

Limited Liability Companies

Table of Contents

Learning Objectives.....	1
Introduction.....	3
Objectives	3
Overview: Why Study LLCs and LLPs?	3
What is a Limited Liability Company?	4
What is a Limited Liability Partnership?.....	5
History of the LLC and the LLP	5
The History of the LLC.....	6
The History of the LLP	6
Introduction Review Questions	9
Chapter 1 Choosing a Form of Business	11
Objectives	11
Overview.....	11
1. A Sole Proprietorship	12
Advantages.....	12
Disadvantages	13
2. A Partnership	14
Partnerships in General	14
Limited Partnerships.....	16
3. A Corporation	17
“C” versus “S” Corporations.....	17
C Corporations.....	18
S Corporations	19
4. Limited Liability Companies	21
Advantages.....	21
Disadvantages	22
5. Limited Liability Partnerships	23
Advantages.....	23
Disadvantages	23
Chapter 1 Review Questions	25
Chapter 2 Classification as an LLC	27
Objectives	27
Overview.....	27
Corporation, Partnership, or Association?	28
Early Decisions.....	28
The IRS’ Response	29
The IRS Regulations	29
The Two-for-Two Test.....	29
The Epilogue to 1960.....	30
The LLC Issue	31
1. Classification from 1988 to 1996	31
a. Limited Personal Liability of the Owners	31

b. Centralized Management	32
c. Continuity of Life of the Entity	33
d. Free Transferability of Interests.....	34
Passing the Two-for-Two Test	36
“Bulletproof” versus “Flexible” Statutes	37
Rev. Proc. 95-10.....	37
2. Classification after 1996	38
Eligible Entity	38
Default Classification.....	39
Election Under Form 8832.....	39
Chapter 2 Review Questions	41
Chapter 3 Formation of an LLC or LLP	43
Objectives	43
Overview.....	43
General Requirements for LLCs	43
State Statutes.....	44
Owners or Members	44
Business Purpose	45
Articles of Organization	45
Operating Agreement.....	45
LLPs.....	46
Tax Considerations	46
Formation of a New Entity	47
1. Income Recognition on Acquiring the Interest	47
2. Basis of the Member’s Interest.....	51
Conversions of Existing Entities.....	54
Conversion of a Partnership into an LLC.....	54
Conversion of a Corporation into an LLC.....	55
Conversion of a Corporation into an S Corporation	57
Conversion of a Trust into an LLC.....	58
Chapter 3 Review Questions	61
Chapter 4 Operations of an LLC	63
Objectives	63
Selection of Tax Year	63
Comparison with Other Entities.....	64
Methods of Accounting	65
Comparison with Other Entities.....	66
Income Allocation.....	66
In General	66
Special Allocations	67
Comparison with S Corporations.....	69
Basis Computations	70
Adjustments to Basis	71
Limitations on Loss Deductions.....	72

Alternate Rule	73
Comparison with S Corporation Provisions	73
Compensation of Members	74
Classifying the Payments	74
Employee versus Independent Contractor	74
Self-Employment Taxes	75
Employer-provided Benefits	75
Comparison with Other Entities	78
Chapter 4 Review Questions	79
Chapter 5 Distributions and Dissolutions.....	81
Objectives	81
Overview	81
Dissolution of an LLC.....	81
Legal Dissolution of an LLC	82
Dissolution for Federal Income Tax Purposes.....	82
Tax Treatment of Distributions	83
Distributions from LLCs or LLPs.....	83
A. Nonliquidating Distributions.....	83
B. Liquidating Distributions.....	86
C. Disproportionate Distributions	88
Distributions from C Corporations.....	90
Dividends	90
Distributions in Excess of Earnings and Profits	90
Property Distributions.....	91
Redemptions	91
Liquidations	91
Distributions from S Corporations	92
Nonliquidating Distributions	92
Tax Planning Considerations.....	94
Liquidating Distributions.....	94
Summary Comparison	95
Chapter 5 Review Questions	97
Chapter 6 Other Issues Affecting LLCs	99
Introduction and Objectives	99
Transferability of Shares	99
Securities Laws.....	100
Publicly Traded Partnerships (PTPs)	100
Optional Basis Adjustments	101
At-Risk Provisions	104
Basic Formula.....	105
Passive Loss Provisions.....	108
Activities Affected	108
Basic Computations	111
Rental Real Estate Exception.....	112

Relationship of Loss Limitations	113
Comparison with Other Entities.....	115
Related Party Provisions	115
Definition of Related Party.....	116
Loss Limitations	116
Gain Restrictions	116
Other Limitations.....	117
Chapter 6 Review Questions	119
Appendices.....	121
Review Question Answers.....	131
Glossary	137
Index.....	139
Final Examination Questions	141