

Update on Tax Classification of Series Entities

The IRS issued proposed regulations today addressing the classification of certain domestic series entities – such as Illinois or Delaware series LLC’s - for federal income tax purposes. Essentially, each series would be treated as a separate entity and then the classification of that entity would be determined under normal federal income tax principals. In the case of a series LLC that would mean that a series with more than one owner would be classified as a partnership by default and a series with only one owner would be classified as a disregarded entity by default (see Prop. Treas. Reg. § 301-7701-1(a)(5)(x), Example 1). The IRS has not addressed the treatment of series entities for federal employment tax purposes and is seeking comments on that issue. There are also special rules for foreign series entities in the insurance business.

New Reporting Requirements

Some series entities have reported the activity of all of the series of the entity on a single entity basis, treating all of the series as separate divisions of a single entity and filing a single federal income tax return. Except in certain cases (see discussion of transition rule below), such entities will no longer be able to do so. If a series of a series entity is classified as a separate entity – like a partnership – the series itself will be required to file a federal income tax return. If the series is classified as a disregarded entity, then the owner of that series would report the activity of the series on the owner’s own federal income tax return.

The IRS is considering creating a new form on which the series entity would have to report certain information about each series of the entity on an annual basis (the proposed deadline is March 15). This form would include the name, address and EIN of the series entity and each series, the jurisdiction of formation of the series entity and each series and whether or not title to the assets is held separately by each series or the series entity. The IRS is also considering revising the Form SS-4 application for EIN to include questions about series entities.

Effective Date

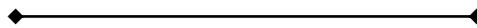
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The regulations generally go into effect when the final regulations are published, and series entities would be required to follow those rules going forward. For example, if a series LLC had been treating all series as part of a single partnership, then there would be a deemed division of that partnership and general tax rules would apply to the treatment of that division.

The IRS has included a transition rule that would allow certain series entities that currently treat all series as part of a single entity to continue to do so until such time as persons who were not owners of the series entity prior to September 14, 2010 own, in the aggregate a 50% or greater interest in series entity. For a series entity taxed as a partnership, “interest” is measured by the capital or profits of the series entity. For a series entity taxed as a corporation, “interest” is measured by vote or value. To qualify for the grandfather rule: (i) each series must have been established prior to September 14, 2010, (ii) each series conducted its own business or investment activities, (iii) no owner of the series treats the series as a separate entity, (iv) the series LLC had a reasonable basis for its claimed classification and (v) the IRS had not notified any owner of the series or the series LLC that the series was under examination. This suggests that a series entity that currently treat all series as part of a single entity for federal income tax purposes and qualifies for the transition rule still will have to treat any new series created after September 14, 2010 as a separate entity.

The IRS has requested comments on the regulations for a public hearing scheduled for December 13, 2010. Thus, it is possible that the IRS could make these regulations effective shortly thereafter. The requirement for the filing of the new statement about the series entity would apply to taxable years beginning after the date of the publication of the final regulations.

These regulations seem to take a sensible approach to classification of series entities, so we would expect the regulations to be substantially unchanged in final form, at least as they relate to the basic issue of whether a series is a separate entity for federal income tax purposes.



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