

CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

SINGLE MEMBER LLCs

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Single member limited liability companies (SMLLCs) have many benefits and uses that

should cause those structuring business activities to consider their usage virtually always.

Under "check the box" entity classification rules, generally conformed to by California, an owner generally can disregard a SMLLC for federal tax and California income tax purposes (but not for property tax or sales and use tax purposes) while existing as a separate legal entity for other purposes. This treatment allows the income and assets of the SMLLC to be reported on its owner's tax return while providing liability protection for the owner of the SMLLC as with any other subsidiary. Conversely, an owner can file an election and make a SMLLC a "C" corporation or "S" corporation or add another owner and make the SMLLC be income taxed as a partnership generally whenever it desires.

The IRS has issued many rulings or rules that demonstrate disregarded status. For instance, it has ruled or made rules that: (i) an LLC can own the stock of an S corporation, (ii) a taxpayer selling real property can acquire all of the

membership interests in a SMLLC as replacement property for a valid like-kind exchange, and (iii) a corporation can merge into a SMLLC owned by a corporation and have the transaction qualify as a tax-free "A" reorganization. There are many more applications for SMLLCs, including in international transactions.

The SMLLC can add a layer of liability protection or set up separate management control without creating taxable events – since an owner cannot loan, sell or exchange property with itself, transfers and payments between the owner and SMLLC should have no income tax effect.

A SMLLC, though, has some tax limitations. In 2009, the IRS started treating SMLLCs as corporations for employment tax purposes. Now, a SMLLC often must get its own employer identification number and file some federal tax returns.

Additionally, California imposes its LLC fee on SMLLCs so a SMLLC has to file FTB Form 568 in California. However, a SMLLC that owns a membership interest in another LLC that has income from California sources does not need to count the passed through income from the

other LLC for purposes of determining the LLC fee of the SMLLC. The instructions to Schedule IW in the FTB Form 568 Booklet recognize this treatment by "bolding" the statement not include amounts already reported by another LLC.

State law issues also impose limitations. As with other LLCs, SMLLCs generally cannot engage in activity in California that requires a B&P Code license. Additionally, whether a creditor of the owner of the SMLLC can reach SMLLC assets also raises unique issues. Finally, an owner must regard fully a SMLLC for all non-income tax purposes to prevent "piercing the veil" and similar liability issues. Accordingly, an owner should adequately capitalize a SMLLC, title the SMLLC assets in the name of the SMLLC, not commingle those assets with assets of the owner, enter into contracts in the name of the SMLLC, sign those documents as the manager or member of the SMLLC, etc.

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