Alberty.com - Spring 2002 Newsletter

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

Tax Treatment of Single Member LLCs

LLCs with one member are an anomaly. They're recognized as separate entities for substantive law purposes, but their existence is disregarded for federal income tax purposes. When single member LLCs were first classified as disregarded entities in the check-the-box-regulations issued in 1997, tax practitioners thought this status might create all kinds of traps and unanswered questions. Happily, this has not been the case. Over the past five years, the IRS has generally been consistent in treating single member LLCs in a manner consistent with their disregarded entity status, and difficult issues have often been resolved favorably from the taxpayer's standpoint.

The IRS has, for example, issued a private letter ruling stating that a single member LLC owned by an individual may own stock in an S corporation without causing a termination of the S corporation's election. Since the LLC is disregarded as a separate entity, the individual is treated as the owner of the stock. Similar reasoning was applied in a private letter ruling relating to the exchange of real estate for an interest in a single member LLC owning real estate. The private letter ruling concludes that the exchange qualifies for tax-free treatment under IRC 1031 because the LLC is disregarded and the membership interest is deemed to be an interest in real estate.

The IRS has also issued two Revenue Rulings dealing with transactions that result in a single member LLC's becoming a multiple member LLC or vice versa. If a second member is admitted to a single member LLC, the LLC is converted from a disregarded entity to a partnership for tax purposes. As a result, the IRS ruled that the original member of the LLC is treated as having contributed the assets of the LLC to a newly created partnership in a transaction that is tax free under IRC 721. If, on the other hand, a multiple member LLC becomes an single member LLC as the result of the acquisition of all members' interests by one of the members or a third party, the IRS has concluded that the LLC is to be treated as a partnership that has terminated for tax purposes. This termination can be taxable for a continuing member as well as for members whose interests have been acquired, but the tax treatment is consistent with the conversion of a partnership to a disregarded entity.

A memorandum issued by the office of the Chief Counsel of the IRS also recognizes the separate existence of a single member LLC as a matter of state law. The memorandum concludes that the assets of a single member LLC cannot be attached for payment of employment taxes payable by the LLC's member because the LLC is an entity separate from its member. In a separate memorandum, the office of the Chief Counsel determined that the member of a single member LLC, and not the LLC, is responsible for withholding and employment taxes on wages paid to the LLC's employees. While it might be nice for the member in a single member LLC to have limited liability with respect to employment taxes incurred in connection with the business of the LLC, the result reached in the memorandum makes sense from the standpoint of tax administration because it is the member, and not the LLC, that obtains the employer identification number for reporting taxes on the LLC's employees.

Moreover, the member of a single member LLC would probably be liable for the taxes as a responsible person even if the taxes were assessed against the LLC.

One potential trap involving disregarded entities exists has received a good deal of recent publicity. This trap relates to qualified subchapter S subsidiaries, however, and not to LLCs. Subsidiaries of S corporations can elect to be disregarded entities under IRC 1361(b)(3), and proposed regulations conclude that such an entity cannot participate in a tax-free merger under IRC 368(a)(1)(A) because it is not classified as a corporation for tax purposes even though it is organized as a corporation under state law. The fact that mergers involving disregarded entities may not qualify as type A tax-free reorganizations does not affect single member LLCs because LLCs cannot participate in tax-free corporate reorganizations in any case.

Web Site Down

Last week, our Web site was out of commission for more than 24 hours as the result of denial of service hacker attack on our Web site hosting service. The integrity of our forms and the confidentiality of customer information were not at risk, but no orders could be placed at our Web site for a time. The attack has ceased, and the FBI is involved in investigating the problem. We regret any inconvenience this caused to our customers and appreciate the concerns of those who contacted us.

Unfortunately, one of the problems with operating a business on the Internet is that our service is occasionally unavailable, usually for only brief periods of time. In addition to hacker attacks, unexpected spikes in the use of Web site hosting service's portal to the Internet can limit or slow access to our Web site, and the computers operated by our Web site hosting service require periodic maintenance, which involves rebooting. If you ever have a problem accessing our Web site, feel free to contact us by e-mail or telephone. We're always happy to fill orders for forms by e-mail when you can't get through to our Web site.

CD-ROM Updates

The sets of forms we sell on CD-ROMs have been very popular, and a number of customers have inquired about our update policy. Our goal is to publish LLC practice forms that reflect current law and practice as well as being technically superior, and we revise all forms sold on our Web site at least once a year. In order to assist customers who have purchased our forms on CD-ROM in keeping their forms current, we offer an annual update. The update is a replacement CD-ROM containing the latest version of all of our forms along with redlined copies showing the revisions that have been made in the forms during the past year. The 2002 update was sent to CD-ROM customers on approval in February and was priced at $45. This update is not available on Web site, so if you purchased a CD-ROM from us prior to December 2001 and didn't receive the update, let us know, and we'll be glad to send you one.

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. But 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.

Alberty Publishing LLC
Online Forms for the Legal Profession
P.O. Box 11504 - Eugene, OR 97440
(888) 930-7007 - fax (541) 344-5073

www.alberty.com