CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

SERIES LLCS

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Delaware, Nevada and other states have enacted legislation that allows a limited liability company to create separate series (a Series LLC). California has yet to revise its LLC law to allow for the formation of a California Series LLC, although it does allows them to be registered as foreign LLCs. Despite the inability to form a California Series LLC, Series LLCs have gained much attention over the last decade in California and elsewhere.

A Series LLC should be distinguished from an LLC that merely has different units or classes of membership interests. With a Series LLC, generally: (i) the members of each series are treated as owning an interest in that series only, and have no rights as members of one series in the assets or income of any other series; (ii) each series maintain separate books and records; (iii) each series has its own assets and is liable only for its own liabilities; (iv) the members of each series are not financially responsible for the debts and obligations of the series; and (v) each series may be managed separately.

In September 2010, the IRS proposed regulations regarding the federal treatment of a Series LLC. The proposed regulations essentially treat EACH series of a domestic Series LLC as disregarded, a "C" or "S" corporation or a partnership based on the general "check the box" classification rules. The logical extension of the proposed regulations is that members can have different tax bases, holding periods and capital accounts, as well as confront different tax rules regarding contributions, distributions, loans and other items for each series.

A significant benefit in California for a Series LLC could have been to avoid the $800 annual minimum tax and LLC fee imposed on LLCs doing business in California, such as by forming one LLC with 5 different series rather than 5 separate LLCs. However, the California Franchise Tax Board has announced that it will treat each series of a Series LLC (having attributes similar to those previously described) as a separate LLC for purposes of those taxes.

Assuming that taxpayers can live with the federal and California tax treatment of Series LLCs, should taxpayers use them? I usually say no or not yet. In many cases, separate LLCs will work well. Moreover, there are simply too many unanswered questions, such as dealing with defunct or insolvent series, dissolving or changing the legal form of the Series LLC, keeping series assets, contracts and liabilities separate, coping with multi-state nexus issues and figuring out to what extent California courts will apply Series LLC liability protection to damaged Californians in various circumstances. Additionally, the operating agreement can be complex since it needs to deal with issues that deal with matters within each series as well as matters that affect the Series LLC.

It seems that a Series LLC could save costs or provide essential controls in some instances, such as where each series is controlled by the same persons or subject to the same cross-collateralized loan. Presumably, Series LLCs will in time occupy a niche in certain situations or industries.

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