

Alberty.com - Fall 2000 Newsletter

We're sending this newsletter to you, as a customer of Alberty Publishing LLC, to bring you news about developments in the law of limited liability companies and what's new at alberty.com.

Self-Employment Tax Law

The self-employment tax treatment of LLC income is not a new development but continues to raise questions. Generally, all income of a member-managed LLC engaged in an active business that is allocated to a member is treated as self-employment income of the member. This is true whether or not the income is distributed to the member. Since self-employment income is subject to old age, survivor, and disability insurance tax and hospital insurance tax at a combined rate of 15.3% on amounts up to \$76,200 and at the rate of 2.9% on greater amounts, this tax is significant and leads many small businesses to organize themselves as S corporations to minimize employment taxes.

It is also possible to minimize employment taxes for equity owners who do not actively participate in the business by organizing a business as manager-managed LLC. Under Proposed Treasury Regulations §1.1402(a)-2(h), members of a manager-managed LLC who do not participate in the LLC's trade or business for more than 500 hours during a taxable year qualify for the exception from self-employment tax accorded to limited partners under IRC §1402(a)(13). After the proposed regulation was issued, Congress enacted legislation preventing its becoming final pending resolution of concerns that some limited partners in existing limited partnerships might become subject to self-employment tax. Although the matter has not been resolved, many practitioners believe that when final regulations are issued, they will make it easier, rather than more difficult, for LLC members to qualify for a limited partner treatment. These practitioners feel that one can rely on the proposed regulation with some confidence.

The 500-hour test is modified under the proposed regulation for LLCs engaged in professional practices, such as medicine, law, accounting, or engineering. If a manager-managed LLC is engaged in a professional practice, no member who provides more than a de minimis amount of services to practice of the LLC can qualify for treatment as a limited partner.

Certain types of income is not subject to self-employment tax. For example, rentals from real estate and capital gains are not considered to be self-employment income, so real estate LLCs often need not be concerned with self-employment tax, whether they are organized as member-managed or manager-managed LLCs.

Client Education Forms

Alberty Publishing offers a number of forms designed to educate your clients about issues like self-employment tax. Form 8.5 is a letter comparing the advantages and disadvantages of LLCs and S corporations in layman's language. This letter can help your client in making the sometimes difficult decision about which form of organization is best for his or her business. The letter also provides a record of the considerations that were taken into account in making this decision.

We also carry a series of letters to clients who have already decided upon the use of an LLC and have organized their business in this form. Form 8.1 explains the organization of a member-managed LLC and contains specific directions for operating the LLC in a way that preserves its significant tax and liability limitation advantages. Form 8.2 is for use if the client has created a manager-managed LLC, and Form 8.3 deals with these issues in the context of a single-member LLC. Particular care must be exercised in organizing and operating a family LLC because of estate and gift tax issues as well as special income tax issues, and a separate form letter, Form 8.4, is available for you to send to clients who have created a family LLC.

Subscription Info

As a customer of Alberty.com, we'd like to continue sending you updates on the law of LLCs and about useful forms that can enhance your practice. If you'd rather not receive our newsletters, just let us know by replying to this e-mail. A human being will be reading your e-mail, so just ask us to take you off our mailing list – no magic words are needed in the subject line.

We welcome your input or feedback about this newsletter. Please feel free to reply with any thoughts or requests. Thank you.

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