SERIES LLCs

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CHAPTER 15
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SERIES LLCs

I. INTRODUCTION

Most "tax lawyers" are also business lawyers who structure and negotiate business organization transactions except in the case of highly specialized tax lawyers in large firms who may function as tax service providers to the business lawyers. Particularly in the case of partnership and limited liability company (LLC) formations and transactions, the "tax lawyer" is likely to be the "business lawyer" intimately involved in the details of the transaction and the laws governing partners and members rights, duties and obligations of the partnership or LLC, respectively. Accordingly, operating under the philosophy that in business deals, the lawyer is always careful to make sure the "tax tail does not wag the business dog," this outline addresses in some detail the statute governing series LLCs in Texas before moving on to the tax issues, federal and state, that involve a series LLC. As the starting point for any tax issue is the Internal Revenue Code (Code), after some brief introductory comments about series LLCs, this outline starts with the statutory provisions which address Texas series LLCs and provides comments and analysis on each statutory section. After addressing the statutory issues, a survey of various federal and state tax issues is provided. Finally, concluding remarks include references to where forms for series LLC agreements may be found.

II. BACKGROUND

The Texas series LLC provisions were added to the Texas Business Organizations Code (TBOC) in 2009 as Subchapter M (Sections 101.601-621) of Title 3 (Sections 101.101-621) of TBOC (LLC Act). A total of eight states now have series LLC statutes: Delaware, Texas, Illinois, Iowa, Nevada, Oklahoma, Tennessee, and Utah. The series LLC concept arose out of the use of statutory business trusts for asset securitization and investment companies. Thus, traditionally the series LLC has been used as a separate investment series of a single investment company, e.g., XYZ Investment Co., Series A, Series B, etc. However, series LLCs have become popular, or useful, in the real estate development business where a large real estate development company organized as an LLC uses a series for the acquisition of each new development property rather than creating a separate LLC or partnership for each such acquisition. From a tax perspective, the current "buzz" about series LLCs resulted from the IRS issuing Revenue Ruling 2008-8 concerning insurance coverage provided through a "Protected Cell Company" structure and associated Notice 2008-19 regarding the treatment of a Protected Cell Company as a separate taxable entity if certain conditions were met. Notice 2008-19 also requested comments on guidance concerning segregated arrangements (e.g., series LLCs) that do not involve insurance. Among others, the American Bar Association Section of Taxation Committee on Partnerships and LLCs, of which I was chair at the time, submitted comments in response to Notice 2008-19. Illustrations of different series LLC structures and usages from the ABA Comments are included at the end of this outline. Because series LLCs have separately identifiable assets and investment or business operations, separate owners which may vary widely from series to series, and separate liability shields, there was critical need for guidance as to whether a series LLC was a separate entity eligible to file its own (presumably partnership) tax return or whether all of the series were to be combined and reported in one tax return of the LLC. Based upon private conversations with practitioners, it was apparent that investment series LLCs tended to file separate tax returns for each series while some real estate developers filed a single partnership tax return for the LLC with the use of schedular allocations to account for the ownership interests of the various members among the various series.

The legislative activity and questions currently surrounding series LLCs is reminiscent of the activity and questions surrounding LLCs after Revenue Ruling 1998-76 held that a Wyoming LLC meeting certain characteristics could be treated as a partnership for federal income tax purposes. At the time of Rev. Rul. 88-76, only Wyoming and Florida had LLC statutes.

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1 6 Del. Cod C. §18-215. The Delaware LLC provisions are in Section 18-201 through 1109 (Delaware LLC Act).
2 ILCS 180/37-40.
3 Iowa Code Ann §489.1201.
4 NRS §86.296.3
5 18 Okla. Stat. §18-2054.4B.
6 Tenn. Code Ann §48-249-309.
7 Utah Code Ann §48-2c-606.
11 2008-1 C.B. 366.
14 See, Robert Beard, "Jurisdictional Competition of the Series LLC: Harnessing the Market for Innovations in
Texas was the fourth state to enact an LLC statute in 1991, and by 1996 all 50 states had LLC statutes. Because of the confusion surrounding classification of LLCs as partnerships or associations taxable as a corporation under Rev. Rul. 88-76, the IRS developed and issued what came to be known as the check-the-box regulations, effective January 1, 1997. The net effect of the check-the-box regulations was that domestic LLCs could elect whether to be taxed as corporations or partnerships. From a non-tax perspective, many of the early concerns about LLCs being recognized as a limited liability entity in a state which did not have an LLC statute were ultimately resolved when all states had enacted LLC legislation. The issues today with series LLC reflect the same concerns that were discussed and extensively addressed in numerous articles during the developing years of LLCs in the 1990s.

From a practical perspective, interesting questions arise about the development and use of series LLCs because of their status as essentially private divisions of an LLC. In Delaware and Texas, for example, while an LLC gains legal existence from filing a certificate of formation with the Secretary of State, a series comes into existence as a result of the LLC agreement in Delaware, or company agreement in Texas, without the need for any state filing. (This is one of the cost savings benefits of a series – the ability to be created without an initial filing fee.) However, because there is no state filing required for legal existence of a series, it is difficult to determine how many series exist. A check with the Delaware Secretary of State found that they do not know how many series exist, and further, that although since July 19, 2005 they have kept separate records of LLC formations including the requisite authorizing language for series in their certificate of formation, they do not keep statistics on the number of series LLCs filed versus non-series LLCs. Texas has the same problem. A telephone conference with staff at the Texas Secretary of State revealed that 61,435 LLCs had been filed between the September 1, 2009 effective date for series LLCs and June 30, 2010. In a subsequent telephone conference with Texas Secretary of State staff, they indicated that they had pulled a random sample of 1023 LLC certificates of formation filed from the total of 56,900 LLC certificates filed between September 1, 2009 and May 10, 2010, finding that 1 had series authorizing language included. Thus, based on the percentages from the random sample (less than 0.1%), it appears that approximately 50 LLCs with series authorization have been formed in Texas since the September 1, 2009 effective date of the series LLC legislation.

III. TEXAS SERIES LLC STATUTORY PROVISIONS

Statutory language is provided in italics with bracketed numerical references to the comments following the statutory language.

**SUBCHAPTER M. SERIES LIMITED LIABILITY COMPANY**[1]

Sec. 101.601. SERIES OF MEMBERS, MANAGERS, MEMBERSHIP INTERESTS, OR ASSETS.

(a) A company agreement[2] may establish or provide for the establishment of one or more designated series of members, managers, membership interests, or assets that:

(1) has separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations; or

(2) has a separate business purpose or investment objective.[3]

(b) A series established in accordance with Subsection (a) may carry on any business, purpose, or activity, whether or not for profit[4], that is not prohibited by Section 2.003.

1. The provisions concerning series LLCs are contained within Subchapter M of Title 3 and Chapter 101 of TBOC concerning LLCs. Accordingly, this is the first (of many) indicators that series are not themselves separate legal entities (as we would generally consider an LLC, partnership, or corporation); rather, they are more akin to a division of a corporation, notwithstanding their ability to own assets and sue and be sued, enter into contracts and grant

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16 Id., 13.

17 Treas. Reg. §§301.7701-1, 2 and 3.

18 Private telephone conference with Delaware Secretary of State staff July 23, 2010.

19 Private telephone conference by my faithful secretary, Babs Clay, with Texas Secretary of State staff July 19, 2010.

20 Id.
liens and security interests in their own name. Because of their "division" construct, they are clearly different from limited liability partnerships (LLPs), which are defined in Subchapter J of Chapter 152 of TBOC governing general partnerships, and limited liability limited partnerships (LLPs), addressed in Subchapter H of Chapter 153 of TBOC governing limited partnerships. Although separate constructs included within the broader general partnership and limited partnership provisions, the LLP and LLP elections do not change the "whole" nature of the affected general partnership or limited partnership as is the case with the use of series within an LLC. This division versus entity construct forms the basis for many of the questions that provide hesitation for the use of series LLCs other than in tightly controlled circumstances where management and ownership are relatively uniform. In some ways, the division versus entity ambiguity is similar to the aggregate versus entity questions that have historically plagued the interpretation and development of partnership business and tax law.

Several intriguing issues arise as a result of this division concept including the identification of a series under state law. An LLC's name, and state record, is found in the certificate of formation for an LLC. Because there is no separate state filing required to form a series, there is no state record of the entity once the series is formed. So, where is the source for the name of the series that is entitled to conduct its own business, hold title to assets, etc.? Nothing addresses this issue in Subchapter M of the LLC Act. Texas Secretary of State Form 313 (Application for Registration of a Foreign Series Limited Liability Company) provides direction on this issue in its commentary on the purpose and use of the Form when it notes that a foreign LLC with a series doing business in Texas must file an assumed name certificate in compliance with Chapter 71 of the Business and Commerce Code (BCC). Unfortunately, Form 313 states this as a requirement for a "series limited liability company that is treated as a single legal entity under the laws of its jurisdiction of organization." Delaware, as with Texas, does not refer to a series LLC as an entity. Thus, if any single series of a Delaware LLC does business in Texas, the Delaware LLC, rather than the series, must register in Texas. On the other hand, Illinois, Iowa and Tennessee do have separate entity recognition concepts for series in their statutes. Thus, it appears that an Illinois, Iowa or Tennessee series of an LLC could register as a foreign LLC in Texas rather than the LLC which authorized and created the series.

The foreign registration requirements for a series LLC seem to point Texas series LLCs to the assumed name provisions of Chapter 71 of the BCC and a requirement that a Texas series LLC file an assumed name for itself. BCC §71.002(2)(H) provides that an "assumed name" means, "for a limited liability company, a name other than the name stated in its certificate of formation or a comparable document." Thus, it appears that a Texas series LLC, using a name other than the name of the LLC, must file an assumed name certificate. Further, BCC §71.103 states that the assumed name certificate must be filed with the Secretary of State and with the county clerk where the LLC's registered office is located. Note that regardless of the term of the LLC or series provided in the certificate of formation or company agreement, the assumed name filing is effective only for a maximum of ten (10) years. Failure to file an assumed name certificate does not "impair the validity of any contract or act" by the series, but it does prevent the series or LLC from suing or defending itself in judicial proceedings and may result in penalties and court costs being awarded to a plaintiff for fees incurred in locating and serving process on the series or LLC. These provisions concerning foreign registration of series LLCs and the assumed name provisions of Chapter 71 of the BCC further point to the status of a series LLC in Texas as something other than a legal entity in the traditional sense.

2. The company agreement establishes series of members, managers, membership interests, or assets. Several items are worth noting here. First, "a company agreement" is referenced—not company agreements (plural) or series agreements. All of the language in Subchapter M of the LLC Act references a singular company agreement rather than any idea of multiple agreements addressing different series. Thus, notwithstanding the ability of the company agreement to establish multiple series, the company agreement remains a singular document. This is important because Section 101.502(b)(2) of the LLC Act provides that an LLC must furnish to any member of the LLC, upon request, a complete copy of the company agreement including any amendments. By definition, this means that if there is only one company agreement and many series with different members, each of those members is entitled to see the entire company agreement, including all the terms, conditions, rights, etc., applicable to all members of all series. This poses a severe confidentiality issue if there

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21 See TBOC §101.605.
22 See, Illinois 805 ILCS 18/37-40(b); Iowa, Iowa Code Ann §489.1201.3; Tennessee, Tenn. Code Ann §48-249-309(d), (e), (f) and (g).
23 BCC §71.151.
24 BCC §71.201
is any intent that the terms for one series should not be available for comparison by members of another series. Likewise, Section 101.502(b)(3) of the LLC Act requires the company to furnish tax returns of the company to each member. Thus, not only are the business terms of each series available to all members of every series of an LLC, but the tax returns and associated financial information for every series are available to all members of every series. This means that if a series is treated as a single filing entity for federal or other state income tax purposes, those tax returns will be available for inspection by members of the LLC and other series who may not be members of that federal or state filing series. Again, this poses significant obstacles to any intent that the business terms and financial results of one series be kept confidential from members of the LLC or another series. Aside from basic notions that the business of "Investment Series A" should be only the business of Investments Series A members rather than completely different members of "Investment Series B," any notion of keeping different fee structures or rights among the different series confidential is lost because non-series members will have rights to that information as a result of the record requirements of Section 101.502 of the LLC Act. While many, if not most, provisions of the LLC Act may be changed by the company agreement under the Act's freedom of contract principles, the record and disclosure provisions of Section 101.502 of the LLC Act are mandatory and may not be changed by the company agreement.

The second issue raised is that although Section 101.601(a) addresses series of members, managers, membership interests, or assets, the clear emphasis of Subchapter M of the LLC Act is on series of assets and the ability to separate those assets from the claims of creditors of the LLC and other series. Thus, the typical thinking about series LLCs tends toward segregating assets or businesses into different series where there are different members and managers owning, operating and benefitting from the financial results of those segregated assets versus other assets in different series. It is the idea of segregated assets and operations in series, rather than the idea of different classes of members referenced in Section 101.104 of the LLC Act, that is the key point of interest and utility with series LLCs.

3. Series may be established within an LLC for separate business purposes or investment objectives. In theory, an LLC might operate an investment advisory series, a farming series, an apartment series, a construction series, a manufacturing series, a retail series, etc. Accordingly, through an assortment of series, an LLC could function as a widely diversified business conglomerate containing diversified ownership and equity investors for diverse interests. For a variety of reasons, including the record disclosure provisions of Section 101.502 of the LLC Act discussed above, it appears that such an approach is not likely until there is further development of series LLC laws.

4. The idea that a single LLC could have separate series engaged in separate for-profit and not-for-profit activities also raises questions. Generally, not-for-profit entities have very different membership and management structures than for-profit entities. Further, in the federal income tax arena, the qualification procedures for a not-for-profit entity wishing to obtain tax exemption are not required of a for-profit entity, and operating and return filing requirements also are significantly different. Without clear guidance from the IRS that a series would be treated as a separate entity for return filing purposes, it is difficult to conceive how such an arrangement would operate. However, in the context of a small closely-held business, one might imagine a business owner operating a successful merchandising business in one series, while owning a lake house in a different series and a boat in another different series. Even an airplane, used for business and non-business purposes, might be owned in another separate series without the need of forming a different entity for each activity, while limiting liability for the business, lake house, boat and airplane to the assets of each respective series.

Sec.101.602. ENFORCEABILITY OF OBLIGATIONS AND EXPENSES OF SERIES AGAINST ASSETS.[1]

(a) Notwithstanding any other provision of this chapter or any other law, but subject to Subsection (b) and any other provision of this subchapter:

(1) 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 that series only, and shall not be enforceable against the assets of the limited liability company generally or any other series;[2] and

(2) 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 shall be enforceable against the assets of a particular series.[3]

(b) Subsection (a) applies only if:

1. After the introductory concept of series provided in Section 101.601 of the LLC Act, Section 101.602 begins the focus of the rest of Subchapter M on the notion of a series as a separate business or grouping of assets with separate owners and management and liability protection.

2. Section 101.602(a)(1) of the LLC Act states that the liabilities, etc., of a series are enforceable only against assets of that series and not against the assets of the LLC or any other series. Several interesting issues arise from this statement. First, this implicates the entity/division issue and implies that the assets of series are not assets of the LLC. This differentiates a series from an unincorporated division of a corporation or even a separately incorporated subsidiary of a corporation. Obviously, the assets of an unincorporated division of a corporation are assets of the corporation. Similarly, although the assets of an incorporated subsidiary are not direct assets of a corporate parent, the equity in that subsidiary is reflected as an investment asset of the parent. Here, however, the liability limitation language clearly states that liabilities of a series may be satisfied only out of that series’ assets thereby excluding those assets from the assets of the LLC or other series for liability satisfaction purposes. Conversely, the equity of a corporate subsidiary represents an asset out of which the parent’s liabilities may be satisfied.

Second, given the premise of separate assets, what do we do with an unpaid employment tax liability of an insolvent series? In the context of a disregarded entity (DRE) the IRS has stated that the owner of the DRE is responsible for the unpaid employment taxes of the DRE.25 But if the series is not owned by the LLC as its sole member and thus a DRE, will the LLC be liable for federal taxes assessed at the entity level? One would think in a DRE context, the federal rule would easily trump the state notion of separate assets and liabilities, but if the LLC has no assets and operates merely through a group of different series, some of which are DREs with others not, the issue becomes more complex.

Third, what about the Texas franchise, or margin, tax? Subchapter M of the LLC Act clearly does not give entity status to a series, thus the question arises as to whether a series is subject to margin tax. What is the situation with a series owned only by individuals – the same as a general partnership – yet the series offers the benefit of limited liability to its members, which is the hallmark for subjecting an entity (not a series) to liability for margin tax? Assuming that a series’ operations are subject to the margin tax, who files the margin tax return and who is liable for that tax if the assets of the series are insufficient to pay the tax? If the default answer is that the LLC files the margin tax return for all of its series, how is that done in the face of different rules for not-for-profit and for-profit entities and series that may have such different ownership that they would be separate reporting, rather than combined reporting, entities?

While none of the questions concerning margin tax have been formally answered by the Texas Comptroller in published guidance, private conversations with staff attorneys have yielded some answers as to the Comptroller's current thinking. Consistent with the Secretary of State requirement that the LLC, rather than the series, register for foreign qualification on Secretary of State Form 313, the Comptroller believes that the LLC, rather than any series, will be the entity required to file a margin tax return. Thus, even though an LLC may have series with ownerships that could not otherwise use combined reporting, they will have to do so with the LLC being the entity required to file a return. This approach also raises obvious issues in the context of series with different business activities (e.g., manufacturing, versus rental real estate, etc.). If the LLC is, in fact, responsible for filing and paying the margin tax for all of its series, this means that the company agreement

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will need to address this issue and provide appropriate arrangements for allocating the margin tax expense to each series and assuring repayment of the tax from the assets of each series. If there are different types of business operations among the series of the LLC, this may limit the ability of each series to use the most advantageous formula for calculating its margin tax and may even cause a series that would otherwise have no margin tax liability, due to insufficient revenues or a passive activity exemption, to incur margin tax because of combined reporting. Thus, the inequities inevitably caused by combination reporting will require discussion of this issue and negotiation of those tax inequities in the additions to the company agreement addressing each series. Further, the Comptroller's staff has suggested that for nexus purposes, nexus for any series will constitute nexus for the LLC (and all other series of the LLC). This approach will affect apportionment issues. Note that the Texas approach is the opposite of that in California which treats each series as a separate entity for California income tax purposes.\(^\text{26}\)

3. This provision is the flip side of Section 101.602(a)(1), providing that the liabilities of the LLC and other series may not be enforced against another series. In the context of the margin tax discussion immediately above, one might wonder how the Comptroller will collect franchise taxes from an LLC that has no assets itself but rather a number of series with assets. The answer may lie in the ability of the Comptroller to cancel the registration of the LLC for non-payment of taxes, and the termination of an LLC causes the termination of each series, although not vice-versa.\(^\text{27}\)

4. The liability limitation provision for the assets of a series only applies if the records of the series account for the assets separately from assets of the LLC or other series. This requirement, and some of the issues it presents, are addressed in greater detail below in the comments to Section 101.603 of the LLC Act.

5. It is important to remember that the company agreement must affirmatively include a statement regarding liability limitation for the assets of the series in order for that protection to issue. Further, since liability limitation applies on a series by series basis, it appears that the company agreement should provide the required language in the documentation used to authorize and establish each separate series for which liability limitation is desired.

6. The notice of liability limitation in the certificate of formation provides the third requirement for obtaining series asset protection from non-series liabilities. Accordingly, if one anticipates ever wanting liability limitation for a series, it is not enough only to reference that an LLC may have series in the certificate of formation; rather, one must also specifically add language in the certificate of formation to the effect that the assets of series enjoy the benefits of protection from liabilities that are those of the LLC or other series.

**Sec. 101.603. ASSETS OF SERIES.**

\(a\) Assets associated with a series may be held directly or indirectly, including being held in the name of the series, in the name of the limited liability company, through a nominee, or otherwise.\(^\text{[1]}\)

\(b\) If the records of a series are maintained in a manner so that the assets of the series can be reasonably identified by specific listing, category, type, quantity, or computational or allocational formula or procedure, including a percentage or share of any assets, or by any other method in which the identity of the assets can be objectively determined, the records are considered to satisfy the requirements of Section 101.602(b)(1).\(^\text{[2]}\)

1. While this provision offers a great deal of flexibility in how ownership, or title, of assets may be held for a series, one has to question whether holding title to a series asset in the name of the LLC, rather than the series, might not create problems under the following provision of Section 101.603(b) concerning the adequacy of records for confirming an asset as that of the intended series rather than the LLC or another series. Without a compelling reason for holding title to a series asset in the name of the LLC, rather than the series, it would seem that best practices would suggest titling the assets of a series in the name of the series in order to minimize tracing and other mechanisms to avoid disputes and questions about proper ownership.

2. The statement in Section 101.603(b) concerning record keeping for series seems at first blush to be

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\(^{26}\) See California Franchise Tax Board Publication 3556, p.4. For an analysis of California's position on this issue, see Jacob Stein, "Tilting at Windmills: Examining FTB's Treatment of Series LLCs," 10 Business Entities May/June 2008 (Warren, Gorham & Lamont), 16.

rather straightforward, but a plethora of issues quickly arises upon further consideration. The key phrase is "in which the identity of the assets can be objectively determined." The first question is "objectively determined" by who? Creditors making claims? Or the series and its owners? Obviously, the objectivity of these two adversely positioned groups will come from different perspectives. Further, as a matter of operational familiarity, what may seem obvious to the series members and managers may not seem so obvious to creditors poring through records produced in discovery. Also, over time, records tend to deteriorate in their completeness so that it may become more difficult for the series to prove the identity and ownership of particular assets of the series.

Consider the alternatives available just in defining records. A general ledger rarely identifies specific assets except in the case of large assets. Subledgers may provide further detail but fungibility of inventory items, office equipment, etc., is always a problem in businesses depending on the detail and sophistication of the accounting systems used. Aside from accounting records there are title documents for land and automobiles and certain other tangibles, but if these are recorded in the name of the LLC, rather than the series for whatever reason, then there will need to be clear accounting records reflecting the identity of those assets as belonging to the series rather than the LLC in which title is maintained. Of course, there are other business records for expenditures: checks, credit card receipts, purchase invoices, accounts payable invoices, sales receipts for receivables, etc. Without accurate identification procedures, conflicts or sheer lack of connection between payment records and purchase records can quickly lead to questions as to the identity of assets as belonging to a series and being protected from the claims of creditors other than the series claiming liability protection.

Separate from the issue of trying to track and coordinate purchase records and accounting records is the issue of commingling. Many companies have multiple subsidiaries or affiliates for which they maintain a master checking account in order to minimize the expense and paperwork of multiple checking accounts while maximizing cash balances for credit facilities or interest accruals. While master cash accounts may have excellent records, most secured lenders for special purpose entity (SPE) financings insist on separate cash accounts or lockbox arrangements in order to assure segregation and identification of cash collateral proceeds. One can expect that creditors making claims against one series are going to challenge master cash account arrangements where another series claims that funds in the cash account are exempt from the creditor's claims.

Similar issues arise in situations where a single company may act as the employer for employees who perform work for a variety of affiliated companies. In the series LLC context, one would imagine that it would not go well for an LLC employer who claimed that it could not pay wages because all of the assets were held by the series rather than the LLC. Likewise, where multiple series and businesses are housed in one building or office location, identification of assets or clear allocations of resources and obligations for asset use will have to be maintained in order to keep intact the liability shields for the various series. And even assuming that outstanding accounting and record keeping systems are in place with an LLC having multiple series, accounting errors will be made thereby necessitating clear records of corrections that may move an asset from one series to another in the accounting records.

Perhaps none of the above concerns are any different than the concerns that would arise in a holding company structure of separate single member LLCs or affiliated LLCs. However, the premise of liability protection for series is conditioned upon reasonable identification of assets that can be objectively determined. Without satisfying that condition, the series liability shield is a house of cards that collapses, and case law has not yet developed to predict how the rules will be interpreted.

Sec. 101.604. NOTICE OF LIMITATION ON LIABILITIES OF SERIES. Notice of the limitation on liabilities of a series required by Section 101.602 that is contained in a certificate of formation filed with the secretary of state satisfies the requirements of Section 101.602(b)(3), regardless of whether:

(1) the limited liability company has established any series under this subchapter when the notice is contained in the certificate of formation; and

(2) the notice makes a reference to a specific series of the limited liability company.

1. While the notice of liability limitation in the certificate of formation affords the general liability limitations for a series, it is important to remember the assumed name filing requirement for a series previously addressed in comment 1 under Section 101.601 of the LLC Act of this outline. Because a series has no other public record of existence upon creation, the assumed name filing may
represent a particularly important factor in providing notice to creditors of the series existence.

Sec. 101.605. GENERAL POWERS OF SERIES. A series established under this subchapter has the power and capacity, in the series' own name, to:

(1) sue and be sued;[1]
(2) contract;[2]
(3) hold title to assets of the series, including real property, personal property, and intangible property;[3] and
(4) grant liens and security interests in assets of the series.[4]

1. The flush language of the statute provides that a series can sue and be sued in its own name. In the only reported case involving a series LLC, GxG Management LLC v. Young Brothers & Co., Inc., 2007 WL 1702872 (D.Me. 2007), an LLC attempted to pursue litigation on behalf of a series to which it had transferred an asset which was the subject of the litigation. While the circumstances are different than where a series had attempted to be directly involved in the litigation without the LLC, the case and ruling are interesting because it is clear that the issue of whether a series is an entity separate from the LLC, and the LLC's ability to pursue litigation on behalf of the series, created confusion and complexities for both the litigants and the court.\(^4\) Notwithstanding the flush language of the LLC Act on this point, it is not difficult to imagine that standing and jurisdictional issues will be multiplied for a series that clearly has no legal existence as a separate entity other than an assumed name filing and a corporate existence only through a company agreement of the LLC that purports to govern the rights of the series and its members. Given the series' lack of entity status, it may make sense to include the LLC as a 0% member of each of its series thereby always providing the LLC with an identifiable interest in the series. This also may prove useful if all other members of the series retire.

2. While a series may contract in its own name, one must consider the correlation between contracting and asset identification discussed above regarding Section 101.603 of the LLC Act.\(^30\) Since all series of an LLC will be affiliated with the LLC for their legal existence, one would hope that all purchase invoices and major contracts, in addition to checks for payments, would bear the name of the series than the LLC. In closely held affiliated businesses, however, attention to those details is often not the case, and that lack of attention to detail in executing contracts may result in later problems if the identity of specific assets is called into question.

3. While a series may hold title to assets in its own name, the division/entity issue continues to create problems for series because of their necessary dependence on the LLC for existence. Real estate transactions rarely take place without a title insurance policy being involved, and it appears that some title insurance companies are not willing to write title insurance policies in the name of a series.\(^31\) Similarly one can expect difficulties with lenders who are asked to make loans to a series.\(^32\) Lenders invariably want a certificate of good standing (or tax clearance) from the Comptroller and a certificate of fact (existence) from the Secretary of State for a borrower that is an entity. In the case of a series in Texas, the only certificate of good standing that can be issued by the Comptroller or certificate of fact (existence) issued by the Secretary of State is for the LLC – not the series, because a series exists nowhere in the records of the Comptroller and only in the assumed name records of the Secretary of State.\(^33\) The procedures for issuance of a certificate of termination by the Secretary of State are expressly omitted by Section 101.617 of the LLC Act concerning the procedures for winding up and termination of a series. Thus, other than in the context of a judicial

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29 Section 101.102(c) of the LLC Act states that a person may be a member of an LLC without having a membership interest, thereby reflecting the concept of a 0% member.

30 See comment 2 thereunder.

31 See, William L. Horton, Jr., "Series LLCs – Current Questions, Future Promise," 36 Real Estate Taxation (2008), 4, 13; also, John C. Murray, "A Real Estate Practitioner's Guide to Delaware Series LLCs (With Form)," (2007), at http://title.firstam.com/assets/title/uploads/asset-upload-file631-1--63.pdf, (John Murray is with First American Title Insurance in Chicago.) On the other hand, a private conversation with the local office of one of Texas' largest title insurance companies found that the title company was quite willing to work with counsel and the series to provide title insurance in the name of the series with appropriate documentation of the series existence.

32 Id. Horton.

33 Delaware has tracked LLC filings with series authorization since July 19, 2005 and can issue good standing certificates which recognize the LLC as a series LLC, but the good standing certificate does not provide status on any particular series since there is no state filing for the series. (Telephone conversation with Delaware Secretary of State staff July 23, 2010.).
termination of a series, there are no public records with the Secretary of State for the existence or termination of a series (other than the assumed name filing which can be terminated). Accordingly, typical lending practices will likely make it difficult for the lender to become comfortable with the legal existence of a series borrower. Presumably, a lender might obtain comfort by requiring the LLC to join in the loan, but that process cuts against the idea of the liability limitations integral to creation of the series in the first place.

4. If one can get past the problems of title insurance and loans for series, hurdles still remain with the idea that a series can grant liens and security interests in assets of the series. Again, because a series is not an entity, per se, but derives its existence only from the LLC, questions arise not only in the law of secured transactions but also in practice as to how a security interest can be created and perfected with respect to something that exists only by reference to the company agreement of an LLC - and maybe an assumed name filing. For a much better description of the security interest issues than this author can provide, or space allows, see, Norman N. Powell, "Delaware Alternative Entities: The Benefits and Burdens of Contractual Flexibility," 23 Probate & Property (Jan., Feb. 2009) 11, 14-15.

Sec. 101.606. LIABILITY OF MEMBER OR MANAGER FOR OBLIGATIONS; DUTIES.

(a) Except as and to the extent the company agreement specifically provides otherwise, a member or manager associated with a series or a member or manager of the company is not liable for a debt, obligation, or liability of a series, including a debt, obligation, or liability under a judgment, decree, or court order.[1]

(b) The company agreement may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person associated with a series has to:

- the series or the company;
- a member or manager associated with the series; or
- a member or manager of the company.[2]

1. This provision of the LLC Act clearly states that members and managers of a series do not have personal liability for the debts and obligations of a series. The Delaware series LLC provisions do not expressly provide for this liability shield for members of a series although it is assumed to be the case. This may be a significant interpretive advantage of the LLC Act concerning series versus that of the Delaware statute.

2. This provision tracks Section 101.401 of the LLC Act which provides that the company agreement may limit fiduciary duties of members and managers to each other and the company. Again, the Delaware series LLC provisions do not expressly reference the ability to limit fiduciary duties among members and managers of a series.

Sec. 101.607. CLASS OR GROUP OF MEMBERS OR MANAGERS.

(a) The company agreement may:[1]

- establish classes or groups of one or more members or managers associated with a series each of which has certain express relative rights, powers, and duties, including voting rights; and

- provide for the manner of establishing additional classes or groups of one or more members or managers associated with the series each of which has certain express rights, powers, and duties, including providing for voting rights and rights, powers, and duties senior to existing classes and groups of members or managers associated with the series.

(b) The company agreement may provide for the taking of an action, including the amendment of the company agreement,[3] without the vote or approval of any member or manager or class or group of members or managers,[4] to create under the provisions of the company agreement a class or group of the series of membership interests that was not previously outstanding.

(c) The company agreement may provide that:
(1) all or certain identified members or managers or a specified class or group of the members or managers associated with a series have the right to vote on any matter separately or with all or any class or group of the members or managers associated with the series;\[5\]

(2) any member or class or group of members associated with a series has no voting rights;\[6\] and

(3) voting by members or managers associated with a series is on a per capita, number, financial interest, class, group, or any other basis.\[7\]

1. This language applicable to series tracks the language of Section 101.104(a) of the LLC Act applicable to LLCs generally.

2. This sentence tracks the language of the second sentence of Section 18-215(e) of the Delaware LLC Act.

3. Note that this provision authorizes amendment of the company agreement to create an additional series without the vote of any member or manager of the LLC (or series). Section 101.053 of the LLC Act states that the company agreement may not be amended without the consent of each member, although the company agreement may provide for different amendment procedures since Section 101.053 of the LLC Act is not referenced in Section 101.054 of the LLC Act as one of the provisions which may not be waived or modified by the company agreement.\[34\]

4. The language states that the company agreement can be amended without the vote or approval of "any member or manager or class or group of members or managers" to create a series. One wonders exactly who it is that makes such a decision if it is not the members or managers. Presumably, authorization of series in the certificate of formation allows series to be formed in due course according to whatever provisions the company agreement may provide.

5. This provision tracks the first sentence of Section 18-215(f) of the Delaware LLC Act.

6. This provision tracks the last sentence of Section 18-215(e) of the Delaware LLC Act.

7. This provision tracks the last sentence of Section 18-215(f) of the Delaware LLC Act.

Sec. 101.608. GOVERNING AUTHORITY.

(a) Notwithstanding any conflicting provision of the certificate of formation of a limited liability company, the governing authority of a series consists of the managers or members associated with the series as provided in the company agreement.\[1\]

(b) If the company agreement does not provide for the governing authority of the series, the governing authority of the series consists of:

(1) the managers associated with the series, if the company's certificate of formation states that the company will have one or more managers; or

(2) the members associated with the series, if the company's certificate of formation states that the company will not have managers.\[2\]

1. Section 3.010(1) of the LLC Act requires the certificate of formation of an LLC to state whether the LLC will or will not have managers. This provision relating to series provides that regardless of what the certificate of formation states about managers, the company agreement can provide whether a series will or will not have managers. Thus, even if the certificate of formation for the LLC states that it will not have managers, the company agreement can provide for a series to have managers for that series. This is another subtle reminder that series are but a subset or division of the LLC rather than a separate legal entity notwithstanding their liability shield and separate series members, etc.

2. This Section 101.608(b) of the LLC Act provides the default governance mechanism if the company agreement does not state whether a series will be

\[34\] Earlier versions of the Texas Business Corporation Code governing LLCs had many provisions starting with "Except as provided in (the company agreement)...." The LLC Act has eliminated the prefatory language meaning that all provisions of the LLC Act may be modified by the company agreement except for those listed in Section 101.054.
managed by its members or managers. If the company agreement is silent as to management of the series, then the series will be managed either by managers or members as provided for by the LLC in its certificate of formation.

Sec. 101.609. APPLICABILITY OF OTHER PROVISIONS OF CHAPTER; SYNONYMOUS TERMS.[1]

(a) To the extent not inconsistent with this subchapter, this chapter applies to a series and its associated members and managers.

(b) For purposes of the application of any other provision of this chapter to a provision of this subchapter, and as the context requires:

1. This section generally incorporates the balance of the LLC Act into Subchapter M as it applies to series. The magic phrase in subsection (a) is "To the extent not inconsistent with this subchapter," and similarly in subsection (b), "as the context requires." These are not model phrases for providing clarity.

Sec. 101.610. EFFECT OF CERTAIN EVENT ON MANAGER OR MEMBER. [1]

(a) An event that under this chapter or the company agreement causes a manager to cease to be a manager with respect to a series does not, in and of itself, cause the manager to cease to be a manager of the limited liability company or with respect to any other series of the company.

(b) An event that under this chapter or the company agreement causes a member to cease to be associated with a series does not, in and of itself, cause the member to cease to be associated with any other series or terminate the continued membership of a member in the limited liability company or require the winding up of the series, regardless of whether the member was the last remaining member associated with the series.[2]

1. This section essentially provides that an event causing a manager or member to lose status with one series is not a "cross-collateralized" event with respect to that person's status with the LLC or another series, if any. It supports the model of contractual flexibility, but it also means that if one wants a person who is manager of the LLC and several series to lose that status upon, say conviction of a felony, that requirement must be separately stated in the company agreement with respect to the LLC and each series. One can imagine circumstances where a monetary default by a member in series A should not be a default for the same person who is also a member of series B. However, one would suppose that a manager of series A who steals funds from series A might also lose manager status in series B even if the manager did not steal funds from series B. This section is a reminder of the separate status of each series and the need when drafting for series to be conscious not only of provisions pertaining to the series at hand but also the potential effect (or non-effect) that events in one series may have on another series. In short, where multiple series are involved, the complexity of the drafter's job is similarly multiplied.

2. The disassociation of the last remaining member of a series does not require the winding up of a series. Section 11.056 of the LLC Act requires the winding up of an LLC upon termination of the membership of the last remaining member. Similarly, Section 101.101 of the LLC Act requires an LLC to have at least one member. If a series has no members and its assets are separate from those of the LLC and other series, to whom do its assets belong – and to whom are its assets distributed when it is wound up?35

Sec. 101.611. MEMBER STATUS WITH RESPECT TO DISTRIBUTION.

(a) Subject to Sections 101.613, 101.617, 101.618, 101.619, and 101.620, when a member associated with a series established under this subchapter is entitled to receive a distribution with respect to the series, the member, with respect to the distribution, has the same status as a creditor of the

35 See comment 2 below under Section 101.611.
series and is entitled to any remedy available to a creditor of the series.[1]  
(b) Section 101.207 does not apply to a distribution with respect to the series.[2]

1. This provision functions much the same as Section 101.207 of the LLC Act does with respect to an LLC and its members by providing creditor status to a member who is entitled to a distribution which has not been made or received.

2. Interestingly, Section 101.207 of the LLC Act has a reference to Section 11.053 of the TBOC which, in subparagraph (c) thereof, states that once an entity has discharged all of its obligations, it shall distribute any remaining property to its owners. If Section 11.053 of the TBOC is not applicable to a series, this again raises the question of what happens to the assets of a series with no members when it is wound up. The inapplicability of Section 101.027 of the LLC Act to distributions with respect to series also may be included as a reminder that a series member who is due a distribution from a series may have creditor status as to the series but not as to the LLC (notwithstanding Section 101.613(a) of the LLC Act which provides that the LLC, not the series, makes distributions with respect to a series).[3]

Sec. 101.612. RECORD DATE FOR ALLOCATIONS AND DISTRIBUTIONS. A company agreement may establish or provide for the establishment of a record date for allocations and distributions with respect to a series.[1]

1. This section mirrors for series Section 101.208 of the LLC Act as to distributions for LLCs.

Sec. 101.613. DISTRIBUTIONS.

(a) A limited liability company may make a distribution with respect to a series.[1]

(b) A limited liability company may not make a distribution with respect to a series to a member if, immediately after making the distribution, the total amount of the liabilities of the series, other than liabilities described by Subsection (c), exceeds the fair value of the assets associated with the series.[2]

(c) For purposes of Subsection (b), the liabilities of a series do not include:

(1) a liability related to the member's membership interest; or

(2) except as provided by Subsection (e), a liability of the series for which the recourse of creditors is limited to specified property of the series.[3]

(d) For purposes of Subsection (b), the assets associated with a series include the fair value of property of the series subject to a liability for which recourse of creditors is limited to specified property of the series only if the fair value of that property exceeds the liability.[4]

(e) A member who receives a distribution from a series in violation of this section is not required to return the distribution to the series unless the member had knowledge of the violation.[5]

(f) This section may not be construed to affect the obligation of a member to return a distribution to the series under the company agreement or other state or federal law.[6]

(g) Section 101.206 does not apply to a distribution with respect to a series.[7]

(h) For purposes of this section, "distribution" does not include an amount constituting reasonable compensation for present or past services or a reasonable payment made in the ordinary course of business under a bona fide retirement plan or other benefits program.[8]

1. This short and seemingly innocuous sentence raises some interesting questions because it states that an LLC -- not a series -- may make a distribution with respect to a series. This again appears to emphasize that a series is not an entity but a "division" of its forming LLC, notwithstanding the ability of the series to own title to assets in its own name, etc. However, given the ability of a series to contract in its own name, incur liabilities and operate businesses, it seems odd that only the LLC can make distributions "with respect
to the series," rather than the series being able to make distributions to its own series members who may not otherwise be members of the LLC. Further, as noted below with respect to Section 101.613(g) of the LLC Act, the assets of the series are not included in the assets of the LLC with respect to Section 101.206 concerning the prohibition on an LLC's distributions in excess of the fair value of its assets. Possibly, the answer relates to the idea that under Section 101.610(b) a series may exist without members, but this again raises the question raised in the comments to that provision of who is entitled to distributions if the series has no members.

2. This provision tracks Section 101.206(a) of the LLC Act concerning distributions by LLCs. Note that, in keeping with the concept of a series having assets segregated from the LLC, the fair value concept is based only on the series' assets and not the assets of the LLC or any other series. Accordingly, it appears entirely possible that an LLC with several series, viewed as a whole, could be seriously insolvent, but a single solvent series could continue to make distributions to its members (even if those members were also members of the LLC or another insolvent series) without any restriction or violation of the prohibitions under Section 101.206 of the LLC Act.

3. This provision tracks Section 101.206(b) of the LLC Act.

4. This provision tracks Section 101.206(c) of the LLC Act.

5. This provision tracks Section 101.206(d) of the LLC Act.

6. This provision tracks Section 101.206(e) of the LLC Act.

7. The effect of this provision is to exclude all of the provisions of Section 101.206 of the LLC Act from application to series, as all the distribution provisions applicable to series are intended to be covered by Section 101.613.

8. This provision tracks Section 101.206(f) of the LLC Act.

Sec. 101.614. AUTHORITY TO WIND UP AND TERMINATE SERIES. Except to the extent otherwise provided in the company agreement and subject to Sections 101.617, 101.618, 101.619, and 101.620, a series and its business and affairs may be wound up and terminated without causing the winding up of the limited liability company.[1]

1. That the winding up and termination of a series does not cause the winding up of the LLC is further evidence of the subordinate character of a series with respect to the LLC to which it is attached. It is in some ways analogous to the historical rules that the withdrawal of a partner caused the dissolution of a general partnership although the withdrawal of a limited partner did not cause the dissolution of a limited partnership.

Sec. 101.615. TERMINATION OF SERIES.[1]

(a) Except as otherwise provided by Sections 101.617, 101.618, 101.619, and 101.620, the series terminates on the completion of the winding up of the business and affairs of the series in accordance with Sections 101.617, 101.618, 101.619, and 101.620.

(b) The limited liability company shall provide notice of the termination of a series in the manner provided in the company agreement for notice of termination, if any.

(c) The termination of the series does not affect the limitation on liabilities of the series provided by Section 101.602.

1. This provision provides the introduction to the winding up and termination procedures for a series that are provided in greater detail in Sections 101.616 – 101.620 of the LLC Act for a non-judicial termination. Subparagraph (c) reasserts the liability shield of the LLC and other series as to the liabilities of a particular series reminding that any excess liabilities of a series beyond its assets do not become liabilities of the LLC or its other series.

Sec. 101.616. EVENT REQUIRING WINDING UP. Subject to Sections 101.617, 101.618, 101.619, and 101.620, the business and affairs of a series are required to be wound up:

(1) if the winding up of the limited liability company is required under Section 101.552(a) or Chapter 11; or[1]

(2) on the earlier of:
(A) the time specified for winding up the series in the company agreement;

(B) the occurrence of an event specified with respect to the series in the company agreement;

(C) the occurrence of a majority vote of all of the members associated with the series approving the winding up of the series or, if there is more than one class or group of members associated with the series, a majority vote of the members of each class or group of members associated with the series approving the winding up of the series;

(D) if the series has no members, the occurrence of a majority vote of all of the managers associated with the series approving the winding up of the series or, if there is more than one class or group of managers associated with the series, a majority vote of the managers of each class or group of managers associated with the series approving the winding up of the series;

(E) a determination by a court in accordance with Section 101.621.

1. This is the key provision of Section 101.616 of the LLC Act. It states that an event which causes the winding up of the LLC will also cause the winding up of all the series of the LLC. The remaining provisions of subparagraph (2) address events which cause the winding up of a series independent from the series having to be wound up because of a winding up of the LLC. This is one of the key factors indicating that, for state law purposes, a series does not have separate legal existence as an entity in the traditional sense, but exists only in a subordinate and dependent role with respect to the LLC.

Sec. 101.617. PROCEDURES FOR WINDING UP AND TERMINATION OF SERIES.

(a) The following provisions apply to a series and the associated members and managers of the series:

(1) Subchapters A, G, H, and I, Chapter 11; and

(2) Subchapter B, Chapter 11, other than Sections 11.051, 11.056, 11.057, 11.058, and 11.059.

(b) For purposes of the application of Chapter 11 to a series and as the context requires:

(1) a reference to "domestic entity," "filing entity," or "entity" means the "series";

(2) a reference to an "owner" means a "member associated with the series";

(3) a reference to the "governing authority" or a "governing person" means the "governing authority associated with the series" or a "governing person associated with the series";

and

(4) a reference to "business," "property," "obligations," or "liabilities" means the "business associated with the series," "property associated with the series," "obligations associated with the series," or "liabilities associated with the series."

(c) After the occurrence of an event requiring winding up of a series under Section 101.616, unless a revocation as provided by Section 101.618 or a cancellation as provided by Section 101.619 occurs, the winding up of the series must be carried out by:

(1) the governing authority of the series or one or more persons, including a governing person, designated by:

(A) the governing authority of the series;

(B) the members associated with the series; or

(C) the company agreement; or
(2) a person appointed by the court to carry out the winding up of the series under Section 11.054, 11.405, 11.409, or 11.410.[3]

(d) An action taken in accordance with this section does not affect the limitation on liability of members and managers provided by Section 101.606.[4]

1. The referenced provisions of Chapter 11 of the TBOC applicable to the procedures for winding up a series include Subchapter A (Definitions), Subchapter G (Judicial Winding Up and Termination), Subchapter H (Claims Resolution on Termination), and Subchapter I (Receivership).

2. Subchapter B of Chapter 11 of the TBOC provides for the winding up and termination of a domestic entity. The events excluded from application to the winding up of a series are Section 11.051 concerning events requiring winding up, because those are addressed for series in Section 101.610 of the LLC Act; Section 11.056 concerning supplemental provisions for the winding up of an LLC, because those address the required winding up of an LLC when it has no remaining members, which is not applicable to a series under Section 101.610(b); Section 11.057 concerning supplemental winding up provisions for general partnerships; Section 11.058 concerning supplemental winding up provisions for limited partnerships; and Section 11.059 concerning supplemental winding up provisions for corporations.

3. These provisions provide winding up procedures for series which are substantially the same as the winding up procedures for an LLC under Section 101.551 of the LLC Act.

4. Section 101.114 of the LLC Act provides the general liability limitations for members and managers of an LLC. This subparagraph provides that the authorized actions of members and managers associated with a series retain the liability protections of Section 101.606 of the LLC Act during the winding up process.

Sec. 101.618. REVOCATION OF VOLUNTARY WINDING UP. Before the termination of the series takes effect, a voluntary decision to wind up the series under Section 101.616(2)(C) or (D) may be revoked by:

(1) a majority vote of all of the members associated with the series approving the revocation or, if there is more than one class or group of members associated with the series, a majority vote of the members of each class or group of members associated with the series approving the revocation; or

(2) if the series has no members, a majority vote of all the managers associated with the series approving the revocation or, if there is more than one class or group of managers associated with the series, a majority vote of the managers of each class or group of managers associated with the series approving the revocation.[1]

1. Section 101.552 of the LLC Act provides procedures for revocation of a voluntary winding up of an LLC which this Section 101.618 tracks for series.

Sec. 101.619. CANCELLATION OF EVENT REQUIRING WINDING UP.

(a) Unless the cancellation is prohibited by the company agreement, an event requiring winding up of the series under Section 101.616(1) or (2) may be canceled by the consent of all of the members of the series before the termination of the series takes effect.[1]

(b) In connection with the cancellation, the members must amend the company agreement to:

(1) eliminate or extend the time specified for the series if the event requiring winding up of the series occurred under Section 101.616(1); or

(2) eliminate or revise the event specified with respect to the series if the event requiring winding up of the series occurred under Section 101.616(2).[2]

1. This provision for cancelling the winding up of a series tracks the provisions of Section 101.552(b) of the LLC Act for LLCs.
2. This provision differs from Section 101.552(c) of the LLC Act concerning acts that must be performed to cancel the winding up of an LLC. Those provisions require a person to cancel the event causing the winding up and become a member of the LLC in order to satisfy the requirement that an LLC have at least one member. Here, the actions are different because a series may exist without members.

Sec. 101.620. CONTINUATION OF BUSINESS. The series may continue its business following the revocation under Section 101.618 or the cancellation under Section 101.619.

This provision tracks Sections 11.151(b) and 11.152(e) of the TBOC which provides that a domestic entity may continue its business after revocation and cancellation, respectively, of events otherwise causing a winding up.

Sec. 101.621. WINDING UP BY COURT ORDER. A district court in the county in which the registered office or principal place of business in this state of a domestic limited liability company is located, on application by or for a member associated with the series, has jurisdiction to order the winding up and termination of a series if the court determines that it is not reasonably practicable to carry on the business of the series in conformity with the company agreement.

Section 11.054 of the TBOC provides that a court may supervise the winding up of a domestic entity upon application of the entity or an owner or member of the entity, and Section 11.051(d) of the TBOC provides that a court decree may cause the winding up an entity. Section 101.621 addresses judicial winding up of a series because, again, a series is not a "domestic entity" per se but rather a part of an LLC which is a domestic entity. Note that jurisdiction over the series is determined by the registered office or principal place of business of the LLC – not the series. The registered office of a series is that of the LLC although the principal place of business of a series may be elsewhere as indicated in its assumed name filing.

IV. TAX CONSIDERATIONS

1. Series as separate reporting entity – or not.

As previously noted in the Background discussion in Section II hereof, the principal federal income tax question currently facing series LLCs is whether a series is a separate business entity for purposes of Treas. Reg. Section 301.7701-2(a) which would allow it to file its own tax return and elect tax classification under the check-the-box regulations. If it is not, then the LLC remains the business entity and it will make the entity classification election and file one return including all the activities of the collective series and members in that tax return. If the LLC, rather than the series, is the reporting entity, then schedular allocations would be used to maintain the separate profit and loss allocations and capital accounts for the members of the LLC which would necessarily include the members of all series as members of the LLC for reporting purposes. Currently, there is no specific mandate from the IRS as to whether the LLC or the series is the appropriate reporting entity. The issue is on their current business plan. Private conversations with IRS national office partnership officials in Washington, D.C. during May, 2010 revealed their expectation that guidance on this issue would be released by June 30, 2010, but that date passed without the anticipated guidance. Consequently, without IRS guidance, it appears that current reporting practice continues to be elective as to whether to file a separate tax return for each series or a single return for the LLC with the combined results of all series. Again, based upon private conversations with private practitioners, the approach generally seems to be as follows:

(i) Investment LLCs generally do not file a tax return at all for the LLC because it has no assets or separate operation, and a separate tax return is filed for each series;

(ii) Non-investment LLCs (i.e., operating businesses) sometimes file a single tax return for the LLC which combines all the series' separate activities into one return. LLCs that follow this approach are often real estate businesses controlled by a small group of majority owners who grant smaller ownership interests to local operational executives for a series created to own, develop and operate a single property. Schedular allocations are used to maintain separate records of ownership among the

37 See Terrence Floyd Cuff, "Series LLCs and the Abolition of the Tax System," 2 Business Entities (Jan-Feb, 2001) for a discussion of series LLCs and schedular allocations.

38 PLR 200803004 treats a Delaware series LLC as a separate entity in an insurance company structure to fund variable annuity contracts but that ruling should not be interpreted over broadly beyond its specific facts.

series. These LLCs, particularly in larger operations, may have more than 100 members who receive K-1s.

(iii) Non-investment partnerships (i.e., operating businesses) which have a few separate business lines with a few different investors for each series beyond the core controlling members of the LLC. These LLCs treat each series as a separate reporting entity and the LLC may also be a separate reporting entity because it houses overhead and management advisory functions with respect to the businesses of the separate series.⁴⁰

2. **Specific federal tax issues.**

   Most of the following issues result from the question of whether to treat a series as a separate reporting entity or not.

   a. Code Sections 704(c), 721, 731, and 737.

      Generally, contributions and distributions of property are not taxable events under Code Sections 721 and 731, respectively. However, contributions of appreciated property followed by distributions to the contributing member trigger gain under Code Sections 701(c)(1)(B) and 737. If a single LLC approach is used, the likelihood of gain being triggered obviously increases compared to an approach which has each series as a different reporting entity.

   b. Code Section 1031.

      Transfers between series, as separate reporting entities, might be eligible for like-kind exchange treatment assuming ownership between the series is not such to trigger related party rules under Code Section 1031(f). However, if the LLC is the reporting entity, deferred exchanges of property between one series and another would be within the same LLC resulting in a taxable treatment due to the transfer and receipt of cash.

   c. Code Section 754.

      If membership interests in a series are sold, the Code Section 754 election could be made on a series by series basis if each series is a separate reporting entity, but if the LLC is the reporting entity, then all series would be bound by whether the LLC has a Section 754 election in place or not.

d. Tax exemption.

   Since Section 101.601(b) of the LLC Act provides that an LLC may establish series "whether or not for profit," an LLC with multiple series, some of which are intended to be tax exempt non-profits, would not be able to obtain a tax exemption unless the series is treated as a separate business entity for federal tax purposes.

   e. Taxpayer identification number.

      Obviously, the issue of whether a series may obtain its own employer identification number depends on whether a series is treated as a separate business entity. As the IRS has not yet definitively ruled on this issue, it is not surprising that the on-line form for application for an employer identification number does not have a choice for "series."⁴¹

   f. Single capital account rule.

      Treas. Reg. Section 1.704-1(b)(2)(iv)(b) provides that a partner with multiple interests in a partnership (e.g., a general partner and limited partner interest, or Class A and B limited partner interests, etc.) "shall have a single capital account that reflects all such interests." If series must be combined in the LLC for reporting purposes, then schedular allocations must be maintained that combine capital accounts into a single capital account for a member with ownership interests in multiple series. Obviously, if each series is a separate reporting entity, then a member with ownership interests in multiple series will simply have a single capital account in each separate series.

   g. Code Section 752 liability allocations.

      Treas. Reg. Sections 1.752-1 through 3 provide rules defining recourse and non-recourse liabilities and how those liabilities are allocated among partners. Whether the LLC or individual series is the reporting entity will affect how liabilities are allocated under Code Section 752 and the corresponding regulations. Consider, for example, how a loan from one series to another within the same LLC would be allocated for Code Section 752 purposes with LLC versus separate series reporting.

   h. Basis.

      Code Section 705 provides the general rules for determining a partner's basis in a partnership

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⁴⁰ An example of a taxicab company with a separate series used for each taxi for liability limitation purposes is an example used by one commentator. See, Carolyn R. Goforth, "The Series LLC, and a Series of Difficult Questions," 60 Ark.L.Rev. (2001-2008), 385, 393-394.

interest. Whether the series or the LLC is the reporting entity can make a significant difference in the basis of a member who has interests in multiple series. For example, if a member has multiple series interests in one LLC, then what might be a distribution in excess of basis with respect to a single series might not be so if the member's basis in all series is combined for reporting by the LLC.

i. Technical terminations.
A partnership terminates under Code Section 708(b)(2) when there is a sale or exchange of 50 percent or more of the partnership interests in capital and profits within a 12-month period. Obviously, whether the LLC or series is the reporting entity will make a significant difference in determining whether a technical termination occurs.

j. Mergers and divisions.
Setting aside state law issues such as how a series could merge with another series or LLC since it is not a legal entity, whether a series can merge with another series under Code Section 708(b)(2)(A) will depend on whether the series is treated as a separate reporting entity. If series are not separate reporting entities, then a merger of series for tax purposes would appear to be a non-event other than for schedular allocation purposes.

k. Code Section 7704.
Whether the series or LLC is the reporting entity will affect application and operation of the publicly traded partnership (PTP) rules under Code Section 7704.

l. Code Section 707.
The disguised sale rules under Code Section 707 obviously will be affected by whether a series is a separate reporting entity or combined with the LLC. Code Sections 707, 704(c) and 737, in particular, seem to be more problematic if the LLC is the reporting entity rather than each series because transactions that could be isolated within different series would be consolidated into one reporting entity if the LLC is the reporting entity. Likewise, the split holding period rules under Treas. Reg. Section 1.1223-3 would seem to be considerably more problematic for an LLC as the reporting entity rather than each individual series.

The various tax issues arising from whether the series or LLC is the reporting entity are nearly limitless. Pitfalls and planning opportunities result from either approach. The above list represents only a small sampling of the issues that must be considered with series LLCs.

a. Texas Franchise (Margin) Tax.
As previously noted in comment 2 concerning Section 101.602 of the LLC Act, although no published guidance has been issued, the Comptroller is expected to take the position that the LLC, rather than each series, is the reporting entity for margin tax purposes. Further, for nexus purposes, the Comptroller is expected to take the position that nexus for any series constitutes nexus for the entire LLC. These approaches suggest that LLCs contemplating series with varied activities will probably obtain better margin tax results by creating individual LLCs rather than having to combine franchise tax reporting of the series under the LLC. Foreign LLCs contemplating doing business in Texas through a series likewise may find better nexus and margin tax results through registration of a separate LLC in Texas rather than the series with the result that nexus attaches to the entire LLC.

b. Other state tax issues.
Given that only eight states have series LLC statutes, their tax treatment in most states is simply unknown at this time. California has declared that each series will be a reporting entity for California income tax.\(^42\) For a broader discussion of the state tax issues and unknowns affecting series LLCs, see Michael W. McLoughlin and Bruce P. Ely, "Series LLCs: Many State Questions are Raised but Few Answers are Yet Available," 9 Business Entities (Jan, Feb 2007) and Lee, Ely and Rimkunas, "State Taxation of Partnerships, Limited Liability Companies, and Their Owners," 11 Business Entities (Sep/Oct 2009).

V. FORMS
The following resources provide useful references for series LLC drafting language:

1. John C. Murray, A Real Estate Practitioner's Guide to Delaware Series LLCs (With Form) (2007);

\(^42\) See discussion in comment 2 under Section 101.602 of the LLC Act.


VI. CONCLUSION

For their original and historical purposes as separate investment series of an investment fund, series LLCs operate pretty well, particularly in an environment where they are permitted to file separate returns for each series. Business does not cross state lines to create concerns about respect for the liability shield, and the investment activity of each series does not create the same title and operational concerns of an operating business. While some real estate developers have apparently used series LLCs to compartmentalize each project in a separate series and save administrative fees and filing costs for separate LLCs, there remain concerns about liability shield issues in jurisdictions without series LLC statutes. Of course, during much of the 2000s, most real estate development financing was on a non-recourse basis upon completion of the asset so that insurance should generally cover operational liability issues. At present, there appear to be significant obstacles to the use of series across broad ownership bases and varied business activities because of uncertain liability shields in non-series states, uncertain federal tax issues and uncertain state tax issues. On the other hand, a closely-held family business, or businesses, that operate mostly within a series LLC state could easily use multiple series to operate those separate businesses. Of course, federal tax issues remain on the LLC versus series reporting entity question, but that question is likely to be resolved relatively soon, as are the Texas Comptroller positions on margin tax reporting for series LLCs.

In short, the use of series LLCs today outside their historical investment company framework offers far more questions than answers. The next few years should answer the question of whether series LLCs become widely popular in everyday use or remain something of the anomaly they are today.
Notice 2008-19 Series LLCs

Example 1 (Investment Fund)
Notice 2008-19 Series LLCs

(Operating Company)

Example 2–Primary Analysis

Series D Series E Series F

LLC-2
Notice 2008-19 Series LLCs

(Operating Company)

Example 2—Alternative Analysis

Series G
(Owns all of the limited liability company interests in Series D, E, and F)

Series D
Series E
Series F

LLC-2

R: 25% Profits Interest and 0% Initial Capital Interest in Series G
S: 25% Profits Interest and 0% Initial Capital Interest in Series G
T: 50% Profits Interest and 100% Initial Capital Interest in Series G
Notice 2008-19 Series LLCs

(Real Estate Developer)

Example 3

Series H
Series I
Series J

LLC-3