

## **Tennessee: State Issues Significant Guidance on the Tax Treatment of Series LLCs**

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Tennessee recently joined California, Florida, Massachusetts, New York, and Texas as states that have published guidance on the state tax treatment of "series limited liability companies" ("series LLCs"). With Tenn. Ltr. Rul. No. 11-42, 9/6/11, Tennessee becomes only the second state with its own series LLC statute to issue such a ruling; Texas is the other (Tex. Policy Ltr. Rul. No. 201005184L, 5/5/10). (The other states' guidance referred to above are: Cal. FTB Informational Pub. No. 3556 ("Limited Liability Company Filing Information"), 4/1/11; Fla. Technical Assistance Advisement (TAA) No. 02(M)-009, 11/27/02; Mass. Ltr. Rul. No. 08-2, 2/15/08; and N.Y. Advisory Opinion TSB-A-98(8)I, 9/4/98.)

**Series LLC background.** To date, eight states (Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah) have enacted series LLCs statutes, which generally allow for the establishment of separate series underneath a series organization or "master LLC." This essentially allows the LLC to be subdivided into separate series with separate rights, powers, and duties with regard to specific property or obligations of the LLC or with regard to profits and losses associated with specific property or obligations. Further, if certain statutory conditions are met, a series LLC can be formed such that the debts, obligations, and liabilities of one series will not be enforceable against the assets of another series—at least in a state that recognizes this type of legal entity. These series under the LLC are generally not treated as separate entities under state law and thus cannot have members, but each series of the LLC will be "associated" with specific members, assets, rights, obligations, and objectives.

For an examination of various potential state and local tax issues raised by this relatively new form of entity, see McLoughlin and Ely, "The Series LLC Raises Serious State Tax Questions but Few Answers Are Yet Available," 16 J. Multistate Tax'n 6 (January 2007) .

**Federal guidance.** In September 2010, the U.S. Department of the Treasury issued guidance, in the form of proposed regulations, as to how a series would be treated for federal income tax purposes. (See REG-119921-09, filed 9/13/10, published 9/14/10 (F.R. Doc. 2010-22793; 75 Fed. Reg. 55699 *et seq.*), adding Prop. Treas. Regs. §§301.6011-6, 301.6071-2, and 301.7701-1(a)(5), and amending §§301.7701-1(e) and (f).) These

regulations were discussed in McLoughlin and Ely, "IRS Issues Long-Awaited Guidance on Series LLCs; Will the States Soon Follow?," 20 J. Multistate Tax'n 8 (January 2011).

**The Tennessee letter ruling.** Under the facts considered by the Tennessee Department of Revenue in Ltr. Rul. 11-42, a Tennessee "master" series LLC (SLLC) was wholly owned by a limited partnership (LP), and each of SLLC's series also was wholly owned by LP. LP owned several rental properties and planned to transfer those properties so that each series would own a separate piece of rental real estate. The question presented by the taxpayer was whether the series LLC could file one Tennessee franchise and excise tax return, including therein all the activities of the series LLC and each of its series.

The Treasury Department's proposed series LLC classification regulations (noted above) were a significant factor in the Department's consideration of this issue. Those regulations conclude that each series is considered as a separate entity *for purposes of determining tax classification*. Thus, for federal income tax purposes, a series with one owner is treated either as a corporation or as a disregarded entity, and a series with two or more owners is treated either as a corporation or as a partnership.

Based on the proposed regulations, the Department concluded that each series would be treated as a separate LLC *for determining its tax classification* for Tennessee franchise and excise tax purposes. Tennessee's tax law, however, departs from federal tax law on the question of whether single-member LLCs are disregarded for franchise and excise tax purposes. To be disregarded for Tennessee franchise and excise tax purposes, a series must be (1) a single-member LLC that is (2) disregarded for federal tax purposes and (3) whose single member is *a corporation*. (See Tenn. Code Ann. §§67-4-2007(d) (excise tax) and 67-4-2106(c) (franchise tax); only by satisfying those three conditions may any entity be disregarded for Tennessee franchise and excise tax purposes.) Under the facts of the ruling, the single member of the SLLC and of each series was a limited partnership. Thus, the SLLC and each series would not be disregarded for Tennessee franchise and excise tax purposes, despite being disregarded for federal income tax purposes. Accordingly, the SLLC and each series all were required to file separate Tennessee franchise and excise tax returns.

**Commentary.** For federal income tax purposes, the SLLC and each series would be disregarded because the SLLC and each series had only one owner—LP—and thus would be included in LP's federal tax report. For Tennessee franchise and excise tax purposes, that result could not be achieved because the single member was not a corporation. Taxpayers should take note of this unfortunate result because one of the purported benefits of a series structure is to reduce administrative costs. Filing individual Tennessee franchise and excise tax returns will likely increase administrative costs, and thus defeat that benefit.

Nevertheless, Tennessee's treatment should give some comfort to certain SLLCs with individual series' holding real property located in various states. The ruling would seem to prevent the Department from attempting to include a noncorporate-owned out-of-state series in a Tennessee franchise and excise tax filing. Additionally, the analysis here should provide comfort to a SLLC and its individual series that are wholly owned by a corporation and that anticipate filing a single Tennessee franchise and excise tax return.

Significantly, the result set forth in this ruling is limited to Tennessee's franchise and excise tax because, for all other taxes (e.g., sales and use tax, property tax, business tax), the state's classification of LLCs is determined based on federal income tax law, with no separate condition regarding disregarded-entity determinations. See Tenn. Code Ann. §48-249-1003. Accordingly, under the facts of the ruling, the SLLC and each series would be

disregarded for purposes of all other Tennessee taxes, unless the entity "checked the box" to be treated as a separate corporate taxpayer. This result is particularly important when evaluating the tax consequences of a transaction between the SLLC and an individual series that is wholly owned and thus disregarded for federal income tax purposes. For examples, sales of tangible personal property between the individual series of the SLLC should not be subject to sales tax because, between the two disregarded entities, no "transfer" has occurred for Tennessee sales tax purposes.

Tennessee's ruling is consistent with rulings (cited above) issued by taxing authorities in California, Florida, Massachusetts, and New York, in that each state follows the Treasury regulations and tests each series of the SLLC separately in determining tax classification. Texas, to the authors' knowledge, is the only state that has issued public guidance concluding that the SLLC and its series will always be treated as one entity for the state's franchise tax purposes. [ ]

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