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# Series LLCs

Utilizing this structure partitions risk.

by Jeffrey M. Friedman and Kelly M. Greco

A series limited liability company is an entity structure that allows for the formation of multiple segregated LLCs, known as “series,” under the umbrella of a single “master” or traditional LLC. In 1996, Delaware became the first state to enact a series LLC statute. Since then, a handful of states have amended their LLC statutes to allow for the formation of series LLCs.

Generally, in the states that recognize them, series LLCs are segregated entities that have separate managers and members, distinct assets, and individual operating agreements. They also incur separate liabilities. However, those states also consider them a single entity for organizational filing and reporting purposes.

The IRS has not issued official federal tax regulations governing series LLCs. However, it has issued proposed regulations (Prop. Treas. Regs. Secs. 301.6011-6; 301.6071-2; and 301.7701.7701-1(a)(5)), which provide that each series within a series LLC

- will be treated as a separate entity for federal income purposes;

- is allowed to choose its own entity classification independent of other series; and
- should only be liable for federal income taxes related to that series.

The proposed regulations do not address entity status for federal taxes or whether each series should obtain a separate employer identification number and file a separate federal tax return. The Treasury Department is expected to release official regulations, but as of January, no final regulations have been issued.

## Real Estate Applications

By utilizing series LLCs, real estate owners can achieve a more streamlined, efficient process for asset protection. A real estate developer, for example, can choose to organize one traditional LLC, and then create separate, protected series for each parcel of real property with the liability of each series limited to the real property and other assets held by that series only. The debts and liabilities of one series cannot spill over and be enforced against a different series so long as certain statutory conditions are met at formation. Essentially, if each series keeps separate records and bank accounts and is treated as its own entity, the assets of each series will be unaffected by judgments against other series.

With this structure, real estate owners will also realize lower state business filing fees. In Illinois, for example, where business filing fees are higher than most states, the cost to form a standard LLC is \$500. While series LLC filing fees involve a higher upfront cost of \$750, there is only a nominal registration fee to form each additional series by filing a certificate of designation for \$50 and amending the master LLC operating agreement. Savings may also be recognized in the form of reduced legal costs associated with the formation of a series LLC if only a single operating agreement is required.

## Risks

While the series LLC may be an attractive investment vehicle, it does not come without risks. A number of legal and tax implications have never been litigated and there is



not much precedent as to how these entities will be respected going forward.

To begin with, not all state statutes regarding the series LLC are identical. Series LLCs are not available in all states, and, where they are not available, each series may not be recognized as a separate entity for state tax purposes.

In addition, without guiding case law, it is unclear exactly what type of record keeping, accounting, and other formalities will preserve liability segregation among the series and avoid the “piercing” of the liability veil. Likewise, it is unclear what practices would be insufficient and expose a client to greater than anticipated liability. Thus, the best course of action is to maintain the strictest possible accounting and other record-keeping standards to maximize the chance of the limited liability being respected.

This issue is of particular concern with respect to claims involving creditors and

other third parties that may not have adequate notice of the segregation of assets and liabilities in a series LLC. It remains unclear how Article 9 of the Uniform Commercial Code applies to the series LLC and how a series will be treated in bankruptcy. To file a petition, a specific series would need to be considered a “person” under the Bankruptcy Code, a designation that includes an individual, partnership, or corporation. If a series does not fall under one of those categories, the series and its stakeholders may not have bankruptcy protection, and bankruptcy courts may consider the assets of all the series to be part of a bankruptcy estate.

These uncertainties, and the fact that lenders do not fully understand the issues involved, may also cause difficulties in securing financing.

There is also a question as to whether a series has the legal capacity to hold title to

real estate, unless the state provides explicit language. In 2007, Delaware amended its statute to make clear series may own, contract, hold title to assets, and grant liens and security interests. Many states, including Illinois, have followed Delaware’s lead and contain similar explicit language. For those states where the LLC statute is silent, however, there remains some ambiguity. Regardless, it may be possible to limit liability by limiting recourse under loan documents to a particular series.

Although the number of states allowing series LLC continues to grow, real estate owners considering this structure should closely consider the legal uncertainties and business risks involved.

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