

Alberty.com - Spring 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 to bring you up to date on what is happening at Alberty.com.

What's New

The What's New page at Alberty.com currently features an outline of the tax aspects of LLC transactions. The outline contains an overview of the income tax aspects of transactions between LLCs and their members, between members and third parties, and between LLCs and third parties.

As LLCs continue to grow in popularity, attorneys are seeing more transactions involving this form of business entity. If you need a quick reference source of information about the tax aspects of these transactions, just go to the What's New section of our web site and check out the outline. It is available for your use at no cost.

LLC Law Changes

We want to bring to your attention to a development that is not strictly a LLC law change. Rather, the development involves the taxation of sales by accrual basis taxpayers.

Under a new law signed by President Clinton on December 17, 1999, accrual basis taxpayers may not use installment reporting for the sale of assets, including the sale of all of the assets of the business. For sales made on or after the date of enactment, accrual basis taxpayers must recognize all of the gain on asset sales even if the purchase price is received over a term of years. This will have a major impact on sales of small businesses, since these sales are often structured as installment sales.

How does this relate to LLCs? First, if you represent an accrual basis LLC desiring to sell its assets, you may want to recommend that the members of the LLC consider selling their membership interests instead. The members may be cash basis taxpayers and will be able to use installment reporting if the sales price is received over a term of years. In many cases, the members will recognize capital gains on the sales of their interests. The buyer may be willing to buy membership interests because he or she will thereby acquire control of the assets. Of course, buying member interests is like buying the stock of a corporation – the buyer may acquire contingent liabilities and potential problems that could be avoided in an asset purchase. If a membership interest sale cannot be arranged, the seller's increased tax cost in the year of sale can also be covered by increasing the down payment.

Secondly, it is more desirable than ever to avoid creating accrual basis business entities if you can avoid it. Under IRC §§ 461(i)(3) and 1256(e)(3)(B), a manager-managed LLC may be characterized as a "syndicate" and therefore a "tax shelter." As such, it will be required to use the accrual basis under IRC §448(a)(3). A member-managed LLC is less subject to syndicate classification, and you may want to encourage your clients to consider using member-managed LLCs, at least in situations in which there is some doubt about the best form of management.

Transaction Forms

Alberty Publishing offers a number of forms for transactions involving LLCs. For transactions between LLCs and their members, Form 5.3 is a Redemption Agreement that can be used to acquire the interest of a withdrawing member. Form 7.1 contains a set of documents for the liquidation of an LLC and distribution of its assets to its members.

Forms for transactions between members and third parties include two forms for assigning all or part of the interest of a member in an LLC to another person. Form 5.1 is a basic form designed for use in a cash sale of a member's interest to someone familiar with the operation of the LLC, such as another member or an employee. Form 5.2 is longer and more complete and contains warranties regarding the status and financial condition of the LLC as well as warranties of title and good right to convey. This latter form is designed for use in installment sales and sales to third parties who have not previously had a relationship with the LLC. If a member's interest is to be pledged in connection with an installment sale of the interest or a loan to the member, we offer Form 5.4, which is a security agreement with an LLC member's interest as collateral.

In the area of LLC transactions with third parties, we offer Form 6.1, which contains a complete set of documents for the merger of LLCs. As with all of our forms, this form includes commentary explaining the tax and substantive law aspects of LLC mergers.

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 or to a future e-mail containing an issue of the newsletter. 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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