Legacy M&A ADVISORS LLC

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A New Look at the Series LLC

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Introduction

The past few years have been exciting for those watching and keeping up with the entity known as the "Series Limited Liability Company" (Series LLC). So much has happened and so much has developed. From the treatment given from the IRS, state trends, and case law, we are now getting a clearer picture of what is and will become of the series LLC.

Background

The Series Limited Liability Company is based upon the Limited Liability Company (LLC). The LLC is a business structure created and allowed by state statute. This is unlike sole proprietorships and partnerships that do not necessarily owe their existence to statute, but more based upon formal or informal agreements. Though states vary, most states also permit "single member" LLCs, those having only one owner. There are limits that exist as to what kinds of businesses endeavors LLCs can partake in. Banks and insurance companies cannot hold LLC status for instance. Further, the name of an LLC MUST include LLC, L.L.C., or Limited Liability Company AND CANNOT HAVE Inc, Corp, Corporation, or Incorporated following the name. All of the rules in this paragraph apply to the Series LLC.

What is a Series LLC?

The Series LLC is a new creature born from a past design. The statutes were created as early as the past 10 years. Liabilities and such are only enforceable against the particular series in question and are not against assets of other series. They are more expensive to set up as opposed to other business entities.

A series LLC is simply an LLC formed at the state level and then the client requests, via a written instrument to the state, how many series are desired. For example a client has ABC, LLC. That client can request to have ABC, LLC, series 1, series 2, 3, 4 and it can go on and on. They are in essence sub companies.

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A CASE STUDY

An S Corporation was allowed to use a lower figure, rather than the sale price, when calculating the tax on built-in gains for the sale of a partnership interest. The built-in gains tax is a tax on an S corporation's gain on disposition of an asset where the gain was accrued while the S corporation was a C corporation. In the first year after conversion from C corporation status to S corporation status, the taxpayer sold a partnership interest for $5.2 million. The taxpayer reported the fair-market-value (FMV) of the partnership interest at $2.6 million, based on a valuation performed prior to the sale. The Tax Court found the sale must be taken into account in the valuation. The Tax Court reasoned the buyer was willing to pay a premium to avoid the exercise of rights of first refusal of the other partners. The Tax Court held the FMV to be $3.7 million.

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CoverStory

Protection Based On Separation

The most important theme now is separation. You must account for the assets separately. Liabilities and assets are reported separately for accounting and legal purposes. Surprisingly, the IRS has acknowledged the existence of the Series LLC and respects the existence as such.

Fortunately, accounting programs via computer make this easier than before. Schedule E already requires a quasi separateness. In addition, it is advisable to have separate books, separate records, even separate checks that say series 1, series 2, and series 3. The reason for the separateness is simple: it provides a greater barrier to each company's assets and is a shield from liability.

Illinois' Departure from the Mold

When Illinois enacted legislation in 2005, it seriously departed from the Delaware legislation. The reason for the departure is notice. Delaware and many previous states do not have much of a demand for notice in their statute. Illinois on the other hand is very stringent. The policy is to notify who you are doing business with and that you are in fact a series LLC. In Illinois, the client must use the complete name of the series. This extends to the client's entire contract and leases.

While it may seem like a detriment to the client, the fact of the matter is that disclosure such as these are always a good thing when trying to defend your firm from liability. The plaintiff does not have the argument of ignorance or fraud against the defendant, thus potentially damaging legal protections.

In Illinois, the Secretary of State has a record of LLCs. Every year, LLCs must declare how many series they have. This way, each year the Secretary of State has a record of each series.

Conclusion

The Series LLC will be the premiere business type for this decade as far as new companies are concerned. The Series LLC gives unsurpassed liability protection along with the advantages given by the old type of LLC. Additionally, the IRS openly recognizes Series LLCs as legitimate business types and has rules and regulations concerning the filing of their returns. While some states such as Delaware allow their companies to "hide the ball" from their creditors, Illinois takes a different approach. It is a more honest and more respectable approach when it comes to utilizing your Series LLC. If you have any questions, concerns or would like to set up a Series LLC, please feel free to call the professionals at The Center at 618 997 3436.

Points of Interest

- **The past few years have been exciting for those watching and keeping up with the entity known as "The Series Limited Liability Company".**
- **The Series LLC is a new creature born from a past design.**
- **The Series LLC gives unsurpassed liability protection along with the advantages given by the old type of LLC.**

Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.

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A CASE STUDY CONTINUED:

Editor's Comment: This case illustrates the importance of using a qualified business valuator. The valuator in this situation saved the taxpayer from paying taxes on $1.5 million. In addition, the case shows how the built-in gains tax can be a concern when converting from a C corporation to an S corporation. Other tax traps and problems can arise when converting from one entity to another, so guidance from The Center's professionals is always advisable.

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3 Most Important Questions a Buyer Can Ask When Buying a Business

Most everyone has heard that the three most important factors in determining the value of real estate are Location, Location, and Location. It is equally true that the three most important factors in valuing an ongoing business are Cash Flow, Cash Flow, and Cash Flow.

So it naturally follows that the most important question a prospective buyer can ask when evaluating a business is: "What it the projected cash flow?"

Many sources talk about the value of a business as a multiple of its cash flow. However, as important as this concept is, there is an alarming lack of consistency about the way cash flow is defined/calculated, so it's extremely important for the prospective buyer to ask two follow up questions. The first is: "How are you defining "cash flow?"

One of the most commonly used measures of cash flow – particularly for owner operated businesses – is Seller Discretionary Cash Flow (SDCF). This is a measure of all the cash that is generated by the business for the benefit of the owner, prior to deducting interest expense and income taxes, but after adding back all of the seller's salary, benefits and perks.

Another commonly used measure, especially for larger, investment-grade businesses is EBITDA, or Earnings Before Interest, Taxes, Depreciation and Amortization. This is similar to SDCF in that the seller's excess compensation, benefits and perks are added back but a deduction is made for the fair market compensation and benefits of a hired manager.

Other measures of cash flow include: EBITDA less Cap Ex, EBIT, Operating Cash Flow (OCF), Free Cash Flow (FCF), and Net Free Cash Flow (NFCF). Depending upon the specific business, some measures of cash flow will be more meaningful than others. Obviously, using the "right" multiple with the "wrong" cash flow can lead to disastrous results.

Even within the profession of business brokers and M&A advisors all of these cash flow measures are not universally understood, and consistently applied. So this leads to the third critical question: "How did you calculate the "cash flow?"

If you know of someone who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation with us, have them contact me at: mertel@legacymandaadvisors.com.

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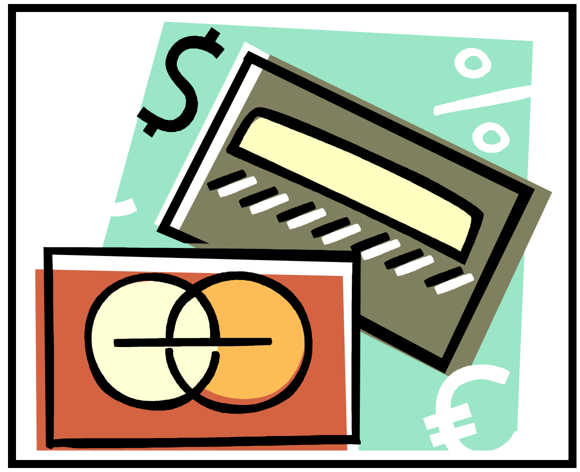

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Frequently Asked Questions…

Q: I have a small business. What is the best way to pass the business on to my family when the time comes?

A: First, there is no one size fits all business succession plan. Service businesses, retail businesses, and wholesale businesses all demand different strategies. Within each type of business, nuances and caveats exist as well. It is best to speak to a competent professional in the area for business succession planning.

Q: I want to invest money into an IRA for 2011, has the opportunity passed?

A: No, individuals have until April 17th this year to make deposits for 2011.

Q: As far as business tax planning for 2012 is concerned, is there anything in particular I should be aware of?

A: There are plenty of new tax laws in place for 2012 and there are many more to be followed as they develop. Among more notable tax changes, Section 179 deductions have been reduced to $139,000. While this is likely to change in some capacity, taxpayer businesses should recognize the large deductions in years past have been reduced for the time being.