. The Delaware Series LLC Solution**

Establish one Delaware Series LLC to be owned by husband and wife which will own each of the separate properties as a Separate Series pursuant to 6 Del. Code. §18-215. By statute, if each property is separately titled, each property will be treated as owned by a separate LLC.

## **6. Statutory Provisions/Authority**

§18-215 Series of Members, Managers or Limited Liability Company Interests

- (a) A limited liability company agreement may establish or provide for the establishment of designated series of members, managers, or limited liability company interest having 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, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.
- (b) Notwithstanding anything to the contrary set forth in the chapter or under other applicable law, in the event that a limited liability company agreement creates one or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held and accounted for 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 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 and obligations 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 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 and generally or any other series thereof shall be enforceable against the assets of such series. 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) 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.

## **7. How to Separately Title Property**

- Form Delaware Series LLC
- Delaware Series LLC establishes single member Massachusetts LLC to be a trustee of a Massachusetts realty trust (let's call this ABC Title, LLC)

### **PLANNING NOTE:**

*The Massachusetts LLC will be a disregarded entity for income tax purposes as it is a wholly-owned subsidiary of the Delaware Series LLC. By formation documents, it is established solely for the purpose of holding title to properties as a trustee of a Massachusetts nominee trust to separately hold title to real estate as required by the Delaware Separate Series LLC.*

## **8. Realty Trust – Sample Language**

WHEREAS, this FIRST AMENDED AND RESTATED 265 FRANKLIN STREET REALTY TRUST has been authorized by the sole Beneficiary and is intended to be such instrument and shall set forth the terms of such amendment;

WHEREAS, the Trustee and its Successors in Trust, will hold all real estate and any and all other property, whether real, personal or mixed, that may at any time be conveyed, assigned, transferred or delivered to said Trustee or its Successors in Trust for the sole benefit of a separate Series of a Delaware Series Limited Liability Company as nominee for the purpose of holding such property separately from the other assets of the Delaware Series Limited Liability Company or any Series thereof pursuant to 6 Del. Code Sec. 18-215, as identified in the Schedule of Beneficiaries, which Schedule has this day been executed by the Beneficiaries and filed with the Trustee with receipt and acknowledged by at least one Trustee (hereafter, as it may be amended, "Schedule of Beneficiaries"); and

WHEREAS, the Trustee desires to amend and restate said Trust in its entirety and upon the following terms and conditions.

## **9. Delaware Certificate of Formation – Sample Language**

The Certificate of Formation must state:

“Notice is hereby given pursuant to Section 18.215(b) of the LLC Act that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of the LLC, shall be enforceable against the assets of such series only and not against the assets of the LLC generally, or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the LLC generally, or any other series thereof, shall be enforceable against the assets of such series.”

#### 10. Series LLC – Sample Language in Operating Agreement

“The debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a Series shall be enforceable against the assets of such Series only and not against any other assets of the Company generally or other Series or none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the Company generally or any other Series shall be enforceable against the assets of such Series. Separate and distinct records shall be maintained for each and every series, and assets associated with any such Series shall be accounted for separately from other assets of the Company, or any other Series of the Company. The Members shall not commingle the assets of one Series with the assets of any other Series. The Certificate of Formation shall contain notice of the limitation of liabilities of a Series as to other Series in conformity with Section 18-215 of the Act.”

#### 11. Sounds Great But Questions Remain

- a) Massachusetts entity status and federal classification for each Series of an LLC. Letter Ruling 08-2 dated February 15, 2008.

##### **PLANNING NOTE:**

*The taxpayer, having received a Private Letter Ruling from the Internal Revenue Service relative to the establishment of a Delaware Series LLC and the establishment of Separate Series with respect to the taxpayer’s various businesses (PLR 200803004 discussed below) sought guidance from the Department of Revenue.*

##### **b) Facts of DOR LR. 08-2**

- Taxpayer was a Massachusetts business trust operating an open-end management investment company, also known as a mutual fund, registered under the Investment Company Act of 1940.
- The beneficial interests in the trusts were divided into transferable shares.
- Trustees of the trust divides its shares into several portfolios.
- Each trust portfolio is separate from each other’s trust portfolio.

- Each trust portfolio is currently taxed as a separate regulated investment company (RIC) under IRC § 851.
- The trust proposed to reorganize its business into a Delaware Series LLC.
- Each LLC Series will be separate from each other LLC Series.
- Each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings.
- The shareholders of an LLC Series may share in the income only of that LLC Series.
- The ownership interest of the shareholders of an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series.
- The payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC's Series' assets.
- The creditors of an LLC Series will be limited to the assets of that LLC Series for recovery or expenses, charges, and liabilities.
- The reorganization consists of the following:
  - (1) a transfer by each Trust Portfolio of its assets to a corresponding LLC Series in exchange for the LLC Series' assumption of its liabilities, if any, and the Trust Portfolio's receipt of LLC Series membership interests, followed by
  - (2) a distribution of the LLC Series membership interests to each of the Trust Portfolio's shareholders in complete liquidation of the Trust Portfolio.
- After the Reorganization, LLC proposes that certain LLC Series, each of which will have only one shareholder, collectively the D Series, will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than a disregarded entity as an entity separate from its owner for federal income tax purposes.
- LLC proposes that certain LLC Series, each of which currently has more than one shareholder (type P Series), will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than as a partnership and will not be treated as a publicly traded partnership taxable as a corporation under IRC § 7704 for federal income tax purposes.

- LLC proposes that certain LLC Series will elect pursuant to Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal income tax purposes, effective from the date of formation of such LLC Portfolio (collectively, "Type C Series").

**c) Requested Rulings**

- The Taxpayers request a ruling that (1) each LLC Series is treated for Massachusetts income and corporate excise tax purposes as a separate entity (or part of a separate entity in the case of a Type D disregarded entity treated as part of its sole owner); (2) each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income tax purposes as a separate LLC; and consequently, each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**PLANNING NOTE:**

*The LLC will have no assets, liabilities, or income because everything will be allocated among the Series and the function of the LLC is to make it easier to file amendments and other documents with the SEC.*

**d) Ruling**

- Each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.
- Each LLC Series and any additional Series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**e) Refusal to Rule**

- The Department of Revenue refused to rule on whether each Series of the LLC is itself a separate LLC.

- 12. Question:** Does the Delaware Series LLC file one partnership income tax return reporting the income and expenses of all the subsidiaries or does each Separate Series have to file a separate partnership income tax return?

Based on the Letter Ruling, it appears that, to the extent that the husband and wife, in this case, share equally with respect to each subsidiary, then each subsidiary Series LLC, although not a separate entity under state law, will be treated as a partnership for federal and state income tax purposes and require a separate income tax return for each Series.

### 13. **IRS in the Proposed Regulations dated October 13, 2010**

On October 13, 2010, the IRS issued Proposed Regulations regarding the tax treatment of Series LLCs.

#### Example 1: Domestic Series LLC:

(i) Facts:

Series LLC is a Series Organization (Series LLC). Series LLC has 3 members, 1, 2 and 3. Series LLC establishes 2 Series (A and B) pursuant to the LLC statute of state Y, a Series Statute within the meaning of the Regulations. Under general tax principles, Member 1 and 2 are the owners of Series A and Member 3 is the owner of Series B. Series A and B are not described in Section 301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of Section 301.7701-4.

(ii) Analysis:

Under these Regulations, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under 301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

#### **PLANNING NOTE:**

*(1) The Regulations look through the Delaware Series LLC entity and assume that each Member of the Series LLC owns a pro rata share of each applicable Separate Series thereby making each a partnership, unless there is only 1 Member with respect to a Series, in which case it is a disregarded entity.*

*(2) This treatment may only be applicable to the extent that the Separate Series is not a "Separate Entity" under state law capable of suing and being sued. Compare the Medallion Realty Trust case in which the Massachusetts realty trust which holds title to the property and which is a single member of the Delaware Series LLC, in such a case, the Regulations may not be applicable since the Regulations are premised upon the fact that, under state series law, a separate legal entity does not exist, at least insofar as the Regulations and its analysis are concerned.*

### 14. **Litigation and Liability**

G&G Management, LLC v. Young Brothers & Company, Inc., United States District Court, District of Maine, Civil Action No. 05-162 BK, dated February 21, 2007.

(i) Facts:

- G&G Management, LLC, a limited liability company organized in Delaware with a principal place of business in New York, New York.
- G&G existed to manage the household affairs and the financial investments of the Goelet Family, including the family residence on Gardiner Island in Long Island Sound and the vessel M-V Captain Kidd Ford IV used to transport the family and household supplies between East Hampton, New York and Gardiner Island, New York.
- In 2002, G&G contracted with Young Brothers & Company to build a new boat to replace Captain Kidd III, which was 40 feet long with a 350 horsepower engine and the new boat would be 45 feet long with an 800 horsepower engine at a cost of approximately \$265,000.
- At some point in time, G&G formed 2 separate interests under Delaware law, Series A and Series B, and gave Series B the purpose of holding the assets' liabilities associated with the Captain Kidd IV, including the boat itself as evidenced by a new Certification of Documentation issued on March 25, 2004.
- The boat was delivered but turned out to be defective and G&G Management, LLC commenced a lawsuit against Young Brothers & Company.
- After a trial, it was determined that Young Brothers & Company, Inc. would be liable to the Plaintiff for \$54,923.70, plus interest.

(ii) Issues in case relating to LLC:

- Just prior to trial, G&G Management, LLC filed a Motion to Join a Real Party in Interest, namely G&G Management, LLC (Series B), a series of limited liability company interests in "certified by G&G Management, LLC" pursuant to Delaware Statute that authorizes Delaware LLCs to establish one or more "Series" of "Limited Liability Company" interests having separate rights, powers or duties with respect to specified property or obligations of the Limited Liability Company, citing 6 Del. Code Ann. Section 18-215(A).
- The Court noted that the Delaware Statute does not indicate what capacity an LLC has to pursue litigation on behalf of its Series, see, Fed. R. Civ. P. 17-B, nor does the Statute indicate what capacity the Series of an LLC has, if any, to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved.

- Although G&G Management, LLC contracted for the construction of the vessel and purchased the vessel, it subsequently identified G&G Management, LLC (Series B) as the owner and G&G Management, LLC as the Managing Owner on the Certificate of Documentation for the vessel.
- The Motion was denied with the Court finding that G&G has a sufficient interest in the boat to maintain the action and that it has a unity of interest with the Series B, such that, under Maine law, Series B could not obtain judgment against Young Brothers & Company for the same events and concluded that G&G can maintain this action as the real party in interest even if it had transferred nominal interest to Series B.

#### **15. Other Matters Uncertain**

- Some attorneys do not create realty trusts to hold separate title. This appears to create a significant problem in terms of securing a particular property in exchange for a Note since the Series LLC will need to be the maker of the Note.
- How should the deed into the Series LLC read? Do not put the name of the particular Series into the Grantee line lest you will have a title defect not easily cured. Use a parenthetical notation at the bottom of the deed stating that this property will be held as a Separate Series with the following language:

\_\_\_\_\_ is held in the \_\_\_\_\_ Series, a separate series of the \_\_\_\_\_ Series, LLC. Pursuant to Section 18-215(b) of the Delaware Limited Liability Company Act the debts, liabilities, and obligations incurred, contracted for or otherwise existing with respect to such series of the Company shall be enforceable against the assets of such series only and not against the assets of the Company generally or any other series thereof, and none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series.

#### **16. Employment Tax & Employee Benefit Issues**

The Regulations expressed concern about whether a Series or a Series Organization is the employer under relevant employment law noting “the

domestic statute authorizing the creation of Series contemplates that a Series may operate a business.” If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans.

Application of the employment tax requirements will depend principally on whether the workers are employees and, if so, who is considered the employer for federal income and employment tax purposes “which the employer is identified additionally may arise, including but limited to the following: (1) how would the wage be determined from employees, particularly if they work for more than one Series in a common line of business; (2) how would the common paymaster rules apply; (3) who would be authorized to designate an agent under Section 3504 for reporting and payment of employment taxes and how would the authorization be accomplished; (5) how would the statutory exceptions from the definition of employment and wages apply given that they may be based on the identity of the employer.

If the Series organization handles payroll for a Series and also is the nominal owner of the Series’ assets, would the owners or the managers of the Series organization be responsible for the trust fund recovering penalty under Section 6672?

## **17. Questions asked in the IRS Proposed Regulations**

Comments were requested on the following issues:

- (1) Whether a Series Organization should be recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its Series;
- (2) The appropriate treatment of a Series does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for federal tax purposes are foreign cells that do not conduct insurance business and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How a Series and Series Organization will be treated for state employment tax purposes and other state employment related purposes and how that treatment should affect the federal employment tax treatment of Series or Series Organizations (comments from the State should be particularly helpful);

- (6) What issues could arise with respect to the Division of Employee Benefits by a Series Organization or Series; and
- (7) The requirement for Series Organization and each Series of the Series Organization to file a statement and what information should be included on the statement.

## **18. Other Matters**

- In California, the Franchise Tax Board in California takes the position that each Series counts as its own LLC for fee purposes.
- Apparently the American Bar Association conducted a review of a Series LLC and declined to endorse them. Illinois and Iowa provides specifically that “Each Series shall be treated as a separate entity to the extent set forth in the Articles of Organization” and, further “Each Series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company.”
- The drafters of the 2006 Revised Uniform Limited Company Act (RE-ULLCA) considered but rejected the idea of including Series provisions in the Act.
- In composite returns, most states allow or require the filing of composite returns for pass-through entities with non-resident owners and is generally filed on behalf of all non-resident members of the entity with the tax being computed at the highest marginal rate.
- If a state determines that each share of an LLC is a separate entity, presumably a composite return would be filed and taxes paid, by each series rather than one return being returned by the LLC as an umbrella entity if the series were treated as disregarded entities.
- If an LLC were to have numerous series with activities in a state where owners were non-residence, a compliance burden would be created as compared to the filing of one composite return if the various Series were disregarded as entities apart from the LLC.

## **19. Bankruptcy Law**

Only a “person” is entitled to file for bankruptcy protection. An LLC generally is considered a person even though an LLC is not within the framework of a “person” in the Bankruptcy Code. As a result, it is uncertain whether a Separate

Series that is not a “Separate Entity,” such as under Illinois law, would be eligible to file for bankruptcy.

Compare, however, the *Medallion Realty Trust* case in which the realty trust was entitled to file for bankruptcy. 11 USC 101, Section 41 provides, “The term person includes individual, partnership, incorporation, but does not include governmental unit...”

## **20. Conclusion**

Proceed with Caution!

## **DELAWARE SERIES LLC – WHERE ARE WE TODAY?**

by

Leo J. Cushing, Esq., CPA, LL.M.  
Cushing & Dolan, P.C.  
Attorneys at Law  
Ten Tremont Street  
Third Floor, Suite 9  
Boston, MA 02108

375 Totten Pond Road, Suite 200  
Waltham, MA 02451

Tel: (617) 523-1555

Fax: (617) 523-5653

*lcushing@cushingdolan.com*  
*www.cushingdolan.com*

April 4, 2012

### **1. Introduction**

- In 1996, Delaware introduced a concept known as a Delaware Series LLC. Del. Code Title 6, §18-215.
- Since then, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah, and Puerto Rico have enacted Series/Cell LLC Statutes.

### **2. Goal of Series LLC**

To create a single entity that would be a partnership for federal income tax purposes that could set up numerous cells known as “Separate Series” to hold various properties and/or businesses. This would eliminate the need to form numerous limited liability companies and eliminate the cost of formation, maintaining and income tax return preparation.

#### Example:

Husband and wife own 10 real estate properties, mostly in Massachusetts, but the titles are held either individually or in so-called Massachusetts realty trusts. Some of the realty trusts provide usual language as follows:

“The Trustees shall have no power to deal in or with the Trust estate except as directed by all of the beneficiaries.”

Other properties held in a document entitled Realty Trust that provides that the Trustee shall have essentially full power of ownership so the Trustee owns the property individually.

### 3. Liability of Owners

It is well settled that the trustee of a true nominee trust is an agent for the principal and therefore is liable. Similarly, the principals are liable, both jointly and severally, on the assumption that the relationship between the beneficiaries of a Massachusetts nominee trust is that of a general partnership.

Remember, a nominee trust is an entity that could file for bankruptcy, but the liability of the principal would be determined by state law. *Medallion Realty Trust*, 150 B.R. 495 (D. Mass. 1990)

### 4. Solution to Liability Problem

- Option 1: Transfer all 10 properties to 1 LLC.  
Problem: There is no firewall between the properties so all properties are at risk assuming there is a problem at 1 property.
- Option 2: Transfer each property to a separate LLC.  
Problem: 10 annual fees, 10 formation fees, and 10 partnership Returns will be required annually.

Annual Fees:	\$ 5,000 (\$500 x 10)
Partnership Returns:	\$25,000 (\$2,500 each x 10)
Total Fees:	\$30,000

- Option 3:  
Create LLC to be owned equally by husband and wife and then LLC will form 10 separate single member LLCs.

Annual Fees:	\$ 5,500 (\$ 500 x 11)
Partnership return:	\$ 2,500 (\$2,500 x 1)
Total Fees:	\$ 8,000

### **PLANNING NOTE:**

*Each single member LLC is owned by the parent LLC so that, pursuant to Treas. Regs. 301.7701-3, it will be taxed as a disregarded entity separate from its owner for federal income tax purposes.*

## **5. The Delaware Series LLC Solution**

Establish one Delaware Series LLC to be owned by husband and wife which will own each of the separate properties as a Separate Series pursuant to 6 Del. Code. §18-215. By statute, if each property is separately titled, each property will be treated as owned by a separate LLC.

## **6. Statutory Provisions/Authority**

§18-215 Series of Members, Managers or Limited Liability Company Interests

- (a) A limited liability company agreement may establish or provide for the establishment of designated series of members, managers, or limited liability company interest having 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, to the extent provided in the limited liability company agreement, any such series may have a separate business purpose or investment objective.
- (b) Notwithstanding anything to the contrary set forth in the chapter or under other applicable law, in the event that a limited liability company agreement creates one or more series, and if separate and distinct records are maintained for any such series and the assets associated with any such series are held and accounted for 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 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 and obligations 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 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 and generally or any other series thereof shall be enforceable against the assets of such series. 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) 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.

## **7. How to Separately Title Property**

- Form Delaware Series LLC
- Delaware Series LLC establishes single member Massachusetts LLC to be a trustee of a Massachusetts realty trust (let's call this ABC Title, LLC)

### **PLANNING NOTE:**

*The Massachusetts LLC will be a disregarded entity for income tax purposes as it is a wholly-owned subsidiary of the Delaware Series LLC. By formation documents, it is established solely for the purpose of holding title to properties as a trustee of a Massachusetts nominee trust to separately hold title to real estate as required by the Delaware Separate Series LLC.*

## **8. Realty Trust – Sample Language**

WHEREAS, this FIRST AMENDED AND RESTATED 265 FRANKLIN STREET REALTY TRUST has been authorized by the sole Beneficiary and is intended to be such instrument and shall set forth the terms of such amendment;

WHEREAS, the Trustee and its Successors in Trust, will hold all real estate and any and all other property, whether real, personal or mixed, that may at any time be conveyed, assigned, transferred or delivered to said Trustee or its Successors in Trust for the sole benefit of a separate Series of a Delaware Series Limited Liability Company as nominee for the purpose of holding such property separately from the other assets of the Delaware Series Limited Liability Company or any Series thereof pursuant to 6 Del. Code Sec. 18-215, as identified in the Schedule of Beneficiaries, which Schedule has this day been executed by the Beneficiaries and filed with the Trustee with receipt and acknowledged by at least one Trustee (hereafter, as it may be amended, "Schedule of Beneficiaries"); and

WHEREAS, the Trustee desires to amend and restate said Trust in its entirety and upon the following terms and conditions.

## **9. Delaware Certificate of Formation – Sample Language**

The Certificate of Formation must state:

“Notice is hereby given pursuant to Section 18.215(b) of the LLC Act that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of the LLC, shall be enforceable against the assets of such series only and not against the assets of the LLC generally, or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the LLC generally, or any other series thereof, shall be enforceable against the assets of such series.”

#### 10. Series LLC – Sample Language in Operating Agreement

“The debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a Series shall be enforceable against the assets of such Series only and not against any other assets of the Company generally or other Series or none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the Company generally or any other Series shall be enforceable against the assets of such Series. Separate and distinct records shall be maintained for each and every series, and assets associated with any such Series shall be accounted for separately from other assets of the Company, or any other Series of the Company. The Members shall not commingle the assets of one Series with the assets of any other Series. The Certificate of Formation shall contain notice of the limitation of liabilities of a Series as to other Series in conformity with Section 18-215 of the Act.”

#### 11. Sounds Great But Questions Remain

- a) Massachusetts entity status and federal classification for each Series of an LLC. Letter Ruling 08-2 dated February 15, 2008.

##### **PLANNING NOTE:**

*The taxpayer, having received a Private Letter Ruling from the Internal Revenue Service relative to the establishment of a Delaware Series LLC and the establishment of Separate Series with respect to the taxpayer's various businesses (PLR 200803004 discussed below) sought guidance from the Department of Revenue.*

##### **b) Facts of DOR LR. 08-2**

- Taxpayer was a Massachusetts business trust operating an open-end management investment company, also known as a mutual fund, registered under the Investment Company Act of 1940.
- The beneficial interests in the trusts were divided into transferable shares.
- Trustees of the trust divides its shares into several portfolios.
- Each trust portfolio is separate from each other's trust portfolio.

- Each trust portfolio is currently taxed as a separate regulated investment company (RIC) under IRC § 851.
- The trust proposed to reorganize its business into a Delaware Series LLC.
- Each LLC Series will be separate from each other LLC Series.
- Each LLC Series will consist of a separate pool of assets, liabilities and stream of earnings.
- The shareholders of an LLC Series may share in the income only of that LLC Series.
- The ownership interest of the shareholders of an LLC Series will be limited to the assets of that LLC Series upon redemption, liquidation, or termination of such LLC Series.
- The payment of the expenses, charges, and liabilities of an LLC Series is limited to that LLC's Series' assets.
- The creditors of an LLC Series will be limited to the assets of that LLC Series for recovery or expenses, charges, and liabilities.
- The reorganization consists of the following:
  - (1) a transfer by each Trust Portfolio of its assets to a corresponding LLC Series in exchange for the LLC Series' assumption of its liabilities, if any, and the Trust Portfolio's receipt of LLC Series membership interests, followed by
  - (2) a distribution of the LLC Series membership interests to each of the Trust Portfolio's shareholders in complete liquidation of the Trust Portfolio.
- After the Reorganization, LLC proposes that certain LLC Series, each of which will have only one shareholder, collectively the D Series, will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than a disregarded entity as an entity separate from its owner for federal income tax purposes.
- LLC proposes that certain LLC Series, each of which currently has more than one shareholder (type P Series), will not elect pursuant to Treas. Regs. 301.7701-3 to be taxed other than as a partnership and will not be treated as a publicly traded partnership taxable as a corporation under IRC § 7704 for federal income tax purposes.

- LLC proposes that certain LLC Series will elect pursuant to Treas. Reg. § 301.7701-3 to be treated as an association taxable as a corporation for federal income tax purposes, effective from the date of formation of such LLC Portfolio (collectively, "Type C Series").

**c) Requested Rulings**

- The Taxpayers request a ruling that (1) each LLC Series is treated for Massachusetts income and corporate excise tax purposes as a separate entity (or part of a separate entity in the case of a Type D disregarded entity treated as part of its sole owner); (2) each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income tax purposes as a separate LLC; and consequently, each LLC Series and any additional series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**PLANNING NOTE:**

*The LLC will have no assets, liabilities, or income because everything will be allocated among the Series and the function of the LLC is to make it easier to file amendments and other documents with the SEC.*

**d) Ruling**

- Each LLC Series should be classified as a separate entity for Massachusetts income tax purposes.
- Each LLC Series and any additional Series established by LLC in the future will be classified for Massachusetts income and corporate excise tax purposes in accordance with its federal classification.

**e) Refusal to Rule**

- The Department of Revenue refused to rule on whether each Series of the LLC is itself a separate LLC.

- 12. Question:** Does the Delaware Series LLC file one partnership income tax return reporting the income and expenses of all the subsidiaries or does each Separate Series have to file a separate partnership income tax return?

Based on the Letter Ruling, it appears that, to the extent that the husband and wife, in this case, share equally with respect to each subsidiary, then each subsidiary Series LLC, although not a separate entity under state law, will be treated as a partnership for federal and state income tax purposes and require a separate income tax return for each Series.

### 13. IRS in the Proposed Regulations dated October 13, 2010

On October 13, 2010, the IRS issued Proposed Regulations regarding the tax treatment of Series LLCs.

#### Example 1: Domestic Series LLC:

(i) Facts:

Series LLC is a Series Organization (Series LLC). Series LLC has 3 members, 1, 2 and 3. Series LLC establishes 2 Series (A and B) pursuant to the LLC statute of state Y, a Series Statute within the meaning of the Regulations. Under general tax principles, Member 1 and 2 are the owners of Series A and Member 3 is the owner of Series B. Series A and B are not described in Section 301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of Section 301.7701-4.

(ii) Analysis:

Under these Regulations, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under 301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

#### **PLANNING NOTE:**

*(1) The Regulations look through the Delaware Series LLC entity and assume that each Member of the Series LLC owns a pro rata share of each applicable Separate Series thereby making each a partnership, unless there is only 1 Member with respect to a Series, in which case it is a disregarded entity.*

*(2) This treatment may only be applicable to the extent that the Separate Series is not a "Separate Entity" under state law capable of suing and being sued. Compare the Medallion Realty Trust case in which the Massachusetts realty trust which holds title to the property and which is a single member of the Delaware Series LLC, in such a case, the Regulations may not be applicable since the Regulations are premised upon the fact that, under state series law, a separate legal entity does not exist, at least insofar as the Regulations and its analysis are concerned.*

### 14. Litigation and Liability

G&G Management, LLC v. Young Brothers & Company, Inc., United States District Court, District of Maine, Civil Action No. 05-162 BK, dated February 21, 2007.

(i) Facts:

- G&G Management, LLC, a limited liability company organized in Delaware with a principal place of business in New York, New York.
- G&G existed to manage the household affairs and the financial investments of the Goelet Family, including the family residence on Gardiner Island in Long Island Sound and the vessel M-V Captain Kidd Ford IV used to transport the family and household supplies between East Hampton, New York and Gardiner Island, New York.
- In 2002, G&G contracted with Young Brothers & Company to build a new boat to replace Captain Kidd III, which was 40 feet long with a 350 horsepower engine and the new boat would be 45 feet long with an 800 horsepower engine at a cost of approximately \$265,000.
- At some point in time, G&G formed 2 separate interests under Delaware law, Series A and Series B, and gave Series B the purpose of holding the assets' liabilities associated with the Captain Kidd IV, including the boat itself as evidenced by a new Certification of Documentation issued on March 25, 2004.
- The boat was delivered but turned out to be defective and G&G Management, LLC commenced a lawsuit against Young Brothers & Company.
- After a trial, it was determined that Young Brothers & Company, Inc. would be liable to the Plaintiff for \$54,923.70, plus interest.

(ii) Issues in case relating to LLC:

- Just prior to trial, G&G Management, LLC filed a Motion to Join a Real Party in Interest, namely G&G Management, LLC (Series B), a series of limited liability company interests in "certified by G&G Management, LLC" pursuant to Delaware Statute that authorizes Delaware LLCs to establish one or more "Series" of "Limited Liability Company" interests having separate rights, powers or duties with respect to specified property or obligations of the Limited Liability Company, citing 6 Del. Code Ann. Section 18-215(A).
- The Court noted that the Delaware Statute does not indicate what capacity an LLC has to pursue litigation on behalf of its Series, see, Fed. R. Civ. P. 17-B, nor does the Statute indicate what capacity the Series of an LLC has, if any, to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved.

- Although G&G Management, LLC contracted for the construction of the vessel and purchased the vessel, it subsequently identified G&G Management, LLC (Series B) as the owner and G&G Management, LLC as the Managing Owner on the Certificate of Documentation for the vessel.
- The Motion was denied with the Court finding that G&G has a sufficient interest in the boat to maintain the action and that it has a unity of interest with the Series B, such that, under Maine law, Series B could not obtain judgment against Young Brothers & Company for the same events and concluded that G&G can maintain this action as the real party in interest even if it had transferred nominal interest to Series B.

#### **15. Other Matters Uncertain**

- Some attorneys do not create realty trusts to hold separate title. This appears to create a significant problem in terms of securing a particular property in exchange for a Note since the Series LLC will need to be the maker of the Note.
- How should the deed into the Series LLC read? Do not put the name of the particular Series into the Grantee line lest you will have a title defect not easily cured. Use a parenthetical notation at the bottom of the deed stating that this property will be held as a Separate Series with the following language:

\_\_\_\_\_ is held in the \_\_\_\_\_ Series, a separate series of the \_\_\_\_\_ Series, LLC. Pursuant to Section 18-215(b) of the Delaware Limited Liability Company Act the debts, liabilities, and obligations incurred, contracted for or otherwise existing with respect to such series of the Company shall be enforceable against the assets of such series only and not against the assets of the Company generally or any other series thereof, and none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the LLC generally or any other series thereof shall be enforceable against the assets of such series.

#### **16. Employment Tax & Employee Benefit Issues**

The Regulations expressed concern about whether a Series or a Series Organization is the employer under relevant employment law noting “the

domestic statute authorizing the creation of Series contemplates that a Series may operate a business.” If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans.

Application of the employment tax requirements will depend principally on whether the workers are employees and, if so, who is considered the employer for federal income and employment tax purposes “which the employer is identified additionally may arise, including but limited to the following: (1) how would the wage be determined from employees, particularly if they work for more than one Series in a common line of business; (2) how would the common paymaster rules apply; (3) who would be authorized to designate an agent under Section 3504 for reporting and payment of employment taxes and how would the authorization be accomplished; (5) how would the statutory exceptions from the definition of employment and wages apply given that they may be based on the identity of the employer.

If the Series organization handles payroll for a Series and also is the nominal owner of the Series’ assets, would the owners or the managers of the Series organization be responsible for the trust fund recovering penalty under Section 6672?

## **17. Questions asked in the IRS Proposed Regulations**

Comments were requested on the following issues:

- (1) Whether a Series Organization should be recognized as a separate entity for federal tax purposes if it has no assets and engages in no activities independent of its Series;
- (2) The appropriate treatment of a Series does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for federal tax purposes are foreign cells that do not conduct insurance business and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How a Series and Series Organization will be treated for state employment tax purposes and other state employment related purposes and how that treatment should affect the federal employment tax treatment of Series or Series Organizations (comments from the State should be particularly helpful);

- (6) What issues could arise with respect to the Division of Employee Benefits by a Series Organization or Series; and
- (7) The requirement for Series Organization and each Series of the Series Organization to file a statement and what information should be included on the statement.

## **18. Other Matters**

- In California, the Franchise Tax Board in California takes the position that each Series counts as its own LLC for fee purposes.
- Apparently the American Bar Association conducted a review of a Series LLC and declined to endorse them. Illinois and Iowa provides specifically that “Each Series shall be treated as a separate entity to the extent set forth in the Articles of Organization” and, further “Each Series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company.”
- The drafters of the 2006 Revised Uniform Limited Company Act (RE-ULLCA) considered but rejected the idea of including Series provisions in the Act.
- In composite returns, most states allow or require the filing of composite returns for pass-through entities with non-resident owners and is generally filed on behalf of all non-resident members of the entity with the tax being computed at the highest marginal rate.
- If a state determines that each share of an LLC is a separate entity, presumably a composite return would be filed and taxes paid, by each series rather than one return being returned by the LLC as an umbrella entity if the series were treated as disregarded entities.
- If an LLC were to have numerous series with activities in a state where owners were non-residence, a compliance burden would be created as compared to the filing of one composite return if the various Series were disregarded as entities apart from the LLC.

## **19. Bankruptcy Law**

Only a “person” is entitled to file for bankruptcy protection. An LLC generally is considered a person even though an LLC is not within the framework of a “person” in the Bankruptcy Code. As a result, it is uncertain whether a Separate

Series that is not a “Separate Entity,” such as under Illinois law, would be eligible to file for bankruptcy.

Compare, however, the *Medallion Realty Trust* case in which the realty trust was entitled to file for bankruptcy. 11 USC 101, Section 41 provides, “The term person includes individual, partnership, incorporation, but does not include governmental unit...”

## **20. Conclusion**

Proceed with Caution!