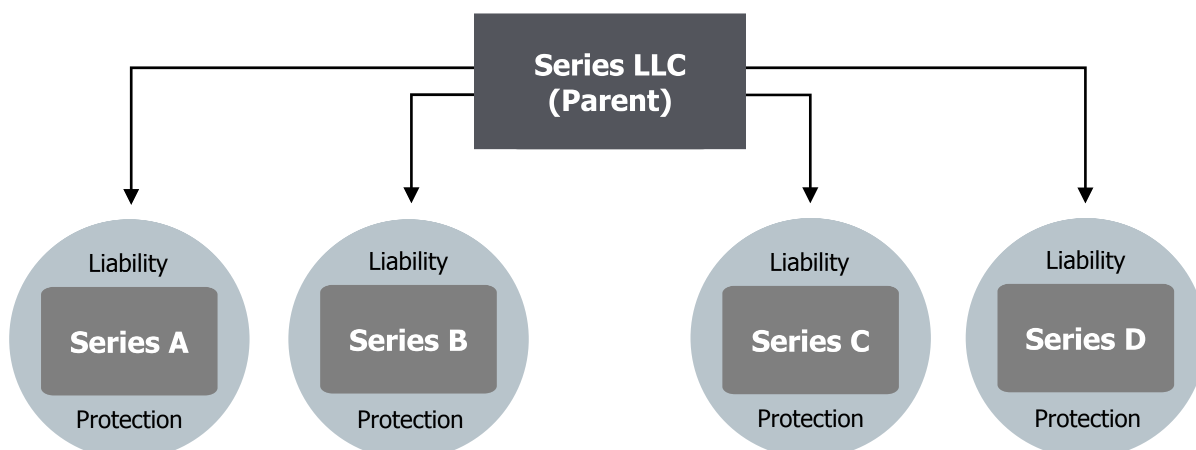
FERRIS FINANCIAL, LLC

HELPING YOU PLAN, PROTECT & PROSPER

Overview

A Series Limited Liability Company (Series LLC) is a form of entity that allows a single "parent" LLC to partition its assets and liabilities among various sub-LLCs called "Series." Each Series may have different assets, operations, and/or investment objectives, and the members and managers, as well as their rights, obligations, and their sharing ratios, may be varied in each Series. The profits, losses, and liabilities of each Series are legally separate from the other Series, which provides a liability shield between each Series and the Parent LLC. The Series LLC effectively creates a Parent/Subsidiary structure without requiring the administrative complexity and cost of creating and managing multiple LLCs.

A Series LLC may be appropriate where a business has a variety of assets or operations that would benefit from liability protection from each other, or where multiple owners have different interests in the business or in different parts of the business operations. A Series LLC may be appropriate in various situations, such as: real estate development; oil and gas exploration; professional businesses; manufacturing and distribution; hedge funds and private equity; or franchise businesses.



The potential benefits of a Series LLC include reduced administrative costs and fewer state filings, liability protection for each Series and the Parent LLC, and the ease of adding or terminating individual Series. Additionally, distributions can be made from any Series, and each Series may have a different sharing ratio. Further, the test of whether sufficient assets exist to permit a distribution is applied at the Series level without regard to the financial condition of the other Series or the Parent LLC; so a particular Series may be able to make a distribution when another Series, or even the LLC itself, could not.

Description & Operation

Series LLC legislation has been enacted in nine states. Delaware enacted the first Series LLC statute in 1996, and has since been followed by Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah and Wisconsin. While each state has different requirements for establishing a Series LLC, typically the statutes require:

- The LLC agreement must establish or provide for the establishment of a series;
- The assets of each series must be separately recorded and maintained;
- The LLC agreement must contain language that contemplates the series and establishes the segregation and distinctness of managers, members, assets, liabilities, and obligations of each series; and,
- The LLC's certificate of formation must contain notice of the liability limitations.

The various statutes generally permit each Series to hold property, sue and be sued, enter into contracts, and generally conduct business operations for the Series' objectives. Typically, a Series may be terminated without affecting the Parent LLC or any other Series, which permits businesses to enter and exit new lines or operations without affecting the remainder of the LLC.

Proposed Regulations

Income Tax Considerations

The IRS issued Proposed Series LLC Regulations in September 2010 (Reg-119921-09). The Proposed Regulations provide the following:

- Each Series will be treated as a separate entity for federal income tax purposes, regardless of its state law status.
- The tax status of each Series would then be determined under the "check-the-box" regulations. This permits each Series within the Parent Series LLC to have a separate status for federal income tax purposes. For example, a Series with a single member associated will be treated as a disregarded entity, but a Series with two or more members will be treated as a partnership (or as a corporation, if elected).
- For federal income tax purposes, the ownership of interests in the series, and the ownership of the assets associated with a series, is determined under general tax principals. For example, the Series LLC will not be treated as the owner of assets merely because it holds the legal title to such assets. Rather, the ownership depends on who has the economic benefits and bears the burdens of the assets.

The proposed regulations do contain a "Grandfather rule" for Series LLCs established prior to September 14, 2010. That provision provides that if all Series have been treated as one entity, such Series may continue that treatment. However, this Grandfather status is lost if on or after September 14, 2010 persons who were not owners prior to that date own 50% or greater of the organization or Series. The IRS will establish forms and require filing for Series LLCs.

The regulations are expected to be effective when finalized.

Employment Tax and State Tax Considerations

The Proposed Regulations do not address how the Series LLC will be treated for federal employment tax purposes, so that remains a point of uncertainty regarding Series LLCs. Similarly, there is limited guidance on state taxation of Series LLCs. Most states whose income taxes conform to federal tax law are expected to adopt treatment as set forth in proposed regulations, but there is no certainty on this topic. States that impose entity level taxation are also likely to embrace separate entity taxation. For example, California's tax board has stated that it will treat each Series separately, thus subjecting each Series to the minimum annual franchise tax, and Texas's Comptroller has issued informal advice that it will treat each Series separately.

Insights and Caveats

The Series LLC is a new type of entity that has not yet been widely adopted, which will likely present unique issues and challenges. The largest potential challenge to the Series LLC is whether the internal liability protections will be respected by bankruptcy courts and courts in states that have not enacted Series LLC legislation. Additionally, there is a lack of uniformity in the legislation among the states that have authorized Series LLCs, which may impact the protection afforded a Series LLC formed in one state if it is operating in another state. It may be advisable to limit Series LLCs to businesses that operate solely in states that have enacted such legislation.

The Series LLC may also be more susceptible to potential veil-piercing arguments, and may necessitate greater adherence with administrative formalities to ensure that the entity is not disregarded. Similarly, Series LLCs may be more susceptible to "substantive consolidation," which is a doctrine that permits bankruptcy courts to collapse multiple legal entities where it appears multiple entities actually operate more as a single entity. The risk of substantive consolidation may be reduced by adhering to the proper formalities in operating each Series separately, such as maintaining separate books and records, and avoiding commingling of assets.

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