

Alberty.com - Summer 2001 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.

Contributions to LLCs

There are ordinarily no federal income tax consequences when a person contributes property or services to an LLC, but there are some exceptions to this rule that you should keep in mind when planning for contributions by new or existing members of LLCs.

Under IRC §721(a), a contribution of property to an LLC is generally tax free to both the contributor and the LLC. There is no 80 percent control requirement to obtain tax-free treatment for a contribution to an entity taxed as a partnership as there is for a contribution to a corporation under IRC §351. Therefore, a contribution of property to an LLC will be tax free even if the contributor obtains only a relatively small interest in the LLC in exchange.

Tax-free treatment under IRC §721(a) is available even a contribution is made by a new member to an LLC that previously had only one member. Revenue Ruling 99-5, 1999-1 CB 434, treats a contribution of property by an new member to a single member LLC as a contribution of property to a new LLC with two members. The existing member is also treated as having made a contribution to a new LLC, so the transaction is generally tax free for both members.

There are, however, some exceptions to the general rule of IRC §721(a) providing tax-free treatment of contributions of property to entities taxed as partnerships. The first of these exceptions applies if substantially all of the assets of the LLC consist of readily marketable stock or securities, a member contributes stock and securities, and the result is a diversification of the member's portfolio. In this case, the member is required to recognize gain on the contribution under IRC §721(b).

Another exception is that a contribution of property by a member to an LLC is taxable if it is treated as part of a disguised sale or exchange under IRC §§704(c)(1)(B), 707(a)(2)(B), or 737. These sections, which are designed to prevent the avoidance of taxable gain by structuring sales or exchanges as tax-free contributions and distributions from an entity taxed as a partnership, apply in the following circumstances:

- A member contributes property to an LLC, and the contributed property is distributed to another member of the LLC within seven years;
- A member contributes property or money to an LLC and receives a related distribution of money or property from the LLC, with a distribution within two years being presumed to be related; or
- A member contributes appreciated property to an LLC and receives other property from the LLC in liquidation of the member's interest within seven years.

In these situations, the contributing member may have taxable gain at the time the disguised sale or exchange is completed.

If a person acquires an interest in an LLC, and the consideration goes to another member rather than to the LLC, the transaction will be treated as a sale of an interest in the LLC by the other member. In this case IRC §721(a) will not apply, and the other member will recognize taxable gain or loss on the sale.

If a person contributes services to an LLC in exchange for a member's interest, the tax consequences are determined under Revenue Procedure 93-27, 1993-2 CB 343. The contributing member will not generally be taxed so long as he or she receives only an interest in the profits of the LLC. But if the contributing member receives an interest in the capital of the LLC in exchange for past or future services, he or she will be deemed to have received taxable compensation income equal to the value of the capital interest. The LLC will have a corresponding deduction for compensation paid.

Revised Forms

We're continuing to revise and update the forms available at Alberty.com. In July 2001, nine of our 33 forms were revised, and all forms are revised at least once a year.

This may be a good time to update the forms you've purchased from us in the past and continue to use in your practice. Since individual forms can be purchased at our Web site, you can update only the forms you use regularly. You can check the latest revision date of any of our forms by selecting the form at the Products & Prices page of our Web site.

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