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VI. USING SERIES LLCs FOR REAL ESTATE

A. What is a Series LLC? Advantages and Disadvantages

A series limited liability company, or Series LLC, is a form of limited liability company that provides liability protection across multiple series “units” or “cells.” The idea is to protect each cell or series unit from being subjected to liabilities arising from the activities of other cells or units in the series. The primary advantage of a series LLC theoretically is that this form of ownership might reduce the costs and administrative burdens associated with creating a separate LLC for each parcel of property owned. This same cost advantage may be used to separate out the liability of different business functions associated with the overall operation. Each unit or cell within the series can own distinct assets, incur separate liabilities, and have different managers or members. The Series LLC may be used as a tool for real estate investors or property management companies with multiple properties.

The Series LLC initially was introduced in the mutual fund industry to avoid the need for multiple SEC filings for difference classes of funds. The idea was to allow one entity to file for all the funds under one umbrella SEC filing, and thus permit the individual funds to be managed separately. The pro-business state of Delaware adopted the first Series LLC law in 1996. Other states soon followed. Missouri adopted its Series

LLC law in 2013. See, §347.186.¹ By one recent count, nineteen states plus the District of Columbia and Puerto Rico now allow for some form of Series LLC.

Under Missouri's version of the Series LLC Act, an operating agreement for a "Master LLC" may establish or provide for the establishment of a designated series of members, managers, or limited liability company interests with separate rights, powers and duties. See, §347.186.1. To the extent permitted in the Master operating agreement, any such series may have a separate business purpose or investment objective. *Id.* And each unit or cell in the series may, in its own name, contract, hold title to assets, grant security interests, sue and be sued or otherwise exercise the powers of any other limited liability company. §347.186.2(4). Yet it remains unclear under the law if each series is considered to be a separate entity for some purposes but not others.

Missouri does not impose separate filing fees associated with units or cells in the same series. The articles of organization for each separate series of the LLC authorized under §347.186 must comply with each of the general requirements for the articles of organization of an LLC under §347.039. See, §347.039.2. Mechanically, this means that the members must file a traditional set of articles of organization for the Master LLC and then file as an attachment a Form LLC-1A for each unit or cell within the series. But the Secretary of State does not impose a new filing fee for each Form LLC 1A. Instead, the filing fee of \$105 for the Master LLC also will cover all the attachments.²

By the same token, each separate member of a series authorized to operate under §347.186 for a foreign limited liability company must produce the same general information imposed on all foreign limited liability companies under §347.153. But just like with a Missouri Series LLC, a foreign limited liability company with a Master LLC

¹ All statutory references to the Missouri Series LLC Act are to RSMo (Cum. Supp. 2013).

² See, Schedule of Fees and Charges published by Missouri Secretary of State on its website at www.sos.mo.gov.

may file as an attachment a Form LLC-4 for each unit or cell within the series. And the Missouri Secretary of State does not impose a new filing fee for each Form LLC-4. The same filing fee of \$105 will apply as it would for any foreign limited liability company seeking to register to do business in Missouri. So, for both domestic and foreign LLCs operating with separate series cells or units, Missouri does significantly reduce the fees for state filing requirements.

Because the Series LLC is a new kind of entity, the Missouri lawyer can look to no controlling body of case law on the subject. The Series LLC thus creates its own unique sets of risks:

- Bankruptcy: It is unclear if a separate series cell or unit may file its own separate bankruptcy petition under federal bankruptcy law. This risk raises important questions for investors if the financial aspects of the transaction should deteriorate.
- Real Estate: HUD does not recognize Series LLCs. And some title companies may be hesitant to issue a title policy for a Series LLC that owns property in a state that does not recognize Series LLCs. Another question is whether the Series LLC can be used as a device to move assets around without incurring transfer taxes, reassessment, or other consequences of a transfer to a third party. It remains uncertain if regulatory authorities will permit the use of the Series LLC for such creative purposes.
- Secured Transactions under Article 9 of the UCC: Although Missouri explicitly allows cells or units in a series to grant security interests, the identity of the debtor in such a transaction may be uncertain. This is an area where the question of whether the series is a separate legal entity under Missouri law could become important. If the series is not considered a separate entity from the Master LLC, the lender is put in a quandary over what constitutes an effective financing statement. The lender may insist on listing the Master LLC as the debtor on its UCC-1, instead of the individual series unit or cell.

- Tax Treatment of Series LLCs: A new Treasury Regulation treats each individual series within a Master LLC as a separate tax entity for federal income tax purposes regardless of whether or not the unit or cell is treated as a separate entity under state law.³ This rule creates some measure of certainty and appears to allow each series to be treated separately for tax purposes as a disregarded entity, a partnership, or a corporation.⁴ But the tax law is still evolving in this area, so the Series LLC may face some unanswered questions over consolidated tax returns, federal employment tax liability, the entity status of the Master LLC and the Series LLC as a whole, as well as liability for sales and use taxes.

With all the risks associated with the Series LLC, an open question is whether the benefits outweigh the risks beyond the continued advantages for SEC filing in the mutual fund industry. Missouri does offer significant savings in filings costs. And Missouri provides explicit benefits in protecting the units or cells from liability for other units or cells within the same series. Yet this explicit protection may be lost if the cell or unit operates in another state that does not contain the same Series LLC protection. And because of the multiple uncertainties as the law evolves, investors may prefer the safer but perhaps more expensive course of creating separate LLCs to perform the same functions. Those who are interested in exploring a Series LLC in Missouri should consult with experienced legal counsel and a tax advisor and give careful consideration to the potential risks.

B. Compartmentalization Strategies

The Missouri version of the Series LLC Act protects the units or cells from the liability of other units or cells in the series or of the Master LLC. In other words, the debts, liabilities, and obligations incurred, contracted for, or otherwise existing for a particular series “shall be enforceable against the assets of that series only, and not

³ 26 C.F.R. §301.7701-1 (2014).

⁴ See, Private Letter Ruling 200803004 (Jan. 18, 2008).

against the assets of the limited liability company generally or any series thereof.” See, §347.186.2(1). Yet this liability protection under the statute presumes that each unit or cell in the Series LLC has been properly compartmentalized. Commentators have offered opinions on how to minimize the chances of one series being held liable for the liability of the entity as a whole or another unit or cell within the series. Because the law is so new in this area, no recognized body of case law offers guidance on whether these kinds of strategies will be successful. Subject to that important caveat, here are few common strategies to consider:

- Maintain separate bank accounts for each unit or cell in the series.
- Sign all contracts, deeds, notes, and other legal documents solely in the name of the unit or cell in the series. For example, sign the contract, deed, or note as “X, LLC, Y Series only.”
- Make sure that any separate loans between different units or cells and the Master LLC are properly documented.
- Conduct any transactions between different units or cells in an arms length manner. So, for example, it is important to use fair market value analysis supported by proper appraisals.
- Keep all the assets and operations of each unit or cell separate from the others. Each asset of the Master LLC should be owned by only one unit or cell in the series. Avoid naming two or more units or cells as co-owners of the same property.
- Make sure that each unit or cell is adequately capitalized. This strategy is designed to avoid attempts by creditors or other third parties to pierce the veil of series ownership.

C. Identifying Managers, Members and Cells

As a general proposition, the operating agreement for the “Master LLC” may establish or provide for the establishment of a designated series of members, managers,

or limited liability company interests with separate rights, powers and duties. See, §347.186.1. To the extent permitted in the Master operating agreement, any such series may have a separate business purpose or investment objective. *Id.* With that in mind, the operating agreement may draw the following types of distinctions in identifying managers, member and cells or units within a series:

- The agreement may provide for classes or groups of members or managers associated with a series, giving such members or managers relative rights, powers and duties as the operating agreement may provide. The agreement may make provision for the future creation of additional classes or groups or series as might be justified as circumstances change. And the operating agreement may provide that the rights, powers and duties of some members or classes are superior to or subordinate to others within the same series. See, §347.186.5(1).
- Under the agreement, each particular unit or cell within the series may be managed by certain identified member or members, or by the manager or managers who may be selected by the members within that series. Unless otherwise provided in the operating agreement, each series unit or cell presumptively will be managed by the members associated with that series. See, §347.186.5(2).
- The agreement may grant to all or certain identified members or managers, or to a specified group or class of members or managers, the right to vote separately or with all or any class or group of members associated with that series. The operating agreement theoretically could provide that any member or class of group associated with a particular series will have no voting rights or ability to participate in the management of the series. Yet such nonvoting members or classes or groups may still have ownership rights. §347.186.5(3).
- The agreement may specify conditions under which the manager of a series will cease to be a manager. But unless otherwise, specified, this removal of a manager may not necessarily cause the manager to cease to be a member of the Master LLC. §347.186.5(5).

- Unless otherwise provided in the agreement, any event that causes a member to cease to be a member of one series does not necessarily cause the member to cease to be a member of the Master LLC or any other series. §347.186.5(6).
- Similar to any ordinary LLC, the operating agreement may impose restrictions, duties and obligations on members or any series thereof in matters of internal governance. So for example, the agreement may make provisions for capital contributions, restrictions on transfers, restrictive covenants on noncompetition, non-solicitation, or confidentiality, fiduciary duties, rights of first refusal or buy-sell obligations. §347.186.5(7).

D. Handling Multiple Investors/Partners

The structural options allowed under a Master LLC operating agreement demonstrate the potential complexities for multiple investors. Will there be different groups of classes applicable to some units or cells, but not others? Will some investors have voting and management rights, but not others? Will some members or groups of members have rights superior to or subordinate to others in the same series? How will the individual units in the series be taxed? Are the organizers structuring the LLC as a series as a means of awarding equity participation to those managing more profitable units or cells? From a practical standpoint, when multiple investors are involved in the formation of the Series LLC, the investors must have separate counsel to protect their respective interests. And each lawyer must have sufficient skill to navigate the uncertainties inherent in this new form of Series LLC ownership. The lawyer should not undertake this kind of project without experience and appreciation for the risks. This article is not designed to answer all these questions. But hopefully it will serve as a warning to multiple investors of the risks they undertake before the rules of the Series LLCs are more firmly established.

E. Profit/Loss Distributions

The use of the more traditional limited liability company boomed when the IRS allowed the newly created entity to be taxed as a partnership and not as a corporation.⁵ And the LLC movement expanded again when the IRS issued its treasury regulation to allow small business owners operating as an LLC to “check the box” and decide for themselves how they wished to be taxed.⁶ By contrast, the Series LLC continues to be plagued by tax and legal uncertainties. These inherent uncertainties have slowed the progression toward this new novel form of business ownership. As noted earlier, a new Treasury Regulation is adding a measure of certainty by treating each individual series within a Master LLC as a separate tax entity for federal income tax purpose regardless of whether or not the unit or cell is treated as a separate entity under state law. This rule allows each series to be treated separately for tax purposes as a disregarded entity, a partnership, or a corporation.⁷ Yet the Series LLC still faces unanswered questions over consolidated tax returns, federal employment tax liability, the entity status of the Master LLC and the Series LLC as a whole, as well as liability for sales and use taxes. With all the unresolved tax implications, the investors in any Series LLC must consult with a competent tax advisor in deciding how to treat profit or loss distributions.

F. Dispute Resolution

Because of the potential for conflicts, the members or managers of any Series LLC should consider including mediation or arbitration provisions in the Master operating agreement. And the scope of the mediation or arbitration must be broad enough to cover potential disputes within any series or over the general operation of the Master LLC. The organizers must address in the agreement whether the dispute resolution procedures in

⁵ In 1988, the IRS issued a Revenue Ruling declaring that a Wyoming LLC could be taxed as a partnership. (Rev. Rul. 88-76, 1988-2 C.B. 360.)

⁶ Treas. Reg. 301.7701-1-3. The final “check the box” regulation became effective January 1, 1997. (61 Fed. Reg. 66584 Dec. 18, 1996).

⁷ See, 26 C.F.R. §301.7701-1 (2014). See also, Private Letter Ruling 200803004 (Jan. 18, 2008).

one series may exclude the members or managers of the Master LLC, or those members or managers of the other units or cells. The danger is that a dispute within one series may draw unaffected parties into the conflict.

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347.186 Designated series of members, managers, or limited liability interests permitted — requirements.

347.186. Designated series of members, managers, or limited liability interests permitted — requirements. — 1. An operating agreement may establish or provide for the establishment of a designated series of members, managers, or limited liability company interests having separate rights, powers, or duties with respect to specified property or obligations of the limited liability company or profits and losses associated with specified property or obligations. To the extent provided in the operating agreement, any such series may have a separate business purpose or investment objective.

2. (1) Notwithstanding any other provisions of law to the contrary, the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof. Such particular series shall be deemed to have possession, custody, and control only of the books, records, information, and documentation related to such series and not of the books, records, information, and documentation related to the limited liability company as a whole or any other series thereof if all of the following apply:

- (a) The operating agreement creates one or more series;
- (b) Separate and distinct records are maintained for or on behalf of any such series;
- (c) The assets associated with any such series, whether held directly or indirectly, including through a nominee or otherwise, are accounted for separately from the other assets of the limited liability company or of any other series;
- (d) The operating agreement provides for the limitations on liabilities of a series described in this subdivision;
- (e) Notice of the limitation on liabilities of a series described in this subdivision is included in the limited liability company's articles of organization; and
- (f) The limited liability company has filed articles of organization that separately identify each series which is to have limited liability under this section.

(2) With respect to a particular series, unless otherwise provided in the operating agreement, none of the debts, liabilities, obligations, and expenses incurred, contracted for or otherwise existing with respect to a limited liability company generally, or any other series thereof, shall be enforceable against the assets of such series, subject to the provisions of subdivision (1) of this subsection.

(3) Compliance with paragraphs (e) and (f) of subdivision (1) of this subsection shall constitute notice of such limitation of liability of a series.

(4) A series with limited liability shall be treated as a separate entity to the extent set forth in the articles of organization. Each series with limited liability may, in its own name, contract, hold title to assets, grant security interests, sue and be sued, and otherwise conduct business and exercise the powers of a limited liability company under this chapter. The limited liability company and any of its series may elect to consolidate its operations as a single taxpayer to the extent permitted under applicable law, elect to work cooperatively, elect to contract jointly, or elect to be treated as a single business for the purposes of qualification or authorization to do business in this or any other state. Such elections shall not affect the limitation of liability set forth in this section except to the extent that the series have specifically accepted joint liability by contract.

3. Except in the case of a foreign limited liability company that has adopted a name that is not the name under which it is registered in its jurisdiction of organization, as permitted under sections 347.153 and 347.157, the name of the series with limited liability is required to contain the entire name of the limited liability company and be distinguishable from the names of the other series set forth in the articles of organization. In the case of a foreign limited liability company that has adopted a name that is not the name under which it is registered in its jurisdiction of organization, as permitted under sections 347.153 and 347.157, the name of the series with limited liability must contain the entire name under which the foreign limited liability company has been admitted to transact business in this state.

4. (1) (a) Upon filing of articles of organization setting forth the name of each series with limited liability, in compliance with section 347.037 or amendments under section 347.041, the series' existence shall begin.

(b) Each copy of the articles of organization stamped "Filed" and marked with the filing date shall be conclusive evidence that all required conditions have been met and that the series has been or shall be legally organized and formed under this section and is notice for all purposes of all other facts required to be set forth therein.

(c) The name of a series with limited liability under this section may be changed by filing articles of amendment with the secretary of state pursuant to section 347.041, identifying the series whose name is being changed and the new name of such series. If not the same as the limited liability company, the names of the members of a member-managed series or of the managers of a manager-managed series may be changed by an amendment to the articles of organization with the secretary of state.

(d) A series with limited liability under this section may be dissolved by filing with the secretary of state articles of amendment pursuant to section 347.041 identifying the series being dissolved or by the dissolution of the limited liability company as provided in section 347.045. Except to the extent otherwise provided in the operating agreement, a series may be dissolved and its affairs wound up without causing the dissolution of the limited liability company. The dissolution of a series established in accordance with subsection 2 of this section shall not affect the limitation on liabilities of such series provided by subsection 2 of

this section. A series is terminated and its affairs shall be wound up upon the dissolution of the limited liability company under section 347.045.

(e) Articles of organization, amendment, or termination described under this subdivision may be executed by the limited liability company or any manager, person, or entity designated in the operating agreement for the limited liability company.

(2) If different from the limited liability company, the articles of organization shall list the names of the members for each series if the series is member-managed or the names of the managers if the series is manager-managed.

(3) A series of a limited liability company shall be deemed to be in good standing as long as the limited liability company is in good standing.

(4) The registered agent and registered office for the limited liability company appointed under section 347.033 shall serve as the agent and office for service of process for each series in this state.

5. (1) An operating agreement may provide for classes or groups of members or managers associated with a series having such relative rights, powers, and duties as an operating agreement may provide and may make provision for the future creation of additional classes or groups of members or managers associated with the series having such relative rights, powers, and duties as may from time to time be established, including rights, powers, and duties senior and subordinate to or different from existing classes and groups of members or managers associated with the series.

(2) A series may be managed either by the member or members associated with the series or by the manager or managers chosen by the members of such series, as provided in the operating agreement. Unless otherwise provided in an operating agreement, the management of a series shall be vested in the members associated with such series.

(3) An operating agreement may grant to all or certain identified members or managers, or to a specified class or group of the members or managers associated with a series, the right to vote separately or with all or any class or group of the members or managers associated with the series, on any matter. An operating agreement may provide that any member or class or group of members associated with a series shall have no voting rights or ability to otherwise participate in the management or governance of such series, but any such member or class or group of members are owners of the series.

(4) Except as modified in this section, the provisions of this chapter which are generally applicable to limited liability companies and their managers, members, and transferees shall be applicable to each particular series with respect to the operation of such series.

(5) Except as otherwise provided in an operating agreement, any event specified in this chapter or in an operating agreement that causes a manager to cease to be a manager with

respect to a series shall not, in itself, cause such manager to cease to be a manager of the limited liability company or with respect to any other series thereof.

(6) Except as otherwise provided in an operating agreement, any event specified in this chapter or in an operating agreement that causes a member to cease to be associated with a series shall not, in itself, cause such member to cease to be associated with any other series, terminate the continued membership of a member in the limited liability company, or cause the termination of the series, regardless of whether such member was the last remaining member associated with such series.

(7) An operating agreement may impose restrictions, duties, and obligations on members of the limited liability company or any series thereof as a matter of internal governance, including, without limitation, those with regard to:

(a) Choice of law, forum selection, or consent to personal jurisdiction;

(b) Capital contributions;

(c) Restrictions on, or terms and conditions of, the transfer of membership interests;

(d) Restrictive covenants, including noncompetition, nonsolicitation, and confidentiality provisions;

(e) Fiduciary duties; and

(f) Restrictions, duties, or obligations to or for the benefit of the limited liability company, other series thereof, or their affiliates.

6. (1) If a limited liability company with the ability to establish series does not register to do business in a foreign jurisdiction for itself and its series, a series of a limited liability company may itself register to do business as a limited liability company in the foreign jurisdiction in accordance with the laws of the foreign jurisdiction.

(2) If a foreign limited liability company, as permitted in the jurisdiction of its organization, has established a series having separate rights, powers, or duties and has limited the liabilities of such series so that the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series are enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof, or so that the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the limited liability company generally or any other series thereof are not enforceable against the assets of such series, then the limited liability company, on behalf of itself or any of its series, or any of its series on its own behalf may register to do business in this state in accordance with this chapter. The limitation of liability shall also be stated on the application for registration. As required under section 347.153, the registration application filed shall identify each series being registered to do business in the state by the limited liability company. Unless otherwise

provided in the operating agreement, the debts, liabilities, and obligations incurred, contracted for, or otherwise existing with respect to a particular series of such a foreign limited liability company shall be enforceable against the assets of such series only and not against the assets of the foreign limited liability company generally or any other series thereof, and none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to such a foreign limited liability company generally or any other series thereof shall be enforceable against the assets of such series.

7. Nothing in sections 347.039, 347.153, or 347.186 shall be construed to alter existing Missouri statute or common law providing any cause of action for fraudulent conveyance, including but not limited to chapter 428, or any relief available under existing law that permits a challenge to limited liability.

(L. 2013 H.B. 510)

*Words "subparagraphs (e) and (f) of paragraph (1) of subdivision 1" appear in original rolls.