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## Series LLCs in Real Estate Transactions

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# SERIES LLCs IN REAL ESTATE TRANSACTIONS

Bradley T. Borden\* and Mathews Vattamala\*\*

*Editors' Synopsis: The first Series LLC statute was enacted in Delaware in 1996. Under that statute, and similar statutes of other jurisdictions, a single LLC may create any number of entities (also known as series), the assets of which are separate from each other and from the LLC that created them. This article explores the ways in which the Series LLC might benefit real estate investors and developers by relieving them of the cost and complication that arise from the transfer of property under more traditional corporate entities. In so doing, the authors address two primary questions that Series LLC liability raises: Whether jurisdictions that have not adopted Series LLC statutes will recognize the existence and limited liability of series, and whether bankruptcy courts and the U.S. Treasury Department will treat series as entities separate from each other and the Series LLC. They conclude that affirmative answers to both questions are likely and that the Series LLC provides at least two tax planning opportunities when dealing with real estate.*

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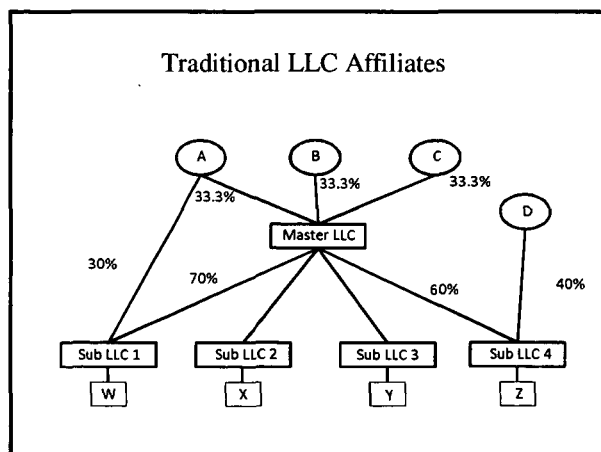
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## I. ADVENT OF SERIES LLCs

In 1996, Delaware became the first state to enact a series limited liability company (LLC) statute.<sup>1</sup> The statute allows a single LLC (referred to in this article as a Series LLC) to create one or more series of members, managers, interests, or assets.<sup>2</sup> Each series can have separate management, ownership, and assets. A Series LLC can protect the assets of a series formed under its umbrella from the liabilities of both the Series LLC itself and any other series, and it can protect its own assets from the liabilities of any series it contains.<sup>3</sup> The structure of a Series LLC replicates that of an affiliated group of LLCs in which a master LLC owns interests in several subsidiary LLCs. The master LLC can wholly own the subsidiary LLCs, or it can be a part owner in them with members of the master LLC or other persons. Each subsidiary of a master LLC can own separate property or conduct a separate business.

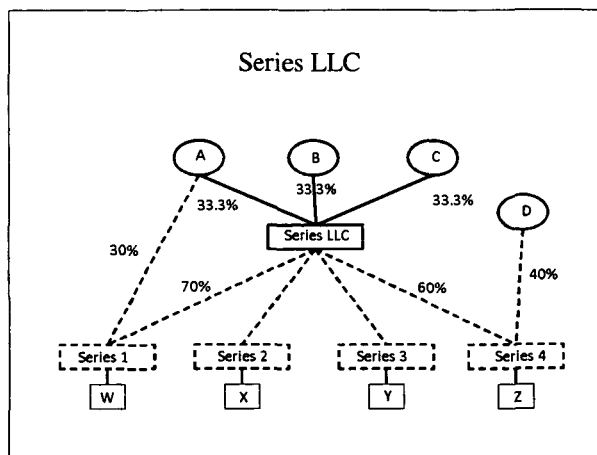


<sup>1</sup> Since then, several other states have enacted Series LLC laws. *See* 805 ILL. COMP. STAT. ANN. 180/37-40 (West 2010); IOWA CODE ANN. § 489.1201 (West 2009); NEV. REV. STAT. ANN. § 86.296 (LexisNexis 2010); OKLA. STAT. ANN. tit. 18, § 18-2054.4 (West Supp. 2011); TENN. CODE ANN. § 48-249-309 (Supp. 2010); TEX. BUS. ORGS. CODE ANN. § 101.601 (Vernon 2010); UTAH CODE ANN. § 48-2c-606 (2010).

<sup>2</sup> *See* DEL. CODE ANN. tit. 6, § 18-215(a) (2005 & Supp. 2010).

<sup>3</sup> *See id.* § 18-215(b).

Although the master LLC structure serves several useful purposes, forming and maintaining it can be cumbersome and costly. Series LLCs help alleviate some of the administrative hassle that master LLC arrangements present. A Series LLC can form several series and allow business and property owners to create, with a single LLC filing, a structure similar to the traditional LLC affiliate structure. The Series LLC performs a function similar to that performed by a master LLC in the traditional LLC affiliate structure. Each series (similar to the subsidiary LLCs in the traditional LLC affiliate structure) can own property and have liabilities and can have one or more members. Those members may include the Series LLC itself, one or more members of the Series LLC, or someone who has no affiliation with the Series LLC or any of its members. Thus, a Series LLC structure may look very similar to the traditional LLC affiliate structure, but the Series LLC structure may require only a single state filing.



Although Series LLCs provide many potential advantages for investors of all kinds, this article focuses on the potential and current use of Series LLCs for tax-planning purposes in the real estate industry. First, they promise to reduce the cost of forming limited liability entities. A state may require a single filing to form a Series LLC. If the filed articles of organization include the required language regarding the establishment of the series, a Series LLC can form an unlimited number of series under its umbrella with no additional filings.<sup>4</sup> Second, movement of property within a Series LLC may be simple. A series can own property without holding title

<sup>4</sup> See *infra* text accompanying notes 15–22.

to the property.<sup>5</sup> As a consequence, a Series LLC could transfer property from itself to a series, or a series could transfer property to another series within the same Series LLC with relatively little paperwork. The ability to transfer property without transferring legal title reduces the costs associated with transferring title, including a reduction of transfer taxes. Third, Series LLCs also may prove to be advantageous in jurisdictions that impose a transfer tax on transfers of property between entities with common ownership. For example, Florida imposes a stamp tax on deeds and other instruments that convey real property or an interest therein to a purchaser in exchange for consideration.<sup>6</sup> The stamp tax appears to apply only if the deed or similar document conveys the property to a person other than a wholly-owned entity.<sup>7</sup> Because inter-series transfers do not require traditional transfer instruments, they may not be subject to the Florida stamp tax. Fourth, if tax laws do not treat each series as separate tax partnerships, the Series LLC itself can file a single tax return, saving the cost of preparing and filing a tax return for multiple entities.<sup>8</sup> If tax laws treat all of the series as one entity, the members of the Series LLC could aggregate the net passive income and losses of the entire enterprise, which would allow losses that the law may otherwise disallow.<sup>9</sup>

Series LLCs are relatively new, but they appear to be a permanent part of entity choice and many practitioners will likely encounter them. Useful information about the number of new Series LLC filings is available from three states.<sup>10</sup> According to that information, business and property owners are forming thousands of Series LLCs each year.<sup>11</sup>

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<sup>5</sup> See *infra* text accompanying notes 39–42.

<sup>6</sup> See FLA. STAT. ANN. §201.02(1)(a) (West Supp. 2011).

<sup>7</sup> See *Crescent Miami Ctr., LLC v. Fla. Dep't of Revenue*, 903 So. 2d 913 (Fla. 2005); *Dep't of Revenue v. Pinellas VP, LLC*, 3 So. 3d 361 (Fla. Dist. Ct. App. 2009).

<sup>8</sup> See *infra* text accompanying notes 62–88.

<sup>9</sup> See Sandra Mertens, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 280 n.61 (2009).

<sup>10</sup> See E-mail from Jeffrey Landerfelt, Customer Service Department, Nev. Sec'y of State, to authors (Mar. 30, 2011, 11:32 EST) (on file with authors); E-mail from Deb Russel, Manager, Ltd. Liab. Div., Dep't of Bus. Servs., Ill. Sec'y of State, to authors (Mar. 16, 2011, 09:30 EST) (on file with authors); Utah Div. of Corps. & Commercial Code, *Statistics*, <http://corporations.utah.gov/services/statistics.html> (last visited March 30, 2011).

<sup>11</sup> For example, in 2010, total LLC filings in Nevada were 33,911, of which 1,529, or 4.51%, were Series LLCs. See e-mail from Jeffrey Landerfelt, *supra* note 10. Illinois's total LLC filings, in the same year, were 27,497, of which 1,084, or 3.94%, were Series LLCs. See e-mail from Deb Russel, *supra* note 10. In Utah, 0.55%, or 1333, of the 24,104 total LLCs filings in 2010 were Series LLCs. See *Statistics*, *supra* note 10.

These figures indicate that Series LLCs are a significant choice of legal entity among business and property owners. At a minimum, tens of thousands of Series LLCs exist today, and business and property owners continue to form them. On September 14, 2010, the Internal Revenue Service (Service) published proposed regulations on the classification of series.<sup>12</sup> Those proposed regulations will draw greater attention to Series LLCs, and that greater attention will likely attract more business and property owners to Series LLCs. The number of filings should increase, and most practitioners will probably encounter Series LLCs in the near future—their clients will ask about forming one, or their clients may do business with a series. Although the information about Series LLC filings does not indicate how many Series LLCs own real estate, the advantages that Series LLCs provide in real estate transactions suggest that a significant number of Series LLCs hold real estate.

<b>NEVADA</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2006–2010</b>
Series LLCs filed	814	2,950	5,163	3,265	1,529	13,721
Total LLCs filed	40,777	43,478	43,912	39,031	33,911	201,109
Series LLC % of total new filings	2.00%	6.79%	11.76%	8.37%	4.51%	6.82%
<b>ILLINOIS</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2006–2010</b>
Series LLCs filed	698	992	1,229	1,181	1,084	5,184
Total LLCs filed	27,509	30,016	27,420	25,542	27,497	137,984
Series LLC % of total new filings	2.54%	3.30%	4.48%	4.62%	3.94%	3.76%
<b>UTAH</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2006–2010</b>
Series LLCs filed	46	73	112	121	133	485
Total LLCs filed	25,699	15,101	25,664	24,415	24,104	114,983
Series LLC % of total new filings	0.18%	0.48%	0.44%	0.50%	0.55%	0.42%

Although Delaware does not track the number of Series LLCs filed as a number separate from its total LLC filings, *see* E-mail from Delaware Division of Corporations to authors (Mar. 16, 2011, 09:30 EST) (on file with authors), a rough estimation of the number of Series LLCs filed there may be made by reference to these other jurisdictions. In 2010, Delaware received 82,027 LLC filings. *See* Delaware Division of Corporations, *2010 Annual Report*, available at <http://corp.delaware.gov/10CorpAR.pdf> (last visited June 30, 2011). If the number of Delaware's Series LLC filings, as a percentage of total LLCs filings, falls between 0.55% (2010's lowest ratio of Series LLC filings to total LLC filings) and 4.51% (2010's greatest ratio of Series LLC filings to total LLC filings), then business and property owners could have formed between 451 and 3,699 Series LLCs in that state. Because Delaware is generally a more popular jurisdiction for forming entities, business and property owners might have formed more Series LLCs (as a percentage of total LLCs formed) there than in other states. Thus, the number of Series LLC filings in Delaware for any recent year could approach several thousand.

<sup>12</sup> *See* Series LLCs and Cell Companies, 75 Fed. Reg. 55,699-01 (Sept. 14, 2010) (to be included in C.F.R. at 26 C.F.R. pt. 301).

## II. LEGAL ASPECTS OF SERIES LLCs

Although other states have enacted Series LLC statutes,<sup>13</sup> this article focuses on the rules of the Delaware statute.<sup>14</sup> The Delaware LLC statute allows for the creation of Series LLCs, defines the legal aspects of Series LLCs and their component series, identifies the formalities that an LLC must satisfy to establish series, grants the series power to do certain things, and establishes the limited liability of series. Finally, the statute addresses the ownership of series property and the management and ownership of the series.

### A. Series LLC Formation and Formalities

An LLC becomes a Series LLC if the certificate of formation provides notice of the limitation on liabilities of a series, and the LLC satisfies other formalities.<sup>15</sup> The notice requirement is important to consider. Entities that provide limited liability must provide general notice of that limitation, often in the name of the entity. For example, a limited liability company generally must include some form of *LLC* in its name.<sup>16</sup> The name puts others on notice that the members are not liable for the entity's obligations,<sup>17</sup> and so the obligations of the entity can be satisfied only with the assets of the entity. A series in a Series LLC does not have to provide similar notice.<sup>18</sup> The certificate of formation may be the only public notice that an entity is a Series LLC and that there may be independent series formed under its umbrella. The public notice issue is a bit more complicated because the certificate of formation does not have to name specific series, and series do not have to

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<sup>13</sup> See, e.g., 805 ILL. COMP. STAT. ANN. § 180/37-40 (West 2010); IOWA CODE ANN. § 489.1201 (West 2009); NEV. REV. STAT. ANN. § 86.296 (LexisNexis 2010); OKLA. STAT. ANN. tit. 18, § 18-2054.4 (West Supp. 2011); TENN. CODE ANN. § 48-249-309 (Supp. 2010); TEX. BUS. ORGS. CODE ANN. § 101.601 (West 2010); UTAH CODE ANN. § 48-2c-606 (2010).

<sup>14</sup> See American Bar Association Section of Taxation, *Comments in Response to Notice 2008-19, Tax Treatment of Individual Cell, Protected Cell Companies*, (January 5, 2009). The American Bar Association Section of Taxation focused specifically on the provisions of the Delaware Series LLC statute. In general, Series LLCs in Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah all share the same characteristics. But, only Delaware, Illinois, and Texas specifically authorize series to contract and hold assets in their own name, and only Illinois and Texas specifically treat series as separate entities for state law purposes. See *id.* at 2 n.10.

<sup>15</sup> See DEL. CODE ANN. tit. 6, § 18-215(b) (2005 & Supp. 2010).

<sup>16</sup> See *id.* § 18-201(1).

<sup>17</sup> See *id.* § 18-207.

<sup>18</sup> See *id.* § 18-215(b).

exist at the time the certificate is filed.<sup>19</sup> Thus, public documents may not notify creditors as to which assets of a Series LLC would be subject to the creditors' claims.

In addition to filing a certificate of formation that provides notice of the series, the LLC must adhere to the following formalities to establish series: (1) the LLC agreement must establish or provide for the establishment of one or more series;<sup>20</sup> (2) the records maintained for any series must account for the assets associated with such series separate from the assets of the LLC or any other series thereof;<sup>21</sup> and (3) the LLC agreement must provide for the limited liability of the series or for the maintenance of records.<sup>22</sup>

Thus, the only public notice that a series may exist will be the general notice in the certificate of formation for the Series LLC. To learn more about each series and their assets and ownership, creditors would have to consult the LLC agreement and specific documents related to specific series. Undoubtedly, a series must conduct business in its own name to ensure that the series is respected under the statute.<sup>23</sup> Thus, any transactions entered into between a series and other parties should disclose the nature of the series.

Creditors of a series should seek to obtain copies of the LLC agreement and the documents governing the series with which the creditor is conducting business. Specifics about other series may not be relevant if a series provides the single-purpose structure that a creditor seeks. If, however, a creditor would like property in another series to become collateral for a loan, documents governing the other series would interest the creditors. Therefore, even though there may be no public notice that a Series LLC has numerous series, contract creditors should inquire about the existence of other series when conducting business with a specific series. The liability protection provided under the Series LLC statute should give sufficient comfort that the assets of a particular series will not be subject to claims arising within other series or the Series LLC.<sup>24</sup>

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<sup>19</sup> *See id.*

<sup>20</sup> *See id.* § 18-215(a).

<sup>21</sup> *See id.* § 18-215(b).

<sup>22</sup> *Id.* The text of the statute does not clearly establish what the LLC agreement must provide. The provision either refers to maintaining records or limited liability for the series. To be safe, attorneys should ensure that the LLC agreement provides for both record maintenance and limited liability for the series.

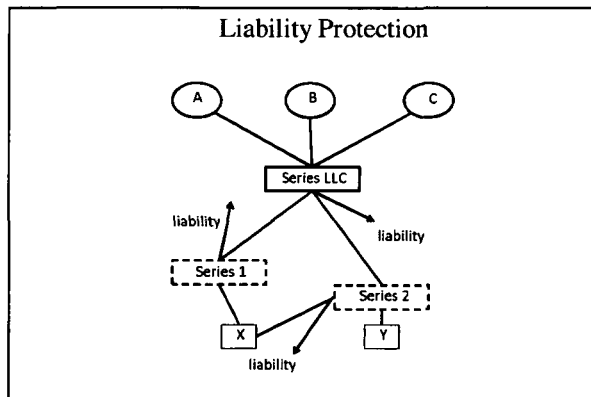
<sup>23</sup> *See id.* § 18-215(c).

<sup>24</sup> *See id.* § 18-215(b).



## B. Series' Limited Liability

The limited liability of each series makes them attractive. If an LLC satisfies the statutory formalities and forms one or more series, "then the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any series thereof."<sup>25</sup> This language suggests that the assets of the Series LLC and other series are protected against another series' liabilities. Furthermore, "none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series."<sup>26</sup> This language suggests that the assets of a series will be safe from liabilities that arise with respect to the Series LLC itself or another series. Thus, the statute provides the same liability protection that an affiliation of LLCs can provide. The question is whether courts will respect the limited liability afforded in the statute.



Both property owners and creditors must be concerned about how effectively a series can protect its assets from the liability of the Series LLC or other series, and how effectively a series protects the assets of the Series LLC and other series from liabilities of that particular series. Several commentators have considered these issues and concluded that the outcome of

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

any dispute over the effectiveness of a series is still an open question.<sup>27</sup> Other commentators, however, suggest that courts will respect the statutory construction.<sup>28</sup> Still others question how bankruptcy courts will treat series.<sup>29</sup> This Article argues that courts in other jurisdictions should respect the limited liability protection afforded to series in the state statute where the Series LLC is formed, and bankruptcy courts should treat series as separate persons. As more practitioners study these issues and gain confidence in their conclusions, undoubtedly more business and property owners will form Series LLCs.

Consider the two primary questions that series limited liability raises. First, will jurisdictions that have not adopted Series LLC statutes recognize the existence of the series and the statutory limited liability granted by other states? Courts have not considered that specific question (perhaps because of the newness of Series LLCs or the question's lack of novelty), but have held that states must respect the limited liability rules of other types of foreign entities, such as LLCs and limited partnerships.<sup>30</sup> Nothing indicates that courts would reverse course with respect to Series LLCs. Furthermore, attorneys have the benefit of resolving certain issues by referring to the statute itself. Practitioners can ensure courts will respect the internal liability shields of a Series LLC and its series by exercising the same due diligence and care demanded by any business form that provides limited liability.

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<sup>27</sup> See, e.g., Amanda J. Bahena, *Series LLCs: The Asset Protection Dream Machines?*, 35 J. CORP. L. 799 (2010); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226 (2009).

<sup>28</sup> See, e.g., Jared L. Peterson, *Unlimited Potential or Uncertain Future: Series LLCs and Intra-Family Wealth Transfers*, 9 J. L. & FAM. STUD. 385 (2007) ("[I]t is likely courts will respect the liability protection accorded to each [s]eries so long as [s]eries LLC members and managers avoid commingling funds and heed the statutory formalities associated with a [s]eries.").

<sup>29</sup> Shannon L. Dawson, *Series LLC and Bankruptcy: When the Series Finds Itself in Trouble, Will It Need Its Parent to Bail It Out?*, 35 DEL. J. CORP. L. 515 (2010); Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 385 (2007).

<sup>30</sup> See, e.g., *Matjasich v. State Dep't of Human Res.*, 2 P.3d 985 (Kan. 2001) (relying on Utah's statute to determine the liability of the manager of a Utah limited liability company); *Liberty Mut. Ins. Co. v. Gardere & Wynne, L.L.P.*, Civ. A. No. 94-10609-MLW, 1994 WL 707133 (D. Mass. Dec. 6, 1994) (deferring to Texas law to determine whether the plaintiff could bring a malpractice suit against the general partners of a law firm registered as a Texas limited liability); *Downey v. Swan*, 454 N.Y.S.2d 895 (App. Div. 1982) (considering New Jersey law to decide the personal liability of the members and managers of a New Jersey limited liability partnership association in a wrongful death suit). See also Thomas E. Rutledge, *To Boldly Go Where You Have Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions*, 58 BAYLOR L. REV. 205, 224-26 (2006) (discussing states' application of the limited liability rules of other states).

Owners can help shield the assets of an individual series from the debts, liabilities, obligations, and expenses of the other series or the Series LLC by complying with the formalities enumerated above.<sup>31</sup>

Second, will bankruptcy courts recognize series as separate entities, or will they consider the Series LLC and the assets of all the series to be part of a bankruptcy estate? If a series can file for bankruptcy, the bankruptcy estate will include only the assets of the series. If, however, the Series LLC must file for bankruptcy, all the assets of the Series LLC and each series could be part of the bankruptcy estate. A series can file for bankruptcy on its own only if it is a person under bankruptcy law.<sup>32</sup> Although the question of whether a series is a person for bankruptcy law purposes is open, one commentator suggests that bankruptcy courts could find support for treating a series as a separate entity in certain situations.<sup>33</sup>

A bankruptcy court relies on several factors to hold that an LLC is a person for bankruptcy purposes.<sup>34</sup> It appears to recognize that an LLC is made up of its owners (that is, its members); that management vests in the members unless the LLC agreement provides otherwise; and that members and managers are not liable for the LLC's debts solely by reason of being members and managers.<sup>35</sup> Because the same factors could return a similar result with respect to a series, a series arguably is a person for bankruptcy purposes. Series can be made up of their members; they can vest management in their members or in other managers; and their members and managers are not liable for the debts of the series solely for the reason that they are members and managers. Thus, they have many of the same attributes that a bankruptcy court considers in evaluating an LLC.

Bankruptcy courts also recognize that LLCs are a cross between corporations and partnerships,<sup>36</sup> both of which are separate persons for bankruptcy purposes. Like LLCs, series manifest characteristics of both corporations and partnerships. Series parallel partnerships to the extent that they offer significant flexibility with respect to their ownership and management

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<sup>31</sup> See *supra* text accompanying notes 14–22.

<sup>32</sup> See 11 U.S.C. § 109(a) (2006).

<sup>33</sup> See Dawson, *supra* note 29 (noting further that the classification for bankruptcy could turn on the federal tax classification of series).

<sup>34</sup> See, e.g., *In re ICLNDS Notes Acquisition, LLC*, 25 B.R. 289 (Bankr. N.D. Ohio 2001).

<sup>35</sup> See *id.* at 292–93.

<sup>36</sup> See *In re Allentown Ambassadors, Inc.*, 361 B.R. 422, 442 (Bankr. E.D. Pa. 2007); *In re Calhoun*, 312 B.R. 380, 383 (Bankr. N.D. Iowa 2004); *In re Avalon Hotel Partners, LLC*, 302 B.R. 377, 380 (Bankr. D. Or. 2003).

structure. Partnerships cannot, however, provide limited liability protection to their members; in contrast, series can offer this protection and in this respect they resemble corporations. Thus, like LLCs, series represent a sort of hybridization of partnerships and corporations. Bankruptcy courts most likely will recognize this affinity and, provided the series has satisfied the required legal formalities, consider each series as a separate person for bankruptcy purposes.

One other potential bankruptcy issue warrants consideration: Will the bankruptcy court substantively consolidate series? Generally, an affiliated corporate or LLC structure can avoid substantive consolidation by following the formalities of corporate and LLC statutes.<sup>37</sup> The potential for substantive consolidation should be no greater with series formed under an LLC than with traditional affiliate structures. Practitioners can help ensure that a Series LLC will not be substantively consolidated by following the Series LLC formalities.

The concerns that arise regarding Series LLCs affect both property owners and creditors. Property owners will be concerned that the series may not provide the liability limitation provided in the statute. Creditors will be concerned that the entity that holds title to the property does not own the property. Existing case law in other areas should help both sides overcome their respective concerns.<sup>38</sup> Both sides of a transaction will, however, have a vested interest in the owners of a Series LLC and in the adherence of each series to the formalities required to retain their status as separate entities.

### C. Property Ownership

The Delaware statute does not require a series to hold property directly. Instead, it provides that assets associated with a series may be held in the name of the series, in the name of the Series LLC, through a nominee, or otherwise.<sup>39</sup> Nonetheless, the records for a series must account for the assets

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<sup>37</sup> See *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005).

<sup>38</sup> For example, in *Olmstead v. FTC*, 44 So. 3d 76 (Fla. 2010), the Eleventh Circuit held that, "a court may order a judgment debtor to surrender all right, title, and interest in the debtor's single-member LLC to satisfy an outstanding judgment." *Id.* at 83. The Court based its conclusion on the uncontroverted right of a single-member LLC's owner to transfer their entire interest in the LLC freely and the operative language of the Florida Act, which "does not in any way suggest that [a] charging order is [the] exclusive remedy" in the LLC context. *Id.* In the case of a single-member LLC, "an assignee of the membership interest of the sole member in a single-member LLC becomes a member—and takes the full right, title, and interest of the transferor—without the consent of anyone other than the transferor." *Id.*

<sup>39</sup> See DEL. CODE ANN. tit. 6, § 18-215(b) (2005 & Supp. 2010).

associated with it.<sup>40</sup> Records satisfy this requirement if they reasonably identify the assets of the series.<sup>41</sup> Records reasonably identify the assets of a series by “specific listing, category, type, quantity, computational or allocational formula, procedure (including a percentage or share of any asset or assets), or by any other method where the identity of such assets is objectively determinable.”<sup>42</sup> This language provides the series great latitude in establishing the property it owns.

A series can own property for liability protection purposes, even though it does not hold legal title to the property. Accounting for the assets associated with a series “separately from the other assets of the series LLC and other series” suffices to establish a series’ ownership of property.<sup>43</sup> The statute does not address a situation in which more than one series accounts for ownership of the same property, however. Perhaps if it is ambiguous as to what property the series owns, the identity of the assets owned by the series will not be objectively determinable, and the series will not own the property. The law therefore places the burden on the series to establish the identity of its assets, and failure to do so would result in the series not owning assets.

#### D. Series Management and Ownership

Series do not have traditional ownership interests. Instead, the Series LLC agreement provides which members or managers of the Series LLC shall be associated with particular series.<sup>44</sup> The LLC agreement also determines the rights, powers, and duties of owners and managers who are associated with particular series.<sup>45</sup> The LLC agreement may allow the Series LLC to create additional classes or groups of members or managers associated with a series.<sup>46</sup> Those members or managers may have rights, powers, and duties that are senior to existing members or managers associated with the series.<sup>47</sup> Thus, traditional notions of entity ownership do not appear to apply to series. Instead of holding ownership interests in a series, owners of series hold interests in the Series LLC or are managers of the Series LLC

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<sup>40</sup> *See id.*

<sup>41</sup> *See id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *See id.* § 18-215(e).

<sup>45</sup> *See id.*

<sup>46</sup> *See id.*

<sup>47</sup> *See id.*

and are associated with the series. Members of the Series LLC must closely examine the Series LLC agreement to determine their rights with respect to any series and to understand what might affect those rights. This new form of entity ownership may make classifying series for tax purposes difficult.

The Series LLC agreement also determines the procedures for taking action with respect to the Series LLC or any of the series. The Series LLC agreement may, for example, allow for the creation of a class or group of members or managers associated with a series.<sup>48</sup> In fact, if the Series LLC agreement so provides, the Series LLC may create a new class or group of members without the vote or approval of any member, manager, or group of members or managers.<sup>49</sup> Furthermore, the Series LLC agreement may provide that certain members or class or group of members associated with a series shall have no voting rights.<sup>50</sup> These rules may strip some members or managers of power associated with the Series LLC and every series. The only protection members or managers will have is often that provided for in the Series LLC agreement. The agreement may, however, provide for its own amendment without the vote or approval of any member or manager.<sup>51</sup> Investors must therefore be familiar with the contents of the Series LLC agreement. The statute does not restrict the manner in which the Series LLC agreement may provide for the management of the various series.

The voting structure of a Series LLC can be quite complicated. With respect to each series, the Series LLC agreement may provide complex voting rights.<sup>52</sup> For example, the Series LLC agreement may grant to all members or managers associated with a series the right to vote on any matter.<sup>53</sup> The Series LLC agreement also may grant to certain identified members or managers associated with a series the right to vote separately or to vote with a specified group or class of members or managers associated with the series.<sup>54</sup> The voting arrangements may vary with respect to different matters.<sup>55</sup> The voting may have any basis, including per capita, number, financial interest, class, or group.<sup>56</sup> This suggests that some Series LLCs will be very

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<sup>48</sup> *See id.*

<sup>49</sup> *See id.*

<sup>50</sup> *See id.*

<sup>51</sup> *See id.*

<sup>52</sup> *See id.* § 18-215(f).

<sup>53</sup> *See id.*

<sup>54</sup> *See id.*

<sup>55</sup> *See id.*

<sup>56</sup> *See id.*

complicated. Attorneys representing the Series LLC and existing members and those representing potential investors will undoubtedly create very complex voting structures as Series LLCs become more prevalent.

Thus far, the discussion has revealed that the rules governing series owners and voting defer to the Series LLC agreement and, accordingly, provide the members of the Series LLC significant leeway in determining who owns and votes with respect to a series. In fact, the rules discussed to this point have deferred entirely to the Series LLC agreement, providing no default rules with respect to series ownership and voting thus granting significant leeway to those forming Series LLCs. The rules regarding management similarly defer to the LLC agreement, but they provide default terms, which govern if the Series LLC agreement is silent with respect to the issue.<sup>57</sup> The default rules provide that management of a series shall vest in the members associated with the series in proportion to the members' interests in the profits of the series.<sup>58</sup> The default rules also provide that the decision of members who own more than fifty percent of the interests in profits shall be controlling.<sup>59</sup> Nonetheless, the members may provide different rules in the Series LLC agreement.<sup>60</sup> In fact, the Series LLC agreement may vest the management of the series in a manager who is chosen as provided in the Series LLC agreement.<sup>61</sup>

Series LLCs present many new features. The Delaware statute is, not surprisingly, very generous and allows members of the Series LLC significant latitude in structuring most aspects of the series' ownership and management. Undoubtedly, creative structures will emerge as Series LLCs become more prevalent. The structures will test the fortitude of all parties involved with them. Members of Series LLCs will have to be vigilant in drafting the Series LLC agreement. Investors will likewise have to carefully consider the Series LLC agreement to ensure that their rights are what they anticipate. Finally, creditors and others who transact business with Series LLCs or any series formed under its umbrella, must be aware of their rights with respect to assets of such entities. Lawyers and other advisors will help these parties navigate the uncharted aspects of Series LLCs. Certainly, many aspects of Series LLCs will become more apparent as they become more prevalent, as practices begin to take shape and commentary increases,

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<sup>57</sup> See *id.* § 18-215(g).

<sup>58</sup> See *id.*

<sup>59</sup> See *id.*

<sup>60</sup> See *id.*

<sup>61</sup> See *id.*

and as the common law governing them begins to develop. Despite these challenges, Series LLCs are now a part of the entity choice smorgasbord, and it behooves tax and business law practitioners to become familiar with them.

#### E. Practical Aspects of Series LLCs

Because series are a new creature, those who have not had previous exposure to them may wonder about their general structure and how members transfer ownership interests in a series. The Series LLC agreement will provide for the formation of one or more series and will include the general provisions that the statute requires to form series. It should also provide, in greater detail, how the Series LLC will form series. For example, it could provide that the manager of the Series LLC will execute and deliver a declaration, or other similar document, to create a series. That declaration may establish who will be the original members of the series. Those members may include members of the Series LLC or persons who are not members of the Series LLC. The declaration may also indicate which assets and liabilities will be part of the series. Additionally, the declaration may indicate who will be the original manager of the series and how the members may change the management. Finally, the declaration should provide the manner in which interests in a series can be assigned and how the series will terminate. The declaration will most likely become a part of the Series LLC agreement.

Members of a series will transfer their interests in the series in a manner that compares to transfers of interests in LLCs. Members will most likely use an assignment agreement to transfer the interests in the series. That assignment agreement would be similar to an assignment agreement used to transfer interests in an LLC and would identify the assignor, assignee, and interests to be transferred.

The assignee does not need to be a member of the Series LLC. In fact, a series could have one or more members, all of whom are not members of the Series LLC. That may be unattractive to some potential owners because they would have to maintain a relationship with the Series LLC. Some owners may, however, prefer the thought of dealing with the Series LLC, instead of the state, regarding the status of their legal entity.

### III. TAX CLASSIFICATION OF SERIES LLCs

The tax classification of Series LLCs can be important for at least two reasons. First, one commentator believes it could affect the classification of



a series for bankruptcy purposes.<sup>62</sup> Second, it will affect the attractiveness of Series LLCs. If tax law treats each series as a separate entity, the owners of the Series LLC will have greater latitude in choosing how to classify these series. The existing law suggests that a series should be a separate entity for tax purposes, and proposed regulations,<sup>63</sup> if adopted, would make that classification clearer. From there, practitioners would be left to determine the number of owners of a series.

#### A. Tax Entity Classification Generally

Tax entity classification begins with the question of whether an arrangement is an entity separate from its owners.<sup>64</sup> The separate entity question is generally irrelevant if an arrangement is a state law corporation because such entities are almost always tax corporations.<sup>65</sup> If the separate entity is not a corporation and has a single member, tax law will disregard it, assuming the entity does not elect to be a tax corporation.<sup>66</sup> Consequently, separate entity status for a single-member, noncorporate entity is important only if that entity wishes to be a tax corporation. Generally, asking whether a single-member, noncorporate entity is a separate entity is a superfluous exercise.<sup>67</sup> In fact, asking whether an arrangement is a separate entity generally is the equivalent of asking whether the arrangement is a tax partnership. That is a difficult question to answer.<sup>68</sup>

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<sup>62</sup> See Dawson, *supra* note 29, at 515.

<sup>63</sup> See *infra* Part B.

<sup>64</sup> See Treas. Reg. § 301.7701-1.

<sup>65</sup> See Treas. Reg. § 301-7701-2(b). Unless a state-law corporation is a sham, unreal, or bald and mischievous fiction, courts will recognize it as a separate entity, and it will be a tax corporation under the check-the-box regulations. See *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436 (1943).

<sup>66</sup> See Treas. Reg. § 301.7701-2, -3.

<sup>67</sup> The question could become important if the single-member entity wished to elect to be a tax corporation, in which case it would probably have to be a separate entity for tax purposes.

<sup>68</sup> See Bradley T. Borden, *The Federal Definition of Tax Partnership*, 43 Hous. L. Rev. 925 (2006) (discussing the legal and theoretical challenges raised by the question of tax partnership classification). The question is less difficult for arrangements that are clearly partnerships—those that have co-ownership and require the partnership tax rules to allocate the arrangement's taxable income among the members. For example, an arrangement of two people who own and manage an apartment complex would generally be a tax partnership. An unincorporated law firm with more than two owners would also generally be a tax partnership.

Regulations promulgated by the U.S. Department of the Treasury (Regulations) provide some general guidance regarding whether an arrangement is a separate entity. First, they explain that whether an entity is separate from its owners is a matter of federal tax law and does not depend upon whether local law recognizes it as an entity.<sup>69</sup> The Regulations also provide that a separate entity may exist for federal tax purposes if the participants of an arrangement “carry on a trade, business, financial operation, or venture and divide the profits therefrom.”<sup>70</sup> The Regulations then set out several examples of arrangements that are and are not separate entities for tax purposes. For example, a separate entity exists if co-owners of an apartment complex lease space and provide services to the occupants.<sup>71</sup> A separate entity does not exist, however, if a joint undertaking is a mere cost sharing arrangement.<sup>72</sup> Co-ownership of property, such as farm or ranch land, that is maintained, kept in repair, and rented does not constitute a separate entity.<sup>73</sup> Whether such arrangements are separate entities will determine whether they are tax partnerships, so the body of law addressing whether an arrangement is a tax partnership is important.

Beyond the examples in the Regulations, an expansive body of case law addresses what is a tax partnership.<sup>74</sup> Unfortunately, that body of law does not provide a consensus about the proper test to use to determine whether an arrangement is a tax partnership.<sup>75</sup> That body of law does, however, indicate the type of arrangements that raise the tax-partnership-classification question. That question usually asks whether a multimember arrangement is a tax partnership or one of the following arrangements: (1) an employment arrangement (including employment of an independent contractor), (2) a leasing arrangement, (3) a lending arrangement, or (4) a co-ownership ar-

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<sup>69</sup> See Treas. Reg. § 301.7701-1(a)(1).

<sup>70</sup> Treas. Reg. § 301.7701-1(a)(2).

<sup>71</sup> See *id.*

<sup>72</sup> See *id.*

<sup>73</sup> See *id.*

<sup>74</sup> See Bradley T. Borden, *A Catalogue of Legal Authority Addressing the Federal Definition of Tax Partnership*, 2 THE PARTNERSHIP TAX PRACTICE SERIES: PLANNING FOR DOMESTIC AND FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 30-1 (2010) (identifying numerous cases and rulings that have considered whether an arrangement is a tax partnership).

<sup>75</sup> See Borden, *supra* note 68 (identifying the following ten different tests that courts and the Service have used to test whether arrangements are tax partnerships: (1) the substantive-law test, (2) the state-law test, (3) the joint-profit test, (4) the expense-sharing test, (5) the degree-of-activity test, (6) the type-of-activity test, (7) the source-of-activity test, (8) the business-purpose test, (9) the estoppel test, and (10) the fact-question test).

arrangement.<sup>76</sup> Assuming the members of the arrangements share profits, the answer to the tax-partnership-classification arrangement question often turns on who owns or controls the arrangement's property.<sup>77</sup> A similar question would arise in determining whether an LLC has multiple owners. That inquiry would consider whether a person who provides services for the LLC is a member. If the person has sufficient control of the LLC, the person would be a member. If the LLC has another member, it would be a tax partnership. Thus, the question of whether an arrangement is a partnership often turns on whether two people own or control the resources of the arrangement.

Series LLCs raise several questions about who owns a series. Each question pertains to the tax classification of the Series LLC and the respective series, and each requires an understanding of state law.<sup>78</sup> Those questions are as follows:

1. Who owns the property of a Series LLC and the series for tax purposes?
2. Who are the owners of the respective series for tax purposes?
3. Who controls major decisions regarding the property of the Series LLC and the series?
4. Who is entitled to income generated by the property and other resources of the Series LLC and the series?
5. Who will receive property upon dissolution of the LLC or a series?

Answering these questions for a carefully created series should not be difficult. The Series LLC agreement should provide for the creation of one or more series and indicate how it will create series. The series documents

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<sup>76</sup> See Borden, *supra* note 68, at 937–38 (identifying oil and gas arrangements as other possible multiparty arrangements that may raise the tax-partnership-classification question).

<sup>77</sup> See Bradley T. Borden, *Profits-Only Partnership Interests*, 74 BROOK. L. REV. 1283, 1299 (2009) (“Participating in the control of property distinguishes a partner from an employee.”). See also *Luna v. Comm’r*, 42 T.C. 1067 (1964) (considering whether the parties shared control and responsibilities of the enterprise in holding that no partnership existed); *Fishback v. United States*, 215 F.Supp. 621 (D.S.D. 1963) (finding that parties were joint proprietors and holding that arrangement was a tax partnership); *Beck Chem. Co. v. Comm’r*, 27 T.C. 840 (1957) (finding that the parties had mutual proprietary interest in profits and holding that arrangement was a tax partnership); *Copeland v. Ratterree*, 53 A.F.T.R. 1309 (N.D.N.Y. 1957) (holding no partnership existed even though parties shared profits because they did not share control).

<sup>78</sup> See Jasper L. Cummings, Jr., *Ownership, Series, and Cells*, 2010 TAX NOTES 1129 (Dec. 7, 2010).

should identify the owners of the series and identify the rights that managers, owners, and others have to control the assets of the series. Those rights should help determine whether the arrangement has multiple owners. The question with respect to series should be no more complicated than the question with respect to any other type of arrangement.

In fact, outside of the real estate context, courts and the Service have ruled that a series or similar type of structure may be a separate entity for tax purposes.<sup>79</sup> Those rulings indicate that a series could be a separate entity for tax purposes. That being the case, a series that has a single member could be a corporation or it could be disregarded. It would be a tax partnership if it had more than one member and did not elect to be a tax corporation. The classification of a series under that interpretation is elective. The creator of a series could ensure that it has fewer than one member by regulating the level of control and other ownership attributes that transfer to parties associated with the series. If the series has fewer than one member, it could elect to be disregarded or become a tax corporation. If the creator of the series wanted it to be a tax partnership, the creator could increase the control and other ownership attributes that one or more persons associated with the series has and make the series a multimember arrangement. A series with multiple members would be a tax partnership. The question then becomes whether the Service and courts will always treat a series as a separate entity. Recently published proposed regulations suggest the Service will do so.

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<sup>79</sup> See *Nat'l Sec. Series—Indus. Stock Series v. Comm'r*, 13 T.C. 884 (1949) (holding that several series created within a statutory open end investment fund were each a separate regulated investment company); *Union Trustee Funds v. Comm'r*, 8 T.C. 1133 (1947) (holding that series funds organized by a state law corporation could not be treated as separate tax corporations); *Priv. Ltr. Rul.* 200803004 (Oct. 15, 2007) (ruling privately that the individual series of a limited liability company—in the insurance industry—would qualify as separate eligible entities for federal tax purposes if (1) each series holds a separate pool of assets, liabilities, and stream of income; (2) the shareholders of a series share in the income of only that series; (3) the ownership interests of a series' shareholders are limited to the assets of that series upon redemption, liquidation, or termination of such series; (4) the payment of a series' expenses, charges, and liabilities are limited to its assets alone; (5) a series' creditors can look only to its assets for the recovery of expenses, changes, and liabilities; and (6) each series has its own investment objectives, policies, and restrictions); *Priv. Ltr. Rul.* 9847013 (Aug. 20, 1998) (ruling privately that the series of an open end management investment company are separate entities). See also *Rev. Rul.* 2008-8, 2008-5 I.R.B. 340 (describing cell companies). California and Massachusetts also recognize series as separate entities for tax purposes. See *CAL. CORP. CODE* § 17050 (West 2006); *Mass. Ltr. Rul.* 08-2: Separate Entity Status and Federal Classification for Each Series of an LLC (Feb. 15, 2008); Sheldon I. Banoff & Richard M. Lipton, *California Refines Its Tax Treatment of Series LLCs*, 106 J. TAX'N 316 (2007).

## B. Proposed Regulations

The proposed regulations focus on whether series are separate entities. They address that issue by providing that a state shall treat a series organized or established under the laws of another state as an entity formed under local law.<sup>80</sup> The proposed regulations leave to general tax principles the issue of whether the series is a separate entity.<sup>81</sup> Local law classification does not determine whether an arrangement is a separate entity for tax purposes.<sup>82</sup> In fact, the relevance of local law classification to tax entity classification is uncertain. Nonetheless, the Service appears to take the position that a local entity will be a separate entity, unless it lacks a business purpose or any business activity other than tax avoidance.<sup>83</sup> Consequently, a series, which would appear to be a local entity, will often be a separate entity. That classification is taxpayer-friendly because it provides taxpayers the greatest latitude in structuring Series LLCs. If a series is a separate entity, the creator of the series can make it a disregarded entity by ensuring it has just one member; make it a tax partnership by ensuring it has at least two members; or make it a tax corporation by causing it to elect that status. The creator can control the number of members a series has by adjusting the control and other attributes of those associated with the series. Thus, the Service rule provides series great latitude in determining their tax classification.

The proposed regulations also define terms. The definitions help establish that a series will be a separate entity for tax purposes. First, the proposed regulations define *series* as a segregated group of assets and liabilities established pursuant to a series statute by agreement of a series organization.<sup>84</sup> An understanding of that definition requires knowledge of the definition of *series statute* and *series organization*. A series statute is a statute

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<sup>80</sup> See Prop. Treas. Reg. § 301.7701-1(a)(5)(i), 75 Fed. Reg. 55,699, 55,707 (Sept. 14, 2010).

<sup>81</sup> See Prop. Treas. Reg. § 301.7701-1(a)(5)(iii), 75 Fed. Reg. 55,699, 55,707 (Sept. 14, 2010).

<sup>82</sup> See Prop. Treas. Reg. § 301.7701-1(a)(1), 75 Fed. Reg. 55,699, 55,707 (Sept. 14, 2010).

<sup>83</sup> See Notice of Proposed Rulemaking, Series LLCs and Cell Companies, 75 Fed. Reg. 55,699 (Sept. 14, 2010).

<sup>84</sup> See Prop. Treas. Reg. § 301.7701-1(a)(5)(viii)(C), 75 Fed. Reg. 55,699, 55,708 (Sept. 14, 2010).

that explicitly provides for the establishment of a series as a juridical person.<sup>85</sup> The statute must also explicitly permit the following three items:

1. The members of the series organization must have rights, powers, or duties with respect to the series.
2. A series must have separate rights, powers, or duties with respect to specified property or obligations.
3. The assets and liabilities of a series must be segregated from the assets and liabilities of the series organization and other series.<sup>86</sup>

The series statutes should satisfy those requirements. A series organization is a juridical person that establishes and maintains a series.<sup>87</sup> The term *series organization* includes a Series LLC, a series partnership, a series trust, a protected cell company, a segregated cell company, a segregated portfolio company, or a segregated account company.<sup>88</sup> Thus, the proposed regulations definitely cover Series LLCs, though they also cover much more.

#### IV. TAX PLANNING WITH SERIES LLCs

Series LLCs should help simplify tax planning opportunities available with other types of entity structures. This article offers two potential tax planning opportunities that Series LLCs present for the real estate industry: (1) the *Bramblett* structure and (2) the exchange accommodation titleholder structure. The planning opportunities are, however, much broader.

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<sup>85</sup> The definitions in the proposed regulations introduce the concept of juridical entity without defining it. In this context, the plain definition of that term is appropriate. The proposed regulations seek to grant separate entity status to series. They do that through a string of definitions. If an entity satisfies the definitions of *series*, *series statute*, and *series organization*, then the entity is a state law entity under the substantive rule. By defining a series organization using the term *juridical person*, the proposed regulations appear to simply require that the statute creating the series must also treat the Series LLC as a separate legal person. A statute that failed to do that would have little utility, so all Series LLC statutes should satisfy that requirement. Perhaps the choice of terminology was not the best in the proposed regulations, but it does not appear to alter their apparent intent.

<sup>86</sup> See Prop. Treas. Reg. § 301.7701-1(a)(5)(viii)(B), 75 Fed. Reg. 55,699, 55,708 (Sept. 14, 2010).

<sup>87</sup> See Prop. Treas. Reg. § 301.7701-1(a)(5)(viii)(A), 75 Fed. Reg. 55,699, 55,706 (Sept. 14, 2010).

<sup>88</sup> See *id.*

### A. The *Bramblett* Structure

A Series LLC may reduce the cost and complexity of owning and developing property. Real estate developers often use the structure approved in *Bramblett v. Commissioner*.<sup>89</sup> In *Bramblett*, several people owned property in a partnership.<sup>90</sup> The partnership held the property for investment,<sup>91</sup> so any gain the partnership recognized on the disposition of the property could be taxed at favorable capital gains rates.<sup>92</sup> The selling price of the property would be greater if the property were developed and sold in lots. If the partnership developed and sold the property, the partnership's development efforts would taint all of the gain realized on the ultimate disposition of the property. The taint would cause the owners to lose the favorable capital gains rates that should apply to the gain realized before the owners began developing the property. To avoid tainting the investment intent and losing the favorable rates, the owners caused the partnership to transfer the property to a corporation owned by the partners.<sup>93</sup> The corporation developed and sold the property.<sup>94</sup> The court held that gain recognized by the partnership on the transfer to the corporation qualified for favorable capital gains rates.<sup>95</sup>

Structures like the one used in *Bramblett* require the owners of property to create at least one separate entity to hold the investment property. They also require a separate legal entity to develop and sell the property. The parties likely will wish to hold the investment properties in separate entities to help ensure that the activities relating to one piece of property will not taint the holding purpose of another piece of property. The investment entities will generally be LLCs treated as tax partnerships. The parties will also form a state law corporation or elect to have the developer entity be taxed as a corporation to ensure that any gain realized by an investment LLC prior to transferring the property to the developer obtains capital gain treatment. Thus, one development project may require the formation of several legal entities, and the transfer of property from one entity to another may require

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<sup>89</sup> 960 F.2d 526 (5th Cir. 1992).

<sup>90</sup> See *id.* at 528.

<sup>91</sup> See *id.*

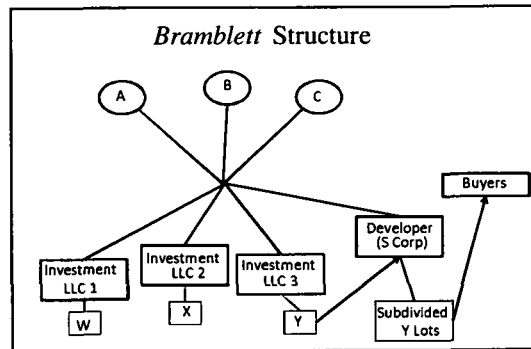
<sup>92</sup> See *id.* at 529.

<sup>93</sup> See *id.* If the entities holding the investment properties are tax partnerships, the developer entity must be an entity other than a tax partnership, such as a tax corporation, to preserve the capital gain treatment. See I.R.C. § 707(b)(2).

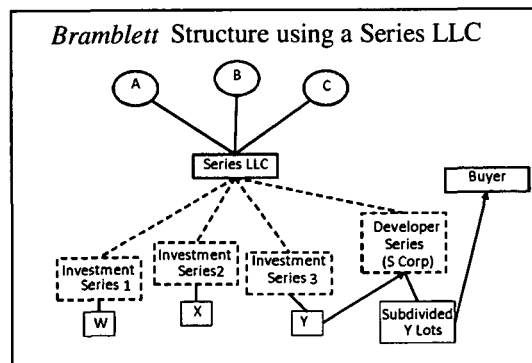
<sup>94</sup> See *Bramblett*, 960 F.2d at 528.

<sup>95</sup> See *id.*

a deed, title work, and payment of transfer taxes. The structure is somewhat complicated, but the tax savings it creates can be significant. The savings could be greater if the owners could use a Series LLC.



A Series LLC may be able to reduce some of the non-tax complexity of such a structure. Instead of forming several entities, the owners of property may be able to form a Series LLC. The owners can then establish several series to own investment property and form one series to be the developer entity. The developer series can make the election to be taxed as a corporation and elect "S status." The owners can structure the ownership of each series to help ensure that each of the other series has multiple owners and is a separate entity for tax purposes. Assuming those other entities do not elect to be tax corporations, they should be tax partnerships. Thus, by filing one document with the state, the owners can create several tax partnerships and a tax corporation. The owners could also use internal documents and book-keeping to transfer property from an investment series to the developer series, so they would not have to transfer title between the series.





The proposed regulations suggest that the Service is amenable to the series being treated as separate entities, so the owners should be able to structure the arrangement to ensure that each series is the appropriate tax entity. Each investment series must have at least two owners to ensure that they are each separate tax partnerships. Thus, attorneys representing the members of the Series LLC will have to ensure that the documents give each series more than one owner. The developer series may have a single owner if it is a separate entity. It could then make an election to be a tax corporation. If the series are separate tax entities, the structure should be a good substitute for the more cumbersome traditional *Bramblett* structure.

#### B. Exchange Accommodation Titleholder Structure

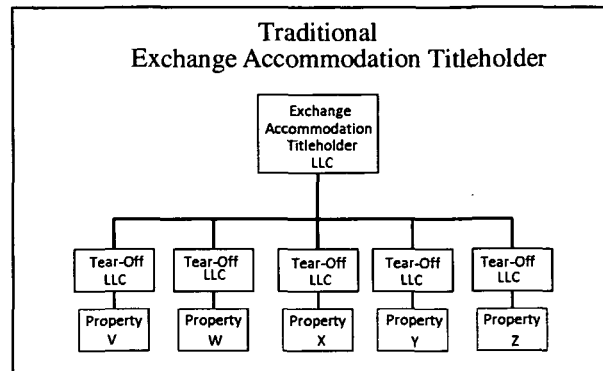
A second possible structure may help simplify reverse like-kind exchanges. Taxpayers will generally use a title-parking arrangement to do a reverse like-kind exchange instead of receiving replacement property prior to the transfer of relinquished property.<sup>96</sup> The title-parking arrangement often requires an exchange accommodation titleholder to take title to the replacement property. Because the exchange accommodation titleholder will likely hold several properties simultaneously, exchangers insist that the exchange accommodation titleholder set up a separate legal entity, generally an LLC, for each piece of property it owns. To prevent the liability from one property attaching to another property, the exchange accommodation titleholder should not use an LLC to hold title to more than one piece of property. As a consequence, the LLCs that hold title are good for one piece of property, after which the exchange accommodation titleholder either transfers the title holding LLC interests to the exchanger or terminates the titleholding LLC. The temporary status of the titleholding LLCs gives them the name of *tear-off LLCs*. Creating a new tear-off LLC for each piece of property adds to the cost of facilitating exchanges. The parties do not want the tear-off LLC to be a separate entity for tax purposes because they want the exchange accommodation titleholder to be the taxpayer that is deemed to hold title to the property.<sup>97</sup> Because tear-off LLCs generally are not state law corporations and have single members, tax law disregards them.<sup>98</sup>

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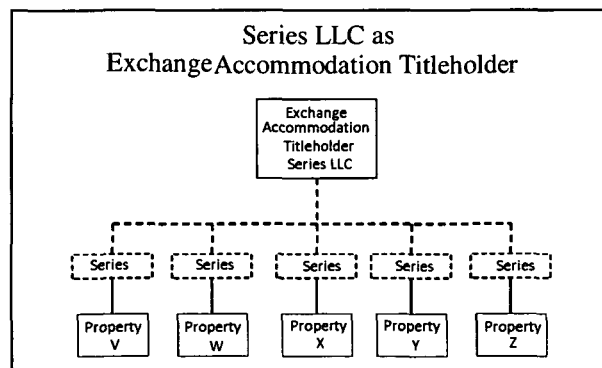
<sup>96</sup> See BRADLEY T. BORDEN, TAX-FREE LIKE-KIND EXCHANGES ¶ 5.3 (2008).

<sup>97</sup> See Rev. Proc. 2000-37 § 4.02(1), 2000-2 C.B. 308.

<sup>98</sup> See Treas. Reg. § 301.7701-3(b)(ii).



Using a Series LLC instead of a traditional LLC may allow the exchange accommodation titleholder to save costs and provide the same liability protection for its clients. Under this alternative, a Series LLC would create a series for each piece of property to which it takes title. It could create the series internally, without filing anything with the secretary of state. The respective series should then be the owners of the property for state law purposes, and the Series LLC's compliance with state law formalities should protect the property in each series from any liability that might arise with respect to the property held in other series. The Series LLC will prefer that each series be disregarded for tax purposes. Under the proposed regulations, a series would be a separate entity, but if the Series LLC is the sole owner, the series would be disregarded.



This structure raises several issues. First, the parties doing the exchange may hesitate to hire an exchange accommodation titleholder who uses a new form of legal entity. Unfortunately, many of the people who do reverse exchanges lack sophisticated legal counsel and will be unable to assess the structure. Consequently, some of the exchangers who do not hesitate to hire a Series LLC as the exchange accommodation titleholder may be unaware of the legal risks that these structures raise. Second, if the exchanger wishes to receive the ownership interests in a tear-off entity, the exchanger would take all of the ownership interests in the series. The series must be associated with a Series LLC. The exchanger may not wish to own a series that is associated with the exchange accommodation titleholder Series LLC. To terminate that association without terminating the series, the exchanger would apparently have to form a Series LLC with which the series could be associated. The Delaware statute does not explicitly allow series to change association, but the structure of Series LLCs and the transferability of series interests suggest that such changes should be possible. That being the case, Series LLCs may become attractive alternatives for exchange accommodation titleholders.

## V. CONCLUSION

Series LLCs are gaining prominence. The Treasury Department's publication of proposed regulations suggests that many taxpayers and advisors have questions regarding the classification of series. Undoubtedly, tax law and state law will continue to evolve as more people begin to use Series LLCs. The uses of Series LLCs in real estate transactions will also evolve with the changing laws. This new form of legal entity is bound to create ownership and tax planning opportunities that will change the face of real estate ownership and practice.