

Office of Chief Counsel
Internal Revenue Service
Memorandum

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CC:PSI:B03:MJGoldman

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date: September 21, 2004

to: Associate Area Counsel (Kansas City)
(Small Business/Self-Employed)
Attn: Charles M. Berlau, CC:SB:5:KCY

from: Jeanne M. Sullivan
Senior Technician Reviewer, Branch 3
(Passthroughs & Special Industries)

subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This Chief Counsel Advice is based solely on the facts presented in your May 5, 2004, request for assistance.

LEGEND

LLC =

Son =

Father =

Co-Organizer =

State =

Date 1 =

Year 1 =

X =

Y =

ISSUES

1. How many members does LLC have for federal tax purposes?
2. Does the fact that Son originally indicated that Father was a member affect the determination of whether LLC is a single- or multi-member entity?
3. How is it determined how many members an LLC has for federal tax purposes?
4. If Son reported the income and expenses from the business on his Schedules C, and represents that he is the only member, should this be enough to consider the LLC a single member LLC and treat it as such back to Year 1?
5. If no income/loss from the business had been reported on any type of tax return, would this make a difference in this particular case? In the alternative, if one member reports all the income from the business, does this preclude anyone else from being a member of the LLC?
6. As active involvement by all the members of an LLC is not a requirement for the LLC to be treated as a multi-member LLC, and as there is no formal form filed either with the state or federal government that indicates who the members of the LLC are, how does the Service determine if there are actually multiple members other than relying on the interviewed taxpayer's word?

CONCLUSIONS

1. Under the facts presented, it is unclear whether LLC has one or more members for federal tax purposes.
2. Son's representations as to the ownership of LLC are taken into account in determining whether the entity has one or more than one member.
3. For purposes of classification, each owner of an eligible entity that is recognized as a separate entity is counted in determining whether an eligible entity is a single- or multi-member entity.
4. In the absence of evidence to the contrary, credible evidence that one member reported all of the income and expenses of an entity and purports to be the only

member is clearly sufficient to establish those facts. The facts of this case provide conflicting evidence of ownership, however.

5. Failure to report income/loss does not resolve the question of ownership of the entity or the classification of a business entity under §§ 301.7701-1 through -3 of the Procedure and Administration regulations.

6. Section 6031 provides that a partnership must furnish the names and addresses of its partners on its annual return of partnership income.

FACTS

Records at the Office of the Secretary of State for State indicate that LLC was created on Date 1 by Son and Co-Organizer. At some point in time prior to the Internal Revenue Service's (Service's) awareness of and/or involvement with LLC, Co-Organizer severed ties with LLC and Son assumed full control of LLC. LLC does not appear to have articles of organization or ownership documents.

In Year 1 the Service first became aware of LLC when LLC requested a taxpayer identification number (TIN) and indicated that it was a partnership with Son as a general partner. Further, LLC has not filed a Form 8832, Entity Classification Election, electing to be treated as other than its default classification.

With regard to employment tax liabilities, LLC refused to cooperate with the Service. As a result, the Service initiated procedures under § 6020(b) of the Internal Revenue Code and assessed the employment taxes. Subsequently, Son represented that Father became a member of LLC at approximately the time the TIN was requested and that x percent of LLC was owned by Son and y percent by Father. Based upon the information supplied when requesting a TIN and on these representations, upon failure to pay the assessed taxes, a notice of federal tax lien (NFTL) was filed in the name of LLC.

Subsequent to the filing of the NFTL, LLC's authorized representative contacted the Service and stated that LLC should be treated as a single member LLC and not as a multi-member LLC. The representative explained that Father was not a member, rather that Father was only an investor. Further, the representative explained that Son reported all of the income from LLC on his Form 1040, U.S. Individual Income Tax Return, (Schedule C, Profit or Loss From Business) for each year of LLC's existence.

When the revenue officer interviewed Father, Father confirmed that he invested money into LLC, but that was the extent of his involvement. Father also explained that he had no knowledge of being a member of LLC and that he understood Son to be the sole owner of LLC.

LAW AND ANALYSIS

Issue 1: How many members does LLC have for federal tax purposes?

Section 301.7701-2(a) of the Procedure and Administration Regulations provides that a business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership, and a business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. Section 301.7701-3(b)(1) provides that, unless it elects otherwise, a domestic eligible entity with two or more members is a partnership and is disregarded as an entity separate from its owner if it has a single owner.

Thus, in order to determine the federal tax classification of LLC it is necessary to determine how many separate entities (including individuals) are owners of LLC. Cf. Rev. Rul. 2004-77, 2004 I.R.B. 119 (despite having two members under local law, an entity has a single owner for federal tax purposes if one of the members is a disregarded entity owned by the other member).

There is insufficient evidence to determine the number of owners of LLC. There are apparently no ownership documents or articles of organization. Moreover, inconsistent information has been provided. Son has asserted that Father is an investor and an owner of y percent of LLC. In contrast, Father and LLC's authorized representative have asserted that Son is the single owner of LLC.

Issue 2: Does the fact that Son originally indicated that Father was a member affect the determination of whether LLC is a single- or multi-member entity?

A taxpayer's intent (or lack thereof) to form a partnership as expressed in reporting of income and representing the status of an LLC to the Service is relevant to the question of whether there is a partnership. See Commissioner v. Culbertson, 337 U.S. 733, 742-743 (1949). Given the conflicting evidence of intent here, however, Son's representations alone are not determinative of the entity's status as a disregarded entity or a partnership.

Issue 3: How is it determined how many members an LLC has for federal tax purposes?

Whether an LLC is a single or multi-member LLC depends on how many separate entities (including individuals) that are recognized for federal tax purposes are owners (again for federal tax purposes) of the entity. Ownership generally involves an analysis of who has the benefits and burdens and control of the entity. See, e.g., Grodt & McKay Realty, Inc. v. Commissioner, 77 T.C. 1221, 1237-1238 (1981).

Thus, the determination as to whether there is more than one owner of an LLC is dependent on the facts and circumstances of each case.

Issue 4: If Son reported the income and expenses from the business on his Schedules C, and represents that he is the only member, should this be enough to consider the LLC a single member LLC and treat it as such back to Year 1?

Credible evidence that one member of an LLC reported all of the income and expenses from the LLC's business for each year of its existence and represents that he or she is now and has always been the sole owner of LLC would be sufficient to consider LLC a single member entity unless or until there is credible evidence to the contrary. Under the facts here, there is conflicting evidence as to whether LLC has a single or multiple members.

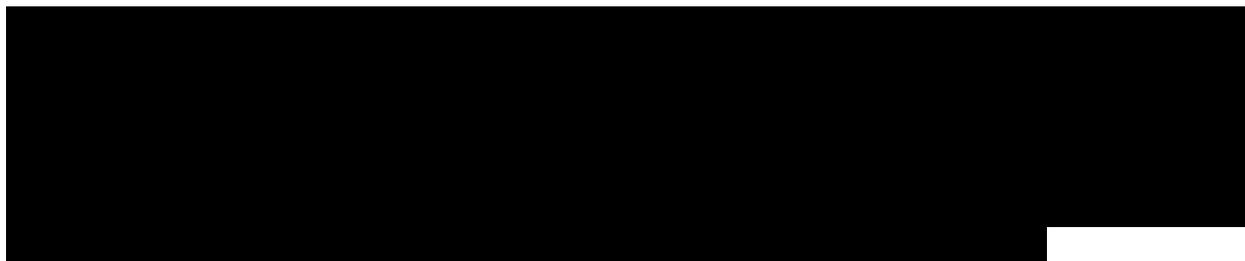
Issue 5: If no income/loss from the business had been reported on any type of tax return, would this make a difference in this particular case? In the alternative, if one member reports all the income from the business, does this preclude anyone else from being a member of the LLC?

See discussion under Issue 1. Failure to report income/loss does not resolve the question of ownership of the entity or the classification of a business entity under §§ 301.7701-1 through -3 of the Procedure and Administration regulations.

Issue 6: As active involvement by all the members of an LLC is not a requirement for the LLC to be treated as a multi-member LLC, and as there is no formal form filed either with the state or federal government that indicates who the members of the LLC are, how does the Service determine if there are actually multiple members other than relying on the interviewed taxpayer's word?

A partnership has an obligation under § 6031 to file a return for each taxable year that includes the names and addresses of the individuals who would be entitled to share in the taxable income if distributed. See also discussion under Issue 3 above.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS





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Please call (202) 622-3080 if you have any further questions.