

LLCs, LPs and Partnerships

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## **The Opportunities and Risks of Texas Series LLCs<sup>1</sup>**

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## I. INTRODUCTION

In 2009, the Texas legislature enacted a statute permitting the formation of series limited liability companies<sup>2</sup> in Texas.<sup>3</sup> The statute provides that the company agreement of an LLC 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 or profits and losses associated with specified property or obligations, or (2) has a separate business purpose or investment objective.<sup>4</sup> As long as the LLC observes certain formalities, the debts, liabilities and obligations of a particular Series are enforceable only against that Series, and none of the debts, liabilities and obligations of the other Series or the Series LLC generally are enforceable against that Series.<sup>5</sup> Accordingly, the statute permits a single state law entity to segregate its assets and liabilities for asset protection and other purposes.

A review of entity formation documents filed with the Texas Secretary of State during the four years since the enactment of the statute reveals that very few LLCs have been formed with the language required by the statute. By some estimates, only about 0.1% of all Limited Liability Company filings in the State of Texas included the language required by the statute.<sup>6</sup>

Clearly, the Series LLC has yet to take the nation by storm in the same way that the LLC did in the late 1980s and early 1990s. In 1988, only Wyoming and Florida had LLC statutes.<sup>7</sup> By 1996, all 50 states had enacted LLC statutes.<sup>8</sup> Delaware enacted the first Series LLC statute in 1996,<sup>9</sup> with the concept arising out of the use of statutory business trusts for asset securitization and investment companies.<sup>10</sup> Seventeen years later at least nine states, plus

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<sup>2</sup> A "Series LLC" in this paper refers to a limited liability company ("LLC") which has met the statutory requirements to have series ("Series"). Generally, reference to a Series LLC refers to the statutory entity, whereas reference to a Series refers to a series of the Series LLC. A Series LLC is contrasted with an LLC only by the fact that a Series LLC is an LLC which has met the statutory requirements to have Series.

<sup>3</sup> TEXAS BUSINESS ORGANIZATIONS CODE ("TBOC") §§ 101.601 – 101.621.

<sup>4</sup> TBOC § 101.601.

<sup>5</sup> TBOC § 101.602.

<sup>6</sup> A telephone conference with staff at the Texas Secretary of State revealed that 86,947 LLCs were formed in 2011 and that in a random sample of 659 LLC certificates of formation reviewed by Secretary of State staff, 5 had Series authorizing language included. Thus, based on the percentages from the random sample (approximately 0.76%), it appears that approximately 660 LLCs with Series authorization were formed in Texas in 2011. An earlier sample in 2010 indicated that perhaps 0.1% or less of the LLCs formed since the September 1, 2009 effective date of the Series LLC legislation included the Series authorizing language in their certificates of formation.

<sup>7</sup> Wyoming was first with an LLC statute in 1977 followed by Florida in 1982. Texas, in 1991, became the fourth state to enact an LLC statute.

<sup>8</sup> Much of the impetus for the sudden acceptance of the LLC form of business was the issuance of Rev. Rul. 88-76, 1988-2 C.B. 366, which held for the first time that an LLC could be treated as a partnership for federal income tax purposes.

<sup>9</sup> DEL. CODE tit. 6, §18-215. The Delaware LLC provisions are in Sections 18-201 through 1109 (Delaware LLC Act).

<sup>10</sup> See, Thomas E. Rutledge, "Again for the Want of a Theory: The Challenge of the 'Series' to Business Organization Law," 46 *Am. Bus. L. J.*, 311, 313 (Summer 2009); see also Donn, Ely, Keatinge, and Schippel, "Series LLCs", *ALI-ABA Video Law Review*, pp. 4-5, February 17, 2011 for discussion of the mutual fund origin of the Series concept. For an excellent summary of the genesis of the Series LLC in Delaware, see James

the District of Columbia<sup>11</sup> and Puerto Rico<sup>12</sup> have Series LLC statutes: Delaware, Texas, Illinois<sup>13</sup>, Iowa<sup>14</sup>, Nevada<sup>15</sup>, Oklahoma<sup>16</sup>, Tennessee<sup>17</sup>, Kansas<sup>18</sup> and Utah<sup>19, 20</sup>.

Some practitioners posit that the slow growth is because the Series LLC was designed only for the investment industry and not for other industries.<sup>21</sup> Other practitioners posit that the LLC filled a gap in the business entity market and was a much-needed solution to many planning problems, while the Series LLC merely supplements that solution. Still other practitioners posit that there are too many uncertainties in order to divert from the standard LLC course. Most likely, however, there is some truth to each view.

Notwithstanding these theories, however, it is clear that while the progression of the Series LLC may be slow, the Series LLC is neither inconsequential nor dwindling – if anything, it is becoming more pronounced and relevant. More practitioners are aware of its existence; more clients are asking about its use and potential viability; and more articles and speeches are being disseminated among the industry. One only has to Google™ "Series LLC" to be inundated with material and talking points. The IRS has issued proposed regulations (the "Proposed Regulations") indicating its position with respect to the federal income tax consequences.<sup>22</sup> The American Bar Association, Tax Section, has issued comments to the IRS regarding such regulations.<sup>23</sup> Much in the same way Rev. Rule. 88-76 spurred the acceptance and development of LLC statutes, the Proposed Regulations on Series LLCs may spur acceptance of Series LLCs. To that end, a recent ABA Tax Section survey of states (the "ABA State Survey") received responses from nearly half of the states addressing how they plan to address Series LLCs for tax purposes.<sup>24</sup> That many states are addressing the Series LLC in a tax context suggests more state Series LLC legislation will be forthcoming. And even in the Texas context, while the original sampling of Series LLCs in 2010 suggested a 0.1% formation rate, the 2011 sample rate of 0.76% represents a seven-fold increase in Series LLC filings.

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Howard, "Where Do We Go From Here? A Survey of Series LLCs in Texas in Light of the Proposed Federal Tax Classification for the Organization?," 63 *Baylor L. Rev.*, 850, 851-855 (2011).

<sup>11</sup> D.C. CODE §29-802.06.

<sup>12</sup> PR LAWS ANN., Tit. 14 §3426(p).

<sup>13</sup> ILCS 180/37-40.

<sup>14</sup> IOWA CODE ANN §489.1201.

<sup>15</sup> NRS §86.296.3

<sup>16</sup> 18 OKLA. STAT. §18-2054.4B.

<sup>17</sup> TENN. CODE ANN §48-249-309.

<sup>18</sup> KSA 17-76, 143.

<sup>19</sup> UTAH CODE ANN §48-2c-606.

<sup>20</sup> Minnesota, North Dakota, and Wisconsin also have statutory provisions that allow for the establishment of "Series" or "classes" of membership interests, but these are more like the concept of a class or Series of shares in a corporation rather than a true Series LLC because they do not specifically provide for separate liability for each Series. See MINN. STAT. § 322B.03; N.D. CENT. CODE § 10-32-02; WIS. STAT. §183.0504.

<sup>21</sup> Traditionally, the Series LLC was used as a separate investment Series of a single investment company, e.g., XYZ Investment Co., Series A, Series B, etc., Rutledge, *supra*, 313-314.

<sup>22</sup> REG. 119921-09, 75 F.R. 55699 (Sep. 14, 2010).

<sup>23</sup> See, letter from William J. Wilkins to IRS Commissioner Shulman, *Tax Analysts*, Doc. 2009-115.

<sup>24</sup> See, Apr. 30, 2013 letter from Rudolph Ramelli to IRS Acting Commissioner Miller, *Tax Analysts*, Doc. 2013-10935.

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