ARTICLE

TAXATION OF SERIES LLCS IN TEXAS: BIGGER ISN'T ALWAYS BETTER IN THE LONE STAR STATE

ALYSON OUTENREATH*

* Assistant Professor of Law, Texas Tech University School of Law.

I. INTRODUCTION

"Everything really is bigger in Texas."[1] For example, Texas is the largest state in the contiguous United States and is comprised of 268,596 square miles.[2] As reported in the 2010 U.S. Census, Texas is the second most-populated state.[3] Texas is also a leading oil producer and has the biggest state capitol building.[4] Furthermore, those who remember the hit television show *Dallas* know that Texas is well known for big hairstyles, big cowboy boots, and big pickups.[5]

In the tax world, this "everything-is-bigger-in-Texas" motto can equally be applied to Texas's policy of taxing series limited liability companies

1. Jesse Greenspan, *9 Things You May Not Know About Texas*, HISTORY.COM (Mar. 1, 2013), http://www.history.com/news/9-things-you-may-not-know-about-texas.

2. *Id.*; *see also* Lib. of Congress, *Explore the States: Texas*, AMERICA'S STORY, http://www.americaslibrary.gov/es/tx/es_tx_subj.html (last visited Nov. 18, 2013) (identifying Texas as the second largest U.S. state by area).

3. Jesse Greenspan, *9 Things You May Not Know About Texas*, HISTORY.COM (Mar. 1, 2013), http://www.history.com/news/9-things-you-may-not-know-about-texas; *see Texas—State Facts for Students*, U.S. CENSUS BUREAU, www.census.gov/schools/facts/texas.html (last visited Nov. 21, 2013) (providing statistical information about Texas).

4. Jesse Greenspan, *9 Things You May Not Know About Texas*, HISTORY.COM (Mar. 1, 2013), http://www.history.com/news/9-things-you-may-not-know-about-texas; *see also Five States Accounted for About 56% of Total U.S. Crude Oil Production in 2011*, U.S. ENERGY INFO. ADMIN. (Mar. 14, 2012), http://www.eia.gov/todayinenergy/detail.cfm?id=5390.

5. Leslie Minora, *Big Hair, Big Boots, Big D. This Is Reality?*, DALL. OBSERVER (Nov. 10, 2011), http://www.dallasobserver.com/2011-11-10/news/big-hair-big-boots-big-d-this-is-reality.

(LLCs).[6] Texas's policy concerning the taxation of series LLCs was announced by the Texas Comptroller of Public Accounts (comptroller) in Comptroller Private Letter Ruling 201005184L (May 5, 2010),[7] in which the comptroller concluded that all series of a series LLC should be aggregated and treated as a single taxable entity for Texas franchise tax purposes.[8] That is to say, the comptroller took the viewpoint that taxing the "bigger" series LLC is better than taxing each individual series separately. The comptroller's policy of aggregating a series LLC into a single taxable entity for Texas franchise tax purposes illustrates that bigger is not always better.[9]

The question addressed in this Article is whether the comptroller's policy concerning the taxation of series LLCs is correct or sound tax policy.[10] This author believes the answer is no because the comptroller's policy does not have statutory support[11] and creates constitutional and procedural issues.[12] The comptroller's policy also treats similarly situated taxpayers differently,[13] and it likely will not significantly lessen

6. *See Franchise Tax Frequently Asked Questions*, TEX. COMPTROLLER OF PUB. ACCTS., http://www.window.state.tx.us/taxinfo/franchise/faq_tax_ent.html#tax_ent19 (last visited Nov. 18, 2013) (noting that series LLCs are treated as a single large entity); *see also* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (interpreting the Texas Tax Code to state that a series LLC is a single taxable entity, and it should submit a franchise tax report on behalf of every series).

7. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html.

8. *Id.*

9. *See generally id.* (instituting a policy of taxing the larger series LLC instead of each series individually).

10. This article does not address all issues surrounding series LLCs. Rather, the focus of this article is the Texas franchise tax treatment of series LLCs.

11. *See* TEX. TAX CODE ANN. § 171.0002(a) (West Supp. 2013) (failing to expressly list the series LLC as a taxable entity).

12. *Compare* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (allowing a state to levy a tax against an entity only if that particular entity's activity has a substantial nexus with the state), *with Franchise Tax Frequently Asked Questions*, TEX. COMPTROLLER OF PUB. ACCTS., http://www.window.state.tx.us/taxinfo/franchise/faq_tax_ent.html#tax_ent19 (last visited Nov. 18, 2013) (authorizing the taxation of a series lacking nexus with Texas because a fellow series has nexus).

13. Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 9, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 ("The most significant con to treating a series LLC as a single entity is that it would result in the inconsistent treatment of series LLCs and combined groups. These two business structures are very similar[,] but treating a series LLC as a single entity for franchise tax purposes would result in significantly different tax consequences.").

administrative burdens for either the comptroller or taxpayers.[14] Furthermore, the comptroller's policy is at odds with the position adopted by other states and the policy applied for federal income tax purposes.[15]

II. WHAT ARE SERIES LLCS?

The entity known as the series limited liability company (series LLC) was first introduced by Delaware in 1996.[16] Although it is not entirely clear, most authorities believe Delaware created the series LLC due to: (1) commercial and manufacturing enterprises rejecting the use of statutory trusts after the Delaware Business Trust Act "promised more than it delivered,"[17] and (2) the popularity of series-type entities outside the United States.[18] At least ten states and Puerto Rico have series LLC statutes.[19]

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14. *Id.* at 8 (opining that the burden on taxpayers to file separate franchise tax forms will be minimized because they already must file separate tax forms for federal income tax purposes).

15. Bruce P. Ely et al., *Survey of States Regarding Their Intent to Conform to the Classification of Series LLCs for Federal Income Tax Purposes*, *in* THE A.L.I.–C.L.E.; PARTNERSHIPS, LLCS, AND LLPS 415, 418 (Feb. 7–8, 2013) ("Texas is the sole outlier, indicating that for purposes of its margin tax, Texas will not follow the Proposed Series LLC Regulations and will treat all series as one taxpayer.").

16. DEL. CODE ANN. tit. 6, § 18-215 (Supp. 2012); *see also* R. Brent Clifton, *Series LLCs*, STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 1 (acknowledging Delaware as the first state to create a series LLC in 1996); Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, BUS. L. TODAY, July–Aug. 2008, at 33, 33 (crediting Delaware as the first state to pass a provision allowing for series LLCs); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 504 (2011) ("In 1996, Delaware—the consistent forerunner in innovative business law—became the first state to promulgate series LLC legislation." (footnote omitted)).

17. Tamar Frankel, *The Delaware Business Trust Act Failure as the New Corporate Law*, 23 CARDOZO L. REV. 325, 346 (2001); *see* James 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, 854 (2011) ("After the commercial and manufacturing enterprises snubbed Delaware's invitation to utilize the statutory trust organization, Delaware incorporated the series concept into its LLC and limited partnership statutes." (footnotes omitted)); Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (recognizing that the series LLC concept evolved from Delaware's previous use of business trusts as vehicles for asset securitization); *see also* R. Brent Clifton, *Series LLCs*, STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 1 ("The series LLC concept arose out of the use of statutory business trusts for asset securitization and investment companies." (footnote omitted)).

18. Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, BUS. L. TODAY, July–Aug. 2008, at 33, 33 ("The [series LLC] concept was derived from the offshore mutual fund and captive insurance industries, which have used segregated portfolio companies and protected cell companies established in locations such as the Cayman Islands, the British Virgin Islands, Bermuda, Belize, Guernsey, and Mauritius."); *accord* Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 504 (2011) (tracing the potential origin of the

A series LLC allows a traditional limited liability company (LLC) to separate into an unlimited number of multiple parts or "cells" with the establishment of one or more series of members, membership interests, managers, or assets—each a "series."[20] The series LLC may or may not own its own assets, and it is oftentimes referred to as nothing more than a "wrapper" (hereinafter "wrapper LLC").[21] Generally, each separate series

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series LLC to practices used by offshore companies located in places such as the British Virgin Islands, Belize, and the Cayman Islands); *see* Sandra Mertens, Comment, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 297 (2009) ("Series LLCs developed from the offshore mutual fund industry in places such as the territory of the Cayman Islands." (footnote omitted)).

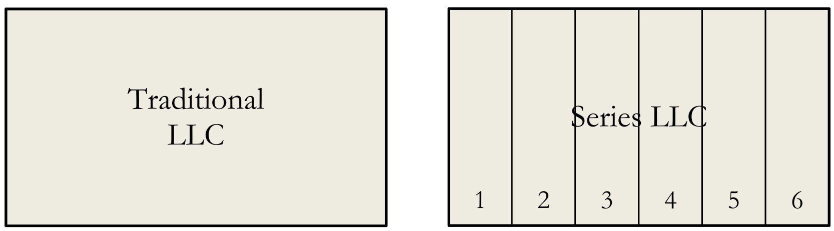
19. DEL. CODE ANN. tit. 6, § 18-215 (Supp. 2012); 805 ILL. COMP. STAT. 180/37-40 (Supp. 2013); IOWA CODE § 489.1201 (2013); KAN. STAT. ANN. §§ 17-76,143 (Supp. 2012); MONT. CODE ANN. § 35-8-102 (2013); NEV. REV. STAT. § 86.286 (2009); OKLA. STAT. tit. 18, § 2054.4 (2012); TENN. CODE ANN. § 48-249-309 (2012); TEX. BUS. ORGS. CODE ANN. §§ 101.601–.604, .606–.608, .610–.621 (West 2012), §§ 101.605, .609, .622 (West Supp. 2013); UTAH CODE ANN. § 48-2c-606 (LexisNexis 2010); P.R. LAWS ANN. tit. 14, § 3967 (2010). Some other states allow the formation of series of ownership interests, but do not provide a liability shield between the various series. *See, e.g.*, WIS. STAT. § 183.0504 (2013) (establishing the ability of a limited liability company to create separate series for the purpose of differences relating to "profits, losses, distributions, voting, property, or other incidents").

20. *See, e.g.*, TEX. BUS. ORGS. § 101.601 (West 2012) ("A company agreement may . . . establish . . . one or more designated series of members, managers, membership interests, or assets . . . .").

21. *See* Deborah Swann, *Weekly Round-Up: A Closer Look at How States Will Treat Series LLC Employment Taxes*, BLOOMBERG BNA (May 17, 2013), http://www.bna.com/weekly-roundup-closer-b17179874060/ ("Characterizing the overarching Series LLC as 'a wrapper of sorts,' Leigh Griffith, tax partner at Waller Lansden Dortch & Davis LLP, in Nashville, Tennessee, observed that 'the Series LLC may or may not have an economic interest in the series organized beneath it,' and it 'may conduct a wholly different business or no business at all.'"). Instead of a "wrapper," some refer to the series LLC as an "umbrella," "parent," "master LLC," "mothership," or "vault." *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (referring to the larger LLC in a series LLC as an "Umbrella LLC"); Adrienne Randle Bond & Allen Sparkman, *The Series LLC: A New Planning Tool*, 45 TEX. J. BUS. L. 57, 59 (2012) ("In the case of a Series LLC, only the Mothership is formed under the [Texas Business Organizations Code], and the individual Series are formed pursuant to the LLC Agreement of the Mothership, which also governs their internal affairs."); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 226–27 (2009) (describing the overarching LLC as a "parent" LLC); *see also* Wendell Gingerich, Note, *Series LLCs: The Problem of the Chicken and the Egg*, 4 ENTREPRENEURIAL BUS. L.J. 185, 185 (2009) ("Acting essentially as an umbrella corporation, the series LLC allows a company to place a series of properties or operations with separate business purposes or investment objectives in one entity."); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 503 (2011) (portraying the larger LLC as a "master" LLC capable of compartmentalizing operations within different series); Sandra Mertens, Comment, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 274 (2009) ("[In the series LLC context], Parent refers to the LLC which files its articles of organization with a state creating one or more series. Unlike the corporate paradigm, the Parent LLC may own part, all, or none of each of its series.").

of the wrapper LLC: (i) owns its own assets and has its own liabilities; (ii) can have different members, managers, and types of membership interests; (iii) has the ability to sue and be sued; (iv) can have its own business purpose; (v) has the ability to contract in its own name; and (vi) can grant a security interest in its own name.[22] Additionally, the debts, liabilities, losses, obligations, and expenses of one series generally will not be enforceable against another series' assets or the assets of the wrapper LLC.[23] Effectively, each series looks and acts like a traditional LLC.[24] The illustration below shows a comparison between the traditional LLC structure and a series LLC:

Illustration 1



In the series LLC above, each of the six series could have distinct business purposes or investment objectives.[25] Furthermore, each series

22. *See, e.g.*, Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) ("In spite of the fact that they are contained within a single Umbrella LLC, each Subunit behaves like a separate LLC. A Subunit may have its own assets, its own liabilities and its own owners, which need not resemble the assets, liabilities or ownership of the Umbrella LLC. A Subunit can, just like a Traditional LLC, enter into contracts in its own name, sue or be sued, and hold title to assets in its own name. And, just like a Traditional LLC, each Subunit within a Series LLC is shielded from the liabilities of the other Subunits.").

23. *See* BUS. ORGS. § 101.602(a)(2) ("[N]one of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the limited liability company generally or any other series shall be enforceable against the assets of a particular series."). *But see id.* § 101.602(b) ("Subsection (a) applies only if: (1) the records maintained for that particular series account for the assets associated with that series separately from the other assets of the company or any other series; (2) the company agreement contains a statement to the effect of the limitations provided in Subsection (a); and (3) the company's certificate of formation contains a notice of the limitations provided in Subsection (a).").

24. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (illustrating that typical series LLC statutes allow an unlimited number of individual series, each of which act almost exactly like an independent LLC).

25. *See* BUS. ORGS. § 101.601(a)(2) (allowing an LLC to create separate series to fulfill different business or investment objectives); *see also* Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 1, *available at* http://

could own different assets.[26] Additionally, each series could have different members, different combinations of the same members, different managers, and different types of membership interests—membership interests offering a preferred return, capital interests, or profits interests.[27] Perhaps most importantly, each series has liability protection against the liabilities of any other series and the wrapper LLC.[28] As Illustration 1 shows, a series LLC is effectively a mechanism that allows owners to have a multiple-entity structure within a single entity.[29] That is to say, a series LLC mirrors in a single entity what would result had multiple entities been formed.[30]

There are two benefits most often cited for using series LLCs.[31] The first is cost savings related to organizational filing fees.[32] Illustration 2

www.texastaxsection.org/LinkClick.aspx?fileticket= DAQpiFpKwlQ%3d&tabid=80 ("Each series may have a separate business purpose or investment objective. For example, LLC X, with members A and B, could form series LLC X-1 in which A and B share profits 60/40 from activity 1 and form series LLC X-2 in which A and B share profits 30/70 from activity 2.").

26. *See* BUS. ORGS. § 101.603 ("Assets associated with a series may be held directly or indirectly, including being held in the name of the series, in the name of the limited liability company through a nominee, or otherwise.").

27. *See id.* § 101.601 ("A company agreement may establish or provide for the establishment of one or more designated series of members, managers, membership interests, or assets . . . .").

28. *See id.* § 101.602 (establishing that each series of a series LLC, including the parent LLC, will not be held liable for the debts, obligations, expenses, or contracts of any other series). There is still a potential liability issue if a series LLC formed in a state that has a series LLC statute operates in a state that does not have a series LLC statute.

29. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (comparing formation of a series LLC with creation of multiple LLCs); Bradley T. Borden & Mathews Vattamala, *Series LLCs in Real Estate Transactions*, 46 REAL PROP. TR. & EST. L.J. 255, 256 (2011) (acknowledging the similarities between a series LLC and a group of affiliated LLCs where a single master LLC controls interests in multiple subsidiary LLCs).

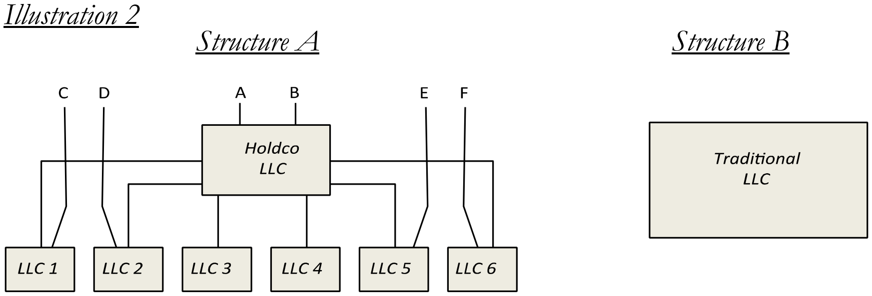
30. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (determining a series LLC is, in effect, a way to avoid creating multiple LLCs in order to segregate assets and liabilities); Bradley T. Borden & Mathews Vattamala, *Series LLCs in Real Estate Transactions*, 46 REAL PROP. TR. & EST. L.J. 255, 256 (2011) ("The structure of a Series LLC replicates that of an affiliated group of LLCs in which a master LLC owns interests in several subsidiary LLCs.").

31. *See* Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 2, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 (describing some potential benefits of series LLCs).

32. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 11–12 (2012) ("[T]he Series LLC is a useful simplification, a way to ease the burden and cost of creating layers of numerous entities . . . . Ideally, the Series LLC looks like a cheaper, easier way to structure a business."); Bradley T. Borden & Mathews Vattamala, *Series LLCs in Real Estate Transactions*, 46 REAL PROP. TR. & EST. L.J. 255, 257 (2011) (attributing the principle reason for establishing a series LLC to its ability to lower the cost of creating limited liability

below highlights the cost savings. In Structure A, where multiple traditional LLCs are used, organizational fees in Texas would total $2,100.[33] By comparison, in Structure B, where a series LLC is used, organizational fees would total only $300.[34]

Illustration 2



Additionally, a series LLC can result in further cost savings if applicable law allows a single securities filing or other regulatory or administrative filing in the name of the wrapper LLC rather than multiple filings in the name of each series.[35] Some also believe that a series LLC can result in

entities); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009) ("Most obvious of the advantages presented by the series LLC is the savings the business may recognize in state filing fees (other than Illinois, which requires a separate filing and payment of an associated fee upon the establishment of each series)."); Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 2, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 ("One of the principal benefits offered by series LLCs is administrative convenience and cost savings."); *see also* William Gingerich, Note, *Series LLCs: The Problem of the Chicken and the Egg*, 4 ENTREPRENEURIAL BUS. L.J. 185, 198 (2009) (pointing out that in situations involving multiple series, the filing savings could become relatively large); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 519 (2011) ("This flexibility to form one business organization with segregated liabilities should also necessarily reap the complimentary benefit of reduced costs."). However, the potential for additional operational costs throughout the life of the series LLC could offset savings at the front end. *See, e.g.*, Sandra Mertens, Comment, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 284–87 (2009) (outlining the potential situations that would negate the series LLC cost-saving function). Increased costs could result, for example, from having to maintain separate accounts and records for internal liability protection purposes. *See, e.g.*, *id.* at 286–87 (spotlighting the potential costly measures that face series LLCs as compared to traditional LLCs, such as out-of-state registration fees, higher attorney fees' rates, and higher administrative costs).

33. *See Business Filings & Trademarks Fee Schedule*, TEX. SECRETARY ST. 1, *available at* http://www.sos.state.tx.us/corp/forms/806_boc.pdf (charging $300 for each of the seven LLCs created for a total of $2,100).

34. *See id.* (costing only $300 for the creation of a single series LLC).

35. *See, e.g.*, Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 3, *available at* http://www.texastaxsection.org/

reduced legal fees related to document preparation as compared to structures utilizing multiple traditional LLCs.[36]

In addition to potential cost savings, Illustration 2 above also highlights a second benefit of series LLCs—a cleaner structure. Anyone who has reviewed the structure chart of a business is familiar with seeing multiple entities, and in today's world, it can oftentimes seem as if the aggregate operations of a business comprise a countless number of entities.[37] The use of series LLCs can help businesses avoid messy and sometimes incomprehensible structures. For example, in Illustration 2 above, Structure B is more streamlined and cleaner than Structure A.

Practitioners and academics have cited other potential benefits to series LLCs, including using series LLCs as "blocker entities" in investment fund structures.[38] A comprehensive discussion of all potential benefits is beyond the scope of this article.

With respect to practical uses, series LLCs have been cited as a viable entity choice for investment companies where different series are used to segregate asset pools.[39] Many believe series LLCs are a viable entity

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LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 (indicating that there may be cost savings if the series LLC is able to limit securities filings, but noting that this "approach is not without risk").

36. *See, e.g.*, Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 & 231 n.3 (2009) (noting a series LLC "may save in legal costs attributable to document preparation and other start-up activities if only a single LLC operating agreement is required[,]" but also noting that any potential cost savings may be lessened due to each series having to provide "for its own allocations, distributions, management provisions (including those relating to fiduciary duties, exculpation, and indemnities), and member access to information[; thus] . . . the potential savings on document drafting may not be that great, unless each series expressly adopts uniform provisions applicable to all series of an LLC").

37. Alyson Outenreath, *"Uncharitable" Policy For Charities: Use of Disregarded LLCs By I.R.C. § 501(c)(3) Organization is Tray for the Unwary in Certain States*, 55 S. TEX. L. REV. (forthcoming 2013).

38. *See, e.g.*, Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 2, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 ("Series LLCs can also be used in the investment fund business when a blocker entity is needed for investments by foreign or tax-exempt investors . . . . [The series LLC] structure may provide a better alternative than setting up a single 'blocker' with multiple investments because [the series LLC] structure provides investors with the opportunity to dispose of only one underlying investment at a time rather than just disposing of their investment in the single corporate 'blocker.'").

39. *See* Sandra Mertens, Comment, *Series Limited Liability Companies: A Possible Solution to Multiple LLCs*, 84 CHI.-KENT L. REV. 271, 290 (2009) (hypothesizing that an investment bank could save costs by creating a single series LLC with individual series for each of its various funds instead of creating multiple LLCs); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 1 (postulating the traditional use of a series LLC as a means of separating the investments of an investment company); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009)

choice in the real estate industry where a real estate development company can form a different series for the acquisition of separate pieces of property.[40] A series LLC can also be used in the oil and gas industry, where an oil company might use different series to create liability shields between multiple oil fields.[41] Generally, a series LLC is a potential entity choice for any business where it is desirable to separate assets or business lines into separate entities.[42] Other cited uses of series LLCs include

("The unique structure of the series LLC is particularly well suited for certain types of businesses. The most common use of the series LLC is for mutual funds. The series LLC format allows for the parent LLC to file a single registration under the Investment Company Act of 1940, and then establish separate funds using the various underlying series.").

40. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 18 (2012) (opining that a series LLC would be useful in a situation where an entity owns multiple real estate projects); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009) ("Another potential use for the series LLC is in the context of a real estate management or development business that will operate various properties or development projects and may wish to segregate ownership rights and liabilities among the various projects."); Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (suggesting that the series LLC might be used in real estate); Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 2, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 (asserting that series LLCs may provide industries that use separate entities for each asset or business line, including real estate investors, with significant cost savings); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010 , at 1, 1 ("[S]eries LLCs have become popular, or useful, in the real estate development business where a large real estate development company organized as an LLC uses a series for the acquisition of each new development property rather than creating a separate LLC or partnership for each such acquisition." (footnote omitted)); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 522 (2011) ("The most touted and perhaps ideal situation is to employ a series LLC for real estate development as a more efficient and cost-effective method for protecting low-risk properties (e.g., residential real estate) from high-risk properties (e.g., commercial parcels with environmental problems)." (footnote omitted)).

41. *See, e.g.*, Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (suggesting that series LLCs might be used to create liability shields between multiple oil fields).

42. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 18 (2012) ("Anytime there is a business that either has a number of assets or operations and wants to limit liabilities to each particular asset or operations, it is important to consider whether a Series LLC would be appropriate to use and whether it could accomplish the same goals with more ease."); Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 385, 395 (2007) ("Any time a business owner has a business with a variety of assets, operations, or where there are multiple owners who may have different stakes in different parts of the enterprise, a series LLC might make sense."); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009) ("The series LLC may also be a useful tool for businesses with multiple assets under different ownership, such as a taxi cab or mobile home business. In each of these scenarios, the ability to provide for diversity of ownership,

where businesses engage in operations involving certain licensing or regulatory approvals, in certain estate planning situations, and in transfer tax structuring scenarios.[43]

Despite the oft-cited benefits and practical uses of series LLCs, they have not yet become widely popular.[44] For example, based on estimates by the Texas Secretary of State, between 652 and 869 out of 86,947 (or 0.75% to 1%) of new LLC filings in 2011 were series LLCs.[45] Additionally, the Secretary of State estimated that between September 1, 2009—the effective date of the Texas series LLC legislation—and May 15, 2010, fewer than 2,574 out of 62,826 (or 4%) of new LLCs formed in Texas were series LLCs, and the number might be as low as 1%.[46]

Many practitioners believe the non-use of series LLCs is due to unanswered questions that remain with respect to their application,[47] as

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segregation of liability, and streamlined administration, combine to make the series LLC seem like an ideal business entity.").

43. *See* Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009) ("Licensed or regulated businesses may be able to use the series LLC to operate separate businesses under a single license or regulatory approval."); Kim Szarzynski & Troy Christensen, *Federal Taxation of Series Limited Liability Companies*, TEX. TAX LAW., Winter 2011, at 1, 2, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=DAQpiFpKwlQ%3d&tabid=80 (asserting that "[s]ome have also suggested that series LLCs can be used to avoid state transfer taxes," but further noting that utilizing a series LLC for such purpose may be risky); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 524 (2011) (recognizing estate planners' use of series LLCs as an easier means of passing separate assets to different beneficiaries).

44. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 12 (2012) ("But several problems and questions surround Series LLCs that have, in the 16 years since the enactment of the Delaware statute, kept them out of mainstream use."); Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, BUS. L. TODAY, July–Aug. 2008, at 33, 33 (noting that in the decade since the first series LLC statute was enacted, they have attracted little attention and much of this attention was negative); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 19 ("In short, the use of series LLCs today outside their historical investment company framework offers far more questions than answers. The next few years should answer the question of whether series LLCs become widely popular in everyday use or remain something of the anomaly they are today.").

45. *See* Lorna Wassdorf, *Secretary of State's Office: A View from the Trenches*, *in* STATE BAR OF TEXAS: ESSENTIALS OF BUSINESS LAW 2013, Mar. 14–15, 2013, *available at* http://www.sos.state.tx.us/corp/forms/boc/essentials-of-business-law-2013.pdf (estimating between 0.75% and 1% of limited liability companies formed in 2011 had the required notice of limitations in their certificate of formations in order to be classified as series LLCs).

46. Lorna Wassdorf, *View from the Secretary of State's Office: Issues, Traps, Developments*, *in* STATE BAR OF TEXAS: ESSENTIALS OF BUSINESS LAW 2011, Apr. 14–15, 2011, http://www.sos.state.tx.us/corp/forms/boc/view-from-sos-2011.pdf.

47. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties*

well as the limited number of states having LLC statutes.[48] Issues creating the most concern include: (i) whether the liability protection granted to a series in its state of organization will be respected in states not having series LLC statutes;[49] (ii) bankruptcy related issues;[50] (iii) veil piercing issues;[51] and (iv) state taxation.[52]

That Remain, 45 TEX. J. BUS. L. 9, 25 (2012) (indicating that, with all the unanswered questions that exist concerning series LLCs, "it is unclear whether, and to what extent, practitioners and their clients will decide that the benefits of Series LLCs are great enough to warrant the risks they entail"); Paul D. Carman et al., *First Steps—Proposed Regulations on Series LLCs Provide Clarity*, 113 J. TAX'N 324, 338 (2010) (warning that due to the unanswered questions existing with regard to series LLCs, "practitioners should be cautious as to the context in which series organizations and series are being used"); Christopher S. McLoon & Margaret C. Callaghan, *The Dangerous Charm of the Series LLC*, 24 ME. B. J. 226, 227 (2009) ("The primary drawback to the series LLC model is that it is new and untested, and is therefore an extremely risky entity choice.").

48. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 15 (2012) (acknowledging the relative newness and lack of recognition by a majority of states as common hazards of series LLCs); Philip D. Weller et al., *Series LLCs*, *in* THE A.L.I.–C.L.E. MODERN REAL ESTATE TRANSACTIONS, July 18–20, 2012, at 777, 781 ("Because [the series LLC] concept is novel, dating back only to 1996, and as only nine jurisdictions have adopted the concept, there is a valid concern that foreign jurisdictions may not give effect to the provisions of the relevant act . . . .").

49. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 12 (2012) (recognizing the lack of hard evidence regarding how states that lack a series LLC statute would treat one formed in a state with a series LLC statute); Paul D. Carman et al., *First Steps—Proposed Regulations on Series LLCs Provide Clarity*, 113 J. TAX'N 324, 338 (2010) ("The authors have heard practitioners say that the liability shield of a series will be effective outside of the state where the series is established. Nevertheless, one of the authors heard comments of a learned commentator—Professor Daniel S. Kleinberger of the William Mitchell College of Law—who explained that the internal affairs doctrine, which many people believe would cause other states to respect the liability shield of series, may not apply."); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 19 (expressing the concern of some real estate developers who utilize series LLCs over how the liability shield within each series will be treated in jurisdictions that lack series LLC statutes).

50. *See, e.g.*, Philip D. Weller et al., *Series LLCs*, *in* THE A.L.I.–C.L.E.: MODERN REAL ESTATE TRANSACTIONS, July 18–20, 2012, at 777, 782 (noting that uncertainty surrounds how Series LLCs "will be treated for the purposes of the Federal Bankruptcy Code"). "The issue is: can a series of a limited liability company file separately for protection under the Bankruptcy Code without involving either the 'parent' limited liability company and some or all of its other series?" *Id.*

51. Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (suggesting Series LLCs' "biggest problem . . . relating to piercing the corporate veil is . . . the uncertainty associated with how Series LLCs will be treated").

52. *See* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 19 ("At present, there appear to be significant obstacles to the use of series across broad ownership bases and varied business activities because of . . . uncertain state tax issues."). *But see* Bruce P. Ely et al., *Survey of States Regarding Their Intent to Conform to the Classification of Series LLCs for Federal Income Tax Purposes*, *in* THE A.L.I.–C.L.E.: PARTNERSHIPS, LLCS, AND LLPS, Feb. 7–8, 2013, at 415, 415 (reporting on a survey sent to state tax administrators

If series LLCs are not being widely used, you might be wondering whether there is any benefit to analyzing issues involving series LLCs. That is to say, why waste time thinking about series LLCs if no one is using them? The answer lies in history repeating itself.[53] For those familiar with the evolution of traditional LLCs, you might remember that up until 1988, only two states had LLC statutes: Wyoming, adopted in 1977, and Florida, adopted in 1982.[54] In fact, in 1975, the Alaska legislature refused to adopt LLC legislation because of unanswered questions as to how such entities would be taxed.[55] After the Internal Revenue Service (IRS) issued Revenue Ruling 88-76 in 1988, addressing how LLCs would be taxed for federal income tax purposes, states started jumping on the LLC bandwagon and began enacting LLC statutes.[56] By 1996, every jurisdiction had enacted LLC legislation.[57] Thereafter, the IRS issued the "Check-the-Box Regulations," which provided more clarity on entity classification for federal income tax purposes and guidance on how single-member LLCs were to be treated.[58] Now, fast-forward seventeen years, and many consider LLCs as the go-to entity choice.[59]

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concerning how their particular state would treat series LLCs for state tax purposes; thus, additional state tax guidance concerning series LLCs might be forthcoming).

53. *See, e.g.*, Paul D. Carman et al., *First Steps—Proposed Regulations on Series LLCs Provide Clarity*, 113 J. TAX'N 324, 338 (2010) ("To quote Yogi Berra, for those of us who were practicing when [the] IRS issued Rev. Rul. 88-76, 1988-2 CB 360, which dealt with the classification of Wyoming LLCs, this is a little like 'déjà vu all over again.'").

54. *See* Carter G. Bishop, *Through the Looking Glass: Status Liability and the Single Member and Series LLC Perspective*, 42 SUFFOLK U. L. REV. 459, 459 (2009) ("Until the release of Revenue Ruling 88-76, only two states adopted limited liability company legislation, Wyoming in 1977 and Florida in 1982.").

55. *See id.* (citing concerns over how a limited liability company would be classified for tax purposes as the reason for Alaska not adopting limited liability company legislation in 1975).

56. *See id.* (explaining the rapid pace of LLC statute adoption by states following Revenue Ruling 88-76).

57. *See id.* (noting that every state adopted LLC statutes within eight years of Revenue Ruling 88-76).

58. *See id.* ("Revenue Ruling 88-76, however, did not resolve whether a single-member limited liability company should be classified as a sole proprietorship or a corporation. That matter was not resolved until 1997 with the release of the check-the-box regulations.").

59. *See generally* DWIGHT DRAKE, BUSINESS PLANNING: CLOSELY HELD ENTERPRISES 51 (Jesse H. Choper et al. eds., 3d ed. 2011) ("Many claim that the LLC is the ultimate entity, arguing that it offers the best advantages of both corporations and partnerships and few of the disadvantages. It's an overstatement, but not by much in some situations. There is no question that the arrival of the LLC has made the choice of entity challenge easier in many cases. Like a corporation, the LLC is an entity organized under state law. And like a corporation, it offers liability protection to all owners, making it possible for its owners to fully participate in the management of the business without subjecting themselves to personal exposure for the liabilities of the business.").

This same turn of events could be on the horizon for series LLCs as the law surrounding them continues to evolve. We should not give up on series LLCs yet. There might come a day when series LLCs become preferred business entities like their predecessor, the traditional LLC.

III. HISTORY OF SERIES LLCS IN TEXAS

Texas enacted its series LLC legislation in 2009.[60] The motivation behind the legislation was to ensure Texas would "remain competitive with the business formation concepts of Delaware."[61] The Texas series LLC provisions are located in subchapter M, sections 101.601–101.621, of title 3 of the Texas Business Organizations Code (TBOC).

TBOC section 101.601 is the starting point.[62] TBOC section 101.601(a) provides:

> (a) A company agreement 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 of the limited liability company or profits and losses associated with specified property or obligations; or
>
> (2) has a separate business purpose or investment objective.[63]

With respect to the powers granted to each series, TBOC section 101.605 states that each series "has the power and capacity, in the series' own name, to: (1) sue and be sued; (2) contract; (3) acquire, sell, and hold title to assets . . . ; (4) grant liens and security interests in assets . . . ; (5) exercise any power or privilege as necessary . . . to the . . . attainment . . . of the business, purposes, or activities of the series."[64] Each series also can have its own business purpose that differs from that of other series.[65]

The provisions relating to liability protection are found in TBOC section 101.602.[66] TBOC section 101.602(a) states that "the debts,

60. Act of May 11, 2009, 81st Leg., R.S., ch. 84, § 45, 2009 Tex. Gen. Laws 128, 140–45, 153 (codified at TEX. BUS. ORGS. CODE ANN. §§ 101.601–.621 (West 2012)).

61. Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 513 (2011).

62. *See* TEX. BUS. ORGS. CODE ANN. § 101.601 (West 2012) (allowing for the creation of a series LLC).

63. *Id.* § 101.601(a).

64. *Id.* § 101.605 (West Supp. 2013).

65. *See id.* § 101.601(b) (West 2012) (stating that each series can "carry on any business, purpose, or activity, whether or not for profit").

66. *Id.* § 101.602(a).

liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to a particular series shall be enforceable against the assets of that series only, and shall not be enforceable against the assets of the limited liability company generally or any other series," and "none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the limited liability company generally or any other series shall be enforceable against the assets of a particular series."[67]

This liability shield exists when three requirements are satisfied.[68] The three requirements, as set forth in TBOC section 101.602(b), are: (i) the certificate of formation of the wrapper LLC must contain a "notice provision," which references the liability protection provided for by TBOC section 101.602(a); (ii) the company agreement of the wrapper LLC must contain a statement setting forth the liability protection provided for by TBOC section 101.602(a); and (iii) records must be maintained for each series that "account for the assets associated with that series separately from the other assets of the [wrapper LLC] or any other series."[69]

With respect to member and manager liability protection, TBOC section 101.606(a) states that "a member or manager associated with a series or a member or manager of the company is not liable for a debt, obligation, or liability of a series, including a debt, obligation, or liability under a judgment, decree, or court order."[70]

In order to form a Texas series LLC, the same certificate of formation for a traditional LLC is used, but special series LLC language must be included.[71] Because a distinct filing is not made to form a Texas series LLC, the only way to determine whether an LLC organized in Texas is a series LLC "is to review its certificate of formation or any amendment to its certificate of formation," to determine if the series LLC language is contained therein.[72]

67. *Id.*

68. *Id.* § 101.602(b).

69. *Id.*

70. *Id.* § 101.606(a).

71. *See Formation of Texas Entities FAQs, Series LLCs*, TEX. SECRETARY ST., http://www.sos.state.tx.us/corp/formationfaqs.shtml#LLC (last visited Nov. 19, 2013) (commenting that forming a series LLC requires additional language in the company agreement and certificate of formation).

72. Lorna Wassdorf & Carmen Flores, *Secretary of State's Office: A View from the Trenches*, *in* STATE BAR OF TEXAS: ESSENTIALS OF BUSINESS LAW 2013, Mar. 14–15, 2013, at 1, 5–6, *available at* http://www.sos.state.tx.us/corp/educational-materials.shtml (follow Secretary of State's Office: A View from the Trenches [Presentation at the 2013 Essentials of Business Law MCLE] "Paper" hyperlink).

The TBOC does not address registration of a foreign LLC in Texas—known as foreign qualification. However, the Texas Secretary of State's website gives guidance.[73] The website states, "[a] series LLC formed under the laws of another jurisdiction will be treated as a single legal entity for qualification purposes," and "[t]he LLC itself rather than the individual series should register as the legal entity that is transacting business in Texas."[74]

The TBOC was recently amended to add new section 101.622, which states: "For purposes of this chapter and Title 1, a series has the rights, powers, and duties provided by this subchapter to the series but is not a separate domestic entity or organization."[75]

IV. TEXAS FRANCHISE TAX: OVERVIEW AND RELEVANT PROVISIONS

Part IV provides an overview of the Texas franchise tax and discusses the provisions relevant to series LLCs.

A. *Overview of the Texas Franchise Tax*

Subtitle F, chapter 171 of the Texas Tax Code (Texas Franchise Tax Code or TTC) imposes the Texas franchise tax on "taxable entities" formed in Texas or otherwise doing business in Texas.[76] The purpose of the Texas franchise tax is to charge taxable entities[77] a price for the privilege of doing business in Texas under the protection of a liability shield.[78]

Only entities having nexus with Texas, and which are considered taxable entities under the Texas Franchise Tax Code, are subject to the Texas franchise tax.[79] The nexus requirement is discussed in Part VI. As to the

73. *See Formation of Texas Entities FAQs, Series LLCs*, TEX. SECRETARY ST., http://www.sos.state.tx.us/corp/formationfaqs.shtml#LLC (last visited Nov. 19, 2013) (answering the question of whether one can register an "out-of-state series LLC to transact business in Texas").

74. *See id.* (indicating the requirement of additional language in the company agreement and certificate of formation when forming a series LLC in Texas).

75 BUS. ORGS. § 101.622 (West Supp. 2013).

76. TEX. TAX CODE ANN. § 171.001 (West 2008).

77. *See id.* § 171.0002(a) (West Supp. 2013) (defining taxable entities).

78. *See* TEX. TAX REFORM COMM'N, TAX FAIRNESS: PROPERTY TAX RELIEF FOR TEXANS 18 (2006), *available at* http://govinfo.library.unt.edu/ttrc/files/TTRC_report.pdf ("The original purpose of the franchise tax . . . was to collect a modest levy in return for the tremendous value afforded to businesses that chose to benefit from a state-provided liability shield.").

79. TAX § 171.001(a) (West 2008).

taxable entity requirement, the definition of the term taxable entity is set forth in TTC section 171.0002(a):

> (a) Except as otherwise provided by this section, "taxable entity" means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity. The term includes a combined group. A joint venture does not include joint operating or co-ownership arrangements meeting the requirements of Treasury Regulation [s]ection 1.761-2(a)(3) that elect out of federal partnership treatment as provided by [s]ection 761(a), Internal Revenue Code.[80]

TTC section 171.0002(b) then provides a list of certain entities that are not considered taxable entities. TTC section 171.0002(b) states:

> (b) "Taxable entity" does not include:
> (1) a sole proprietorship;
> (2) a general partnership:
> (A) the direct ownership of which is entirely composed of natural persons; and
> (B) the liability of which is not limited under a statute of this state or another state, including by registration as a limited liability partnership;
> (3) a passive entity as defined by [s]ection 171.0003; or
> (4) an entity that is exempt from taxation under Subchapter B.[81]

TTC section 171.0002(c) then further expands the list of entities not considered taxable entities to include: (i) certain grantor trusts; (ii) certain estates; (iii) escrows; (iv) certain real estate investments trusts (REITs), as defined in IRC section 856, and certain of their qualified REIT subsidiaries, as such are defined in IRC section 856(i)(2); (v) real estate mortgage investment conduits (REMICs), as such are defined in IRC section 860D; and (vi) certain trusts, including nonprofit self-insurance trusts; and (vii) certain unincorporated entities that are organized as political committees.[82]

TTC section 171.0002(d) also contains a special rule concerning entities that are "disregarded entities" for federal income tax purposes.[83] Section 171.0002(d) states:

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80. *Id.* § 171.0002(a) (West Supp. 2013).
81. *Id.* § 171.0002(b).
82. *Id.* § 171.0002(c).
83. *Id.* § 171.0002(d). The term "disregarded entity" means an entity that exists for state law purposes, but is not distinguished from its owner for federal income tax purposes and, therefore, is

> (d) An entity that can file as a sole proprietorship for federal tax purposes is not a sole proprietorship for purposes of [s]ubsection (b)(1) and is not exempt under that subsection if the entity is formed in a manner under the statutes of this state, another state, or a foreign country that limit the liability of the entity.[84]

Based on the foregoing, generally all entities having state law limited liability protection and that are organized in Texas, or otherwise doing business in Texas, are considered taxable entities for Texas franchise tax purposes unless a specific exclusion or exemption applies.[85] Exclusions and exemptions from Texas franchise tax generally exist for certain charitable entities, entities generating substantial amounts of passive income, and certain small businesses.[86]

If an entity is a taxable entity under TTC section 171.0002 and has nexus with Texas, then the Texas franchise tax is imposed on certain gross revenues, which are amounts pulled over from the entity's federal income tax return, minus the highest of four deductions.[87] The resulting amount, referred to in the Texas Franchise Tax Code as "margin," is then apportioned to Texas pursuant to a single factor ratio of Texas gross receipts over gross receipts from everywhere.[88] The resulting apportioned amount, known as "taxable margin," is subject to tax at a default rate of 1%, with lower rates and discounts applying in certain enumerated situations.[89]

The four allowable deductions under the Texas Franchise Tax Code include: (i) cost of goods sold, as defined in TTC section 171.1012, which can only be taken by taxable entities that are in the business of selling tangible personal property;[90] (ii) compensation, as defined in TTC section

considered disregarded—i.e., as if it does not exist—as an entity separate from its owner for federal income tax purposes. *See* Treas. Reg. §§ 301.7701-1(a)(1); -2(a), (b), (c); -3(a), (b), (c) (2012) (explaining that disregarded entities are entities that are not liable for federal tax payments, and laying out which entities are disregarded, such as certain local entities and certain single-owner entities).

84. TAX § 171.0002(d).

85. *See, e.g.*, Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 962 (2007) (noting that while some describe the Texas franchise tax as "applicable to all entities that have limited liability under state law, the list of taxable entities is more specific than, and sometimes inconsistent with, that description" (footnote omitted)).

86. TAX §§ 171.0002(b)(3)–(4), 171.002(d) (West Supp. 2013), § 171.0003 (West 2008).

87. *Id.* §§ 171.101(a)(1), 171.1011(c) (West Supp. 2013).

88. *Id.* §§ 171.101(a)(2), 171.106(a).

89. *Id.* §§ 171.101(a)(1), 171.002. See *id.* § 171.0022 for the 2014 temporary permissive alternate rates and *id.* § 171.0023 for the 2015 temporary permissive alternate rates.

90. *Id.* §§ 171.101(a)(1)(B)(ii)(a)(1), 171.1012.

171.1013;[91] (iii) a set $1 million;[92] (iv) a standard 30% deduction.[93] Taxpayers take the highest of the four deductions and can change their deduction each year.[94] Application of the 30% standard deduction means the Texas franchise tax rate is effectively 0.7%, assuming a taxpayer is subject to the 1% rate.[95]

B. *Combined Group Reporting*

The Texas Franchise Tax Code requires combined group reporting.[96] TTC section 171.1014(a) provides: "Taxable entities that are part of an affiliated group engaged in a unitary business shall file a combined group report in lieu of individual reports based on the combined group's business."[97]

Certain definitions relating to combined group reporting are found in TTC section 171.0001, which specifically states that the term "combined group" refers to "taxable entities that are part of an affiliated group engaged in a unitary business and that are required to file a group report under [s]ection 171.1014."[98] Thus, there are two requirements for

91. *Id.* §§ 171.101(a)(1)(B)(ii)(a)(2), 171.1013.

92. *Id.* § 171.101(a)(1)(A)(ii), (B)(i).

93. *Id.* § 171.101(a)(1)(A)(i). The 30% standard deduction is not specifically set forth in the Texas Franchise Tax Code as a deduction. *See id.* (addressing the 30% deduction indirectly by capping the taxable margin at 70% of total revenue). Instead, it comes from the mathematical computation of total revenue in section 171.101(a)(1)(A)(i). *Id.* Although not enumerated as a deduction, practitioners and courts refer to section 171.101(a)(1)(A)(i) as the 30% standard deduction. *See, e.g.*, *In re* Nestle USA, Inc., 387 S.W.3d 610, 614–15 (Tex. 2012) (orig. proceeding) (explaining that the TTC provides three deduction options for franchise tax purposes, one of which allows taxpayers to subtract 30% from their total revenue); Eric. L. Stein, *Calculating the Compensation Deduction*, *in* U.T.-C.L.E.: 2008 TEX. MARGIN TAX, Dec. 4–5, 2008, at 1, 1 ("Margin is determined by reducing total revenue by either a 30% standard deduction, or by electing a costs of goods sold deduction or a compensation deduction.").

94. TAX § 171.101(a)(1), (d).

95. For example, if a taxable entity had $15,000,000 in total revenues from its entire business, all of which is apportioned to Texas, and the 30% standard deduction would yield the best tax result, then such taxable entity's taxable margin would be $10,500,000. *See id.* § 171.101(a)(1)(A)(i) (establishing a maximum taxable margin of 70% of total revenue from an entity's entire business). Applying the general 1% rate, the amount of Texas franchise tax due would be $105,000, which is $15,000,000 multiplied by 0.007. *Compare id.* § 171.002(a) (imposing a franchise tax of 1% of an entity's taxable margin), *with id.* § 171.101(a)(1)(A)(i) (limiting an entity's taxable margin to a maximum of 70% of total revenue).

96. *Id.* § 171.1014.

97. *Id.*

98. *Id.* § 171.0001(7).

combined group reporting: (i) the existence of an affiliated group, and (ii) operations comprising a unitary business.

TTC section 171.0001(1) states that the term "affiliated group" refers to "a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or non-corporate, or by one or more of the member entities."[99] The term "controlling interest" has different meanings depending on the type of entity involved.[100] For corporations, the term means "either more than 50 percent, owned directly or indirectly, of the total combined voting power of all classes of stock of the corporation, or more than 50 percent, owned directly or indirectly, of the beneficial ownership interest in the voting stock of the corporation . . . ."[101] For other non-LLC entities, the term controlling interest means "more than 50 percent, owned directly or indirectly, of the capital, profits, or beneficial interest in the partnership, association, trust, or other entity . . . ."[102] For LLCs, the term controlling interest means "either more than 50 percent, owned directly or indirectly, of the total membership interest of the limited liability company or more than 50 percent, owned directly or indirectly, of the beneficial ownership interest in the membership interest of the limited liability company . . . ."[103]

With respect to the unitary requirement, TTC section 171.0001(17) states that the term "unitary business" refers to:

> [A] single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.[104]

TTC section 171.0001(17) further provides that "[i]n determining whether a unitary business exists, . . . any relevant factor" can be considered, and the following are relevant factors:

> (A) the activities of the group members are in the same general line, such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation, or finance;
> (B) the activities of the group members are steps in a vertically structured

99. *Id.* § 171.0001(1).
100. *Id.* § 171.0001(8).
101. *Id.* § 171.0001(8)(A).
102. *Id.* § 171.0001(8)(B).
103. *Id.* § 171.0001(8)(C).
104. *Id.* § 171.0001(17).

> enterprise or process, such as the steps involved in the production of natural resources, including exploration, mining, refining, and marketing; or
> (C) the members are functionally integrated through the exercise of strong centralized management, such as authority over purchasing, financing, product line, personnel, and marketing.[105]

If a combined group exists, then all taxable entities comprising the combined group are aggregated and considered a single taxable entity under the Texas franchise tax.[106] Aggregation into a single taxable entity has several implications. For example, the combined group must make a single deduction election for the whole group, even though group members might individually benefit from a different deduction election.[107] Additionally, the exemption from Texas franchise tax for certain small businesses is determined on an aggregate combined group basis rather than on a separate entity basis.[108]

When a combined group exists, special computation rules relating to the calculation of total revenue and the deduction amount for the combined group come into play.[109] With respect to the total revenue, such an amount is computed by:

> (1) determining the total revenue of each of its members as provided by [s]ection 171.1011 as if the member were an individual taxable entity;
> (2) adding the total revenues of the members determined under [s]ubdivision (1) together; and
> (3) subtracting, to the extent included under [s]ection 171.1011(c)(1)(A), (c)(2)(A), or (c)(3), items of total revenue received from a member of the combined group.[110]

If the combined group elects to take the cost of goods sold deduction, such an amount is computed by:

> (1) determining the cost of goods sold for each of its members as provided by [s]ection 171.1012 as if the member were an individual taxable entity;
> (2) adding the amounts of cost of goods sold determined under [s]ubdivision (1) together; and

105. *Id.* § 171.0001(17).
106. *Id.* § 171.1014(b).
107. *Id.* § 171.1014(d).
108. *See id.* § 171.1014(b) (discussing the small business exemption in terms of calculation in the aggregate for total revenue).
109. *See id.* § 171.1014(c), (d) (listing the factors for calculation of revenue and the rules regarding deduction for a combined group). Effective January 1, 2014, a combined group may also elect to take a set one-million dollar subtraction from total revenue. *Id.* § 171.1014(d).
110. *Id.* § 171.1014(c).

> (3) subtracting from the amount determined under [s]ubdivision (2) any cost of goods sold amounts paid from one member of the combined group to another member of the combined group, but only to the extent the corresponding item of total revenue was subtracted under [s]ubsection (c)(3).[111]

If the combined group elects to take the compensation deduction, such an amount is computed by:

> (1) determining the compensation for each of its members as provided by [s]ection 171.1013 as if each member were an individual taxable entity, subject to the limitation prescribed by [s]ection 171.1013(c);
> (2) adding the amounts of compensation determined under [s]ubdivision (1) together; and
> (3) subtracting from the amount determined under [s]ubdivision (2) any compensation amounts paid from one member of the combined group to another member of the combined group, but only to the extent the corresponding item of total revenue was subtracted under [s]ubsection (c)(3).[112]

Another special rule that applies to combined groups is joint and several liability. The Texas Franchise Tax Code imposes joint and several liability on all combined group members with respect to Texas franchise tax owed by the entire group.[113]

C. *Apportionment*

Texas has a single factor apportionment formula.[114] It is set forth in TTC section 171.106(a), which states:

> [A] taxable entity's margin is apportioned to this state to determine the amount of tax imposed under [s]ection 171.002 by multiplying the margin by a fraction, the numerator of which is the taxable entity's gross receipts from business done in this state, as determined under [s]ection 171.103, and the denominator of which is the taxable entity's gross receipts from its entire business, as determined under [s]ection 171.105.[115]

111. *Id.* § 171.1014(e).
112. *Id.* § 171.1014(f).
113. *See id.* § 171.1014(i) ("Each member of the combined group shall be jointly and severally liable for the tax of the combined group.").
114. *Id.* § 171.106.
115. *Id.* § 171.106(a).

TTC section 171.103(a) addresses how to compute the numerator of the apportionment formula.[116] Pursuant to TTC section 171.103(a), the numerator is the sum of the taxable entity's receipts from:

> (1) each sale of tangible personal property if the property is delivered or shipped to a buyer in this state regardless of the FOB point or another condition of the sale;
> (2) each service performed in this state, except that receipts derived from servicing loans secured by real property are in this state if the real property is located in this state;
> (3) each rental of property situated in this state;
> (4) the use of a patent, copyright, trademark, franchise, or license in this state;
> (5) each sale of real property located in this state, including royalties from oil, gas or other mineral interests; and
> (6) other business done in this state.[117]

If a combined group exists, a special rule applies for computing the numerator of the apportionment formula.[118] This special rule is found in TTC section 171.103(b), which states that "[a] combined group shall include in its gross receipts computed under [s]ubsection (a) the gross receipts of each taxable entity that is a member of the combined group and that has a nexus with this state for the purpose of taxation."[119] This type of combined group apportionment rule is commonly known as the "*Joyce* rule," so named after the 1966 decision of the California State Board of Equalization in *In re Joyce, Inc.*[120]

With respect to the denominator of the Texas franchise tax apportionment formula, TTC section 171.105 states that such is comprised of the sum of the receipts from: "(1) each sale of the taxable entity's tangible personal property; (2) each service, rental, or royalty; and (3) other business."[121] For a combined group, unlike with the numerator, the

116. *Id.* § 171.103(a) (West 2008).

117. *Id.*

118. *Id.* § 171.103(b).

119. *Id.*

120. *In re* Joyce, Inc., No. 66-SBE-070 (Cal. State Bd. of Equalization, Nov. 23, 1966), *available at* http://www.boe.ca.gov/legal/pdf/66-sbe-070.pdf; *see, e.g.*, Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 986 (2007) (reiterating Texas's adoption of the *Joyce* rule for groups that report on a combined group basis).

121. TAX § 171.105(a).

denominator is computed without regard to the nexus of combined group members.[122]

Certain items are excluded from the apportionment formula.[123] For example, items that are excluded from total revenue are likewise excluded from the apportionment formula.[124] A special exclusion provision also applies to combined groups.[125] For example, amounts excluded from total revenue, because such amounts are derived from transactions between combined group members, are generally excluded from the apportionment formula.[126]

Comptroller Rule 3.591 provides additional guidance on the application of the apportionment formula.[127] Most importantly, subsection (e) of Comptroller Rule 3.591 sets forth rules on the classification of specific items as either Texas gross receipts—to be included in the numerator of the Texas franchise tax apportionment formula—or gross receipts from everywhere else—to be included in the denominator of the Texas franchise tax apportionment formula.[128]

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122. *Id.* § 171.105(c). Specifically, TTC section 171.105(c) states: "A combined group shall include in [the denominator of the apportionment formula] . . . the gross receipts of each taxable entity that is a member of the combined group, without regard to whether that entity has nexus with this state for the purpose of taxation." *Id.*

123. *See id.* § 171.1055 (providing an exclusion from the margin apportionment formula for items excluded from total revenue calculations).

124. *Id.*

125. *See id.* § 171.1014(c)(3) (West Supp. 2013) (citing that "items of total revenue received from a member of the combined group" will be excluded from the apportionment formula).

126. *Id.* § 171.1055(b), (c) (West 2008); *see also id.* § 171.1014(c)(3) (West Supp. 2013) (subtracting "items of total revenue received from a member of the combined group" from calculations for the group's total revenue).

127. 34 TEX. ADMIN. CODE § 3.591 (2013) (Comptroller of Pub. Accounts, Tax Administration). Comptroller Rules are promulgated by the comptroller and provide official interpretations and guidance on the Texas franchise tax. *See* TAX § 111.002 (West 2008) ("The comptroller may adopt rules that do not conflict with the laws of this state or the constitution of this state or the United States for the enforcement of the provisions of this title and the collection of taxes and other revenues under this title. In addition to the discretion to adopt, repeal, or amend such rules permitted under the constitution and laws of this state and under the common law, the comptroller may adopt, repeal, or amend such rules to reflect changes in the power of this state to collect taxes and enforce the provisions of this title due to changes in the constitution or laws of the United States and judicial interpretations thereof."); *see also* TEX. GOV'T CODE ANN. § 2001.003(6) (West 2008) (providing that a Comptroller Rule is a generally applicable statement that "implements, interprets, or prescribes law or policy; or . . . [it] describes the procedure or practice requirements" of the comptroller and further "includes the amendment or repeal of a prior rule").

128. 34 ADMIN. § 3.591.

V. TAXATION OF SERIES LLCS AT THE FEDERAL LEVEL

The following section (A) discusses how entities are classified for federal income tax purposes under what is commonly known as the "Check-the-Box Regulations." Section (B) examines proposed regulations that address the classification and tax treatment of series LLCs for federal income tax purposes. The federal tax treatment of series LLCs sets the stage for examining the Texas tax treatment, which is discussed in Part VI.

A. *Entity Classification Under the Check-the-Box Regulations*

Pursuant to the amendment of Treasury Regulation sections 301.7701-1, -2, and -3 (Check-the-Box Regulations), which became effective January 1, 1997, there is now a mechanical system for classifying entities for federal income tax purposes.[129] The Check-the-Box Regulations can be briefly summarized as follows:

1. *Corporations*. A domestic incorporated entity is classified as an association taxable as a corporation for federal income tax purposes.[130] Consequently, these entities are taxed under Subchapter C of the Internal Revenue Code (IRC) at applicable corporate level rates.[131]

2. *Multi-Owner Noncorporate Entities*. A domestic noncorporate entity with two or more owners is classified as a partnership for federal income tax purposes.[132] Consequently, these entities are taxed under Subchapter K of the IRC.[133] For example, the default federal tax classification of an LLC with multiple owners is a partnership.[134] If a partnership does not desire its default classification, then the entity can elect to be classified as a

129. *See* T.D. 8697, 1997-1 C.B. 215, 216 (updating IRS federal income tax regulations in order to "classify certain business organizations under an elective regime"). *See generally* Treas. Reg. §§ 301.7701-1 to -3 (2012) (supplying the current language of the Check-the-Box Regulations). The entity classification regulations are commonly called the Check-the-Box Regulations because certain entities can literally "check a box" on IRS Form 8832 to change what would otherwise be their default tax classification. *See* William J. Rowe, Note, *Right Without Reason? The Check-The-Box Corporate or Partnership Election Regulations Correctly Held Valid:* Littriello v. United States, 59 TAX LAW. 913, 914 (2006) ("These regulations are referred to as the check-the-box regulations because a taxpayer literally checks a box on Form 8832 to indicate whether to tax its domestic unincorporated business entity as a corporation or a partnership.").

130. Treas. Reg. § 301.7701-2(a), (b) (2012).

131. I.R.C. § 11(a) (2006); Treas. Reg. § 301.7701-2(a), (b) (2012).

132. Treas. Reg. § 301.7701-3(a), (b) (2012).

133. I.R.C. § 701(a) (2006); Treas. Reg. §§ 301.7701-3(a), (b) (2012).

134. Treas. Reg. § 301.7701-3(a), (b) (2012).

corporation for federal income tax purposes by timely filing an election with the IRS on Form 8832, Entity Classification Election.[135]

3. *Single-Owner Noncorporate Entities*. A domestic unincorporated entity with a single owner, such as a wholly-owned LLC, is classified as a disregarded entity for federal income tax purposes.[136] If an entity is classified as a disregarded entity, then the operations, assets, and liabilities of such entity are treated as existing, for federal income tax purposes, at the level of the sole owner.[137] Consequently, for federal income tax purposes, a disregarded entity is treated as a sole proprietorship (if the sole owner is an individual) or a division of the owner (if the sole owner is not an individual).[138] Like entities classified by default as partnerships, if a disregarded entity desires to change its default tax classification, then the entity can elect to be classified as a corporation for federal income tax purposes by timely filing an election with the IRS on Form 8832, Entity Classification Election.[139]

4. *Other Entities*. The Check-the-Box Regulations contain specific rules in section 301.7701-4 of the Treasury Regulations addressing the classification of trusts.[140] Additionally, certain entities—REMICs, REITs—are subject to special treatment.[141] The Check-the-Box Regulations also contain special rules for foreign entities.[142]

Prior to the Check-the-Box Regulations, entity classification for federal income tax purposes was determined under what was commonly known as the "*Kintner* regulations," so named after the Ninth Circuit case of *United States v. Kintner*.[143] It was often more complicated to determine how

135. *Id.* § 301.7701-3(c) (2012).

136. *Id.* § 301.7701-3(a), (b) (2012).

137. *Id.* § 301.7701-2(a) (2012); *see also* I.R.S. Priv. Ltr. Rul. 200339028 (Sept. 26, 2003) ("If the entity is disregarded, its activities are treated in the same manner as those of a division of its owner, and its assets will be treated as those of the owner."); I.R.S. Priv. Ltr. Rul. 200050028 (Dec. 15, 2000) (stating that with respect to an LLC classified as a disregarded entity for federal income tax purposes, "the owner of the LLC is treated as owning the LLC's assets directly").

138. *See* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 19 (2012) (noting that "unless a Subunit specifically elects to check the box and treat itself as a corporation, a Subunit with one owner will be treated as a disregarded entity for tax purposes"); Bradley T. Borden & Mathews Vattamala, *Series LLCs in Real Estate Transactions*, 46 REAL PROP. TR. & EST. L.J. 255, 270 (2011) (addressing tax ramifications of a disregarded entity).

139. Treas. Reg. § 301.7701-3(c) (2012).

140. *Id.* § 301.7701-4(a) (2012).

141. I.R.C. § 860D(b) (2006); Treas. Reg. § 301.7701-3(c)(v)(B) (2012).

142. Treas. Reg. §§ 301.7701-2(d), -3(d), -5(a) (2012).

143. *See* United States v. Kintner, 216 F.2d 418, 421–24 (9th Cir. 1954) (laying the foundation for entity classification, and the subsequent Check-the-Box Regulations, by proposing that "[t]he first

noncorporate entities would be classified and taxed for federal income tax purposes under the *Kintner* regulations.[144]

B. *Proposed Regulations and the Taxation of Series LLCs for Federal Income Tax Purposes*

On September 14, 2010, the IRS and the United States Department of Treasury issued proposed regulations addressing the federal income tax treatment of domestic series LLCs (Proposed Regulations).[145]

As an initial matter, for federal income tax purposes, the Proposed Regulations treat each series of a series LLC "as an entity formed under local law."[146] After making this determination, the Proposed Regulations logically conclude that each series is to be classified independently under the Check-the-Box Regulations.[147] Consequently, for federal income tax purposes, each series of the series LLC is classified as either a corporation, partnership, or disregarded entity.[148] The IRS previously reached this same conclusion in Private Letter Ruling 200803004.[149]

In explaining the rationale for treating each series as a separate entity for federal income tax purposes, the Proposed Regulations discuss the pros and cons of regarding or disregarding series as separate entities.[150] In support of disregarding a series as an independent entity, the Proposed Regulations note that "series are not generally considered entities for local law purposes," and no current statute grants series "all of the attributes of independence" typically possessed by other local law entities.[151]

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question to determine is whether the Association is to be treated as a corporation for tax purposes"). After the Ninth Circuit decision in *Kintner*, the IRS issued the "*Kintner* regulations." T.D. 6503, 1960-2 C.B. 409; *see* Louis J. Andrew, Jr., Comment, *Wisconsin Professional Service Corporations Under the New "*Kintner*" Regulations*, 49 MARQ. L. REV. 564, 564 (1966) (tracing the initial proposal and adoption of the *Kintner* regulations).

144. *See generally* Treas. Reg. §§ 301.7701-1 to -11 (1960) (denoting the entity classifications developed after the *Kintner* decision); T.D. 8697, 1997-1 C.B. 215, 216 (stating that the Check-the-Box Regulations replace the *Kintner* regulations "with a much simpler approach").

145. Prop. Treas. Reg. § 301, 75 Fed. Reg. 55,699 (Sept. 14, 2010).

146. *Id.* at 55,702.

147. *Id.*

148. *Id.* at 55,703.

149. *See* I.R.S. Priv. Ltr. Rul. 200803004 (Oct. 15, 2007) (discussing the classification of LLCs as a disregarded entity, a corporation, or a partnership).

150. Prop. Treas. Reg. § 301, 75 Fed. Reg. at 55,703.

151. *Id.* "For example, series generally cannot convert into another type of entity, merge with another entity, or domesticate in another jurisdiction independent of the series organization[, and] . . . the dissolution of a series organization generally will terminate all of its series." *Id.*

Notwithstanding the differences between series and other traditional local law entities, the Proposed Regulations conclude that "the factors supporting separate entity status . . . outweigh the factors in favor of disregarding series as entities separate from the [wrapper LLC] and other series."[152] The Proposed Regulations found that the association of managers and equity holders with individual series and their specifically identified rights, duties, and powers coupled with an individual series' ability to carry out separate business and investment objectives was sufficient to warrant separate entity treatment for series of a series LLC.[153]

The Proposed Regulations only address the classification and tax treatment of each series of a series LLC.[154] The Proposed Regulations do not address the wrapper LLC,[155] how each series "should be treated for [f]ederal employment tax purposes,"[156] and the federal tax treatment of a foreign series LLC, except in the limited circumstance of a foreign series LLC conducting an insurance business.[157]

VI. TAXATION OF SERIES LLCS IN TEXAS

Neither the Texas Franchise Tax Code nor the Comptroller Rules address how series LLCs are to be taxed for Texas franchise tax purposes. However, the comptroller issued guidance in Comptroller Private Letter Ruling 201005184L (Ruling 201005184L).[158]

The question addressed in Ruling 201005184L was whether all series should be aggregated and treated as a single taxable entity for Texas franchise tax purposes or, in contrast, whether each series be treated as a separate taxable entity.[159] In addressing this question, the comptroller identified TTC section 171.0002—which defines the term "taxable

152. *Id.*

153. *Id.* As further support for separate entity treatment, the Proposed Regulations cite the tax status certainty for "domestic series and foreign series that conduct insurance businesses," the consistency with "similar structures using multiple local law entities that can elect their Federal tax classification," and the administrative efficiency compared to the alternative case-by-case evaluation of the relevant statute's terms to determine the tax status of each series. *Id.*

154. *Id.* at 55,699.

155. *Id.* at 55,704.

156. *Id.* at 55,705.

157. *Id.* at 55,702.

158. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html.

159. *Id.*

entity"—as controlling.[160] The comptroller then took a "strict constructionist" approach and observed "Texas Tax Code section 171.0002 defines taxable entities to include a limited liability company; however, a series of an LLC is not separately identified as a taxable entity."[161] Based on this observation, the comptroller ultimately concluded the whole series LLC is a single taxable entity and must, accordingly, submit an individual franchise tax report.[162] The comptroller further disallowed an individual series to "file a franchise tax report separate from the LLC."[163]

After the issuance of Ruling 201005184L, the comptroller's office posted an entry in the "Frequently Asked Questions" section of its website on the subject of series LLCs.[164] The entry, posted on September 9, 2011, states:

> A series LLC is treated as a single legal entity. It pays one filing fee and registers as one entity with the Texas Secretary of State. It files one franchise tax report as a single entity, not as a combined group, under its Texas taxpayer identification number. If one of the series has nexus in Texas, the entire series LLC has nexus in Texas.[165]

Thus, the comptroller and IRS have reached opposite conclusions concerning the taxation of series LLCs for tax purposes—while the Proposed Regulations treat each series as a separate entity for federal income tax purposes, the comptroller aggregates all series and collectively treats them as a single taxable entity for Texas franchise tax purposes.[166] This article next examines whether the comptroller got it right.[167]

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160. *Id. See generally* TEX. TAX CODE ANN. § 171.0002(a) (West Supp. 2013) (providing the definition of "taxable entity").

161. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html; *see* TAX § 171.0002(a) (failing to note an individual series as a unique taxable entity).

162. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html.

163. *Id.*

164. *See Franchise Tax Frequently Asked Questions*, TEX. COMPTROLLER OF PUB. ACCTS., http://www.window.state.tx.us/taxinfo/franchise/faq_tax_ent.html#tax_ent19 (last visited Nov. 19, 2013) (including a question on how a series LLC reports activities for franchise tax purposes).

165. *Id.*

166. *Compare* Prop. Treas. Reg. § 301, 75 Fed. Reg. 55,699, 55,703 (Sept. 14, 2010) (requiring individual series to be classified as separate entities for federal tax purposes), *with* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (mandating that the wrapper LLC file a single tax report on behalf of all of its included series).

167. The author was the lead writer for the State Bar of Texas Tax Section comment project

VII. DID THE TEXAS COMPTROLLER GET IT RIGHT?

The comptroller takes the position that all series of a series LLC are aggregated and taxed collectively as a single taxable entity for Texas franchise tax purposes.[168] In contrast, the comptroller could have determined that each series is a separate taxable entity, a position that would have aligned with how series LLCs are treated for federal income tax purposes and the treatment adopted by other states.[169]

The basis for the comptroller's position is somewhat unclear, but there are two perceived possibilities. First, the comptroller could have reached its conclusion based on the combined group rules.[170] Alternatively, the comptroller could have reached its conclusion based on the theory that a series LLC and all series are, by definition, a single taxable entity under the Texas Franchise Tax Code.[171]

If the comptroller's rationale for its position in Ruling 201005184L was based on the combined group rules, then the comptroller would have first needed to conclude that all series of a series LLC were taxable entities, which were then combined into a single taxable entity based on the control and unitary business requirements of the combined group rules.[172] This does not appear to be the underlying rationale of Ruling 201005184L.

Instead, the comptroller appears to have based its conclusion solely on TTC section 171.0002, the Texas Franchise Tax Code provision providing the definition of "taxable entity."[173] In support of this conclusion, Ruling 201005184L explains that "Texas Tax Code section 171.0002 defines

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submitted to the Texas Legislature on March 30, 2011. *See* Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 3, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (urging the legislature to clarify whether each series of a series LLC should be treated separately or as a single taxable entity for tax purposes).

168. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html.

169. *See* Bruce P. Ely et al, *Survey of States Regarding Their Intent to Conform to the Classification of Series LLCs for Federal Income Tax Purposes*, *in* A.L.I. C.L.E.: PARTNERSHIPS, LLCS, AND LLPS, Feb. 7–8, 2013, at 415, 417–18 (noting Texas as the sole outlier for its aggregate treatment of all series within series LLC).

170. TEX. TAX CODE ANN. § 171.1014(a) (West Supp. 2013).

171. *Id.* § 171.1014(b).

172. *Id.* § 171.1014(a).

173. *See id.* § 171.0002(a) ("Except as otherwise provided by this section, 'taxable entity' means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity.").

taxable entities to include a limited liability company; however, a series of an LLC is not separately identified as a taxable entity."[174] Based on this language, it seems that the comptroller reached its conclusion in Ruling 201005184L solely on the grounds that TTC section 171.0002 does not specifically identify a series of a series LLC as constituting a taxable entity.[175] Additionally, in Ruling 201005184L, the comptroller neither mentions the combined group rules nor addresses whether the series satisfied the control and unitary business requirements of the combined group rules.[176] Thus, it seems more probable that the rationale for the comptroller's decision in Ruling 201005184L was that all series of a series LLC are, by definition, a single taxable entity under TTC section 171.0002. This conclusion is further supported by the comptroller's web posting on series LLCs, which states, in relevant part, that a series LLC "files one franchise tax report . . . as a single entity, not as a combined group, under its Texas taxpayer identification number."[177]

The question addressed in this article is whether the comptroller's decision in Comptroller Ruling 201005184L is correct, sound tax policy. This author believes the answer is no for the reasons discussed below.

A. *Comptroller's Position Is Not Supported Under the "Catch-All" Clause of TTC Section 171.0002*

The comptroller is correct that a series of a series LLC is not specifically identified as a taxable entity in TTC section 171.0002(a).[178] However, the analysis should not stop there because TTC section 171.0002(a) contains a "catch-all" category of entities considered taxable entities for Texas franchise tax purposes, though not specifically identified.[179] At the end of the enumerated list of entities treated as taxable entities, TTC section 171.0002(a) goes on to provide that the term "taxable entity" also includes

174. Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html.

175. *Id.*

176. *Id.*

177. *Franchise Tax Frequently Asked Questions*, TEX. COMPTROLLER OF PUB. ACCTS., http://www.window.state.tx.us/taxinfo/franchise/faq_tax_ent.html#tax_ent19 (last visited Oct. 26, 2013).

178. TAX § 171.0002(a).

179. *See id.* (providing that the taxable entity definition includes numerous specific types of entities as well as "other legal entit[ies]"); *see also* Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 9, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (highlighting the "catch-all" provision included in section 171.0002(a)).

any "other legal entity."[180] Thus, simply because TTC section 171.0002(a) does not specifically enumerate a series of a series LLC as being a taxable entity does not mean a series of a series LLC is not per se a taxable entity for Texas franchise tax purposes.[181] Rather, a series of a series LLC is a taxable entity if it is a "legal entity," as the term "legal entity" is defined for Texas franchise tax purposes.[182]

The question then is whether a series of a series LLC should be classified as a legal entity for Texas franchise tax purposes. Neither the Texas Franchise Tax Code nor the Comptroller Rules provide a definition of the term "legal entity."[183] However, TTC section 171.0001(11–a) provides a definition of "natural person" that is instructive: "'Natural person' means a human being or the estate of a human being. *The term does not include a purely legal entity given recognition as the possessor of rights, privileges, or responsibilities, such as a corporation, limited liability company, partnership, or trust*."[184]

From this definition of natural person, the term "legal entity" for Texas franchise tax purposes appears to mean an entity that is a "possessor of rights, privileges, or responsibilities."[185] Indeed, TBOC section 101.601, which provides for the establishment of a series LLC, indicates that each series possesses its own rights, privileges, or responsibilities.[186] Specifically, TBOC section 101.601(a)(1) provides that each series "has 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."[187] Moreover, each series has,

180. TAX § 171.0002(a).

181. *Compare id.* (allowing for any "other legal entity" to be considered a taxable entity), *with* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (precluding a series of a series LLC from being a taxable entity because it is not specifically mentioned as a taxable entity under Texas Tax Code section 171.0002(a)).

182. TAX § 171.0002(a).

183. *Cf. id.* §§ 171.0001, 0002 (providing definitions for significant terms used in the franchise tax chapter, but failing to provide a definition for "legal entity"); 34 TEX. ADMIN. CODE § 3.581 (2013) (Comptroller of Pub. Accounts, Tax Administration) (failing to define "legal entity," but defining other taxable and nontaxable entities).

184. TAX § 171.0001(11–a) (emphasis added).

185. *Compare id.* § 171.0002(a) (stating that the definition for "taxable entity" includes any "other legal entity"), *with id.* § 171.0001(11–a) (offering substance to the definition of "legal entity" as one "given recognition as the possessor of rights, privileges, or responsibilities").

186. *See* TEX. BUS. ORGS. CODE ANN. § 101.601(a)(1) (West 2012) (granting a series of a series LLC separate rights, powers, and duties).

187. *Id.*

among other powers, the power to own its own assets and to sue and be sued.[188] Each series also has its own individual liability shield.[189] Accordingly, each series of a series LLC should be considered a taxable entity for Texas franchise tax purposes under the "other legal entity" catch-all clause of TTC section 171.0002(a).[190]

Another important element in the analysis is the purpose of the Texas franchise tax. As discussed in Part IV, the purpose of the Texas franchise tax is to impose a levy on an entity in exchange for such entity having liability protection in Texas.[191] With respect to a series LLC, the TBOC specifically grants liability protection to each separate series of a series LLC.[192] TBOC section 101.606(a) further extends liability protection to

188. *See id.* § 101.605 (West Supp. 2013) (enumerating a series' right to, in its own name, "(1) sue and be sued; (2) contract; (3) acquire, sell, and hold title to assets . . . (4) grant liens and security interests . . . ; and (5) exercise any power . . . necessary . . . to the . . . attainment of the . . . activities of the series"); *see also* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (reiterating the individual characteristics each series possesses and the separate actions they can take); Adrienne Randle Bond & Allen Sparkman, *The Series LLC: A New Planning Tool*, 45 TEX. J. BUS. L. 57, 59 (2012) (noting "an individual series of a Texas Series LLC has the power and capacity to, in its own name, contract, hold title to assets . . . and sue and be sued"); Dominick T. Gattuso, *Let's Give the Frog a Little Love*, BUS. LAW TODAY, July–Aug. 2008, at 33, 33 (stating that "unlike an ordinary LLC, a [s]eries LLC has the ability to partition its assets, debts, obligations, liabilities, and rights among distinct series").

189. *See* BUS. ORGS. § 101.602(a)(1) (West 2012) (protecting the one series from the debt, obligations, and liabilities of a fellow series); *see also* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 10 (2012) (stressing that each series is shielded from the obligations of other series); Adrienne Randle Bond & Allen Sparkman, *The Series LLC: A New Planning Tool*, 45 TEX. J. BUS. L. 57, 61 (2012) (discussing means by which a series can take advantage of the internal liability shield provided by a series LLC); Dominick T. Gattuso, *Let's Give the Frog a Little Love*, BUS. LAW TODAY, July–Aug. 2008, at 33, 33 (reiterating that the liabilities of one series are not enforceable against other series).

190. *Compare* TAX § 171.0002(a) (extending "taxable entity" to include other legal entities), *and id.* § 171.0001(11–a) (referring to a legal entity as one "given recognition as the possessor of rights, privileges, or responsibilities"), *with* BUS. ORGS. § 101.601(a)(1) (granting individual series "separate rights, powers, or duties"), *and* Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 3, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (suggesting the "catch-all" provision of Texas Tax Code section 171.0002(a) "could be viewed as support for treating each series as a separate taxable entity" and that "disadvantages of treating a series LLC as a single taxpayer for franchise tax purposes outweigh the advantages of such treatment").

191. *See* TEX. TAX REFORM COMM'N, TAX FAIRNESS: PROPERTY TAX RELIEF FOR TEXANS 18 (2006), *available at* http://govinfo.library.unt.edu/ttrc/files/TTRC_report.pdf (concluding that the initial purpose of the franchise tax was, and still is, to collect a modest return on the significant benefit businesses receive from the liability shield provided by the state).

192. BUS. ORGS. § 101.602(a). Specifically, TBOC section 101.602(a) states:

the members of each series.[193] Because Texas grants liability protection to each separate series of a series LLC, and the purpose of the Texas franchise tax is to impose a tax on each entity with liability protection in Texas, logic dictates that the Texas franchise tax should be imposed separately on each series of a series LLC.[194]

On the other hand, the comptroller could take a counter position and argue that the term "other legal entity" in TTC section 171.0002(a) must mean an entity that is recognized as a separate legal entity for state law purposes, meaning an entity recognized by statute.[195] Certainly until recently, it was questionable under Texas law whether each series of a series LLC is a separate legal entity for state law purposes.[196] However in

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> [T]he debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to a particular series shall be enforceable against the assets of that series only, and shall not be enforceable against the assets of the limited liability company generally or any other series; and . . . none of the debts, liabilities, obligations, and expenses incurred, contracted for, or otherwise existing with respect to the limited liability company generally or any other series shall be enforceable against the assets of a particular series.

Id.

193. *Id.* § 101.606(a). TBOC section 101.606(a) provides:

> Except as and to the extent the company agreement specifically provides otherwise, a member or manager associated with a series or a member or manager of the company is not liable for a debt, obligation, or liability of a series, including a debt, obligation, or liability under a judgment, decree, or court order.

Id.

194. *Compare id.* § 101.602(a)(1) (creating a liability shield between the larger series LLC and individual series, as well as between each individual series), *with* TEX. TAX REFORM COMM'N, TAX FAIRNESS: PROPERTY TAX RELIEF FOR TEXANS 18 (2006), *available at* http://govinfo.library.unt.edu/ttrc/files/TTRC_report.pdf (expressing that the purpose of the franchise tax is to collect a levy in return for a liability shield).

195. TAX § 171.0002(a). Supporting this position would be the issuance of a single Certificate of Formation by the Texas Secretary of State when a series LLC is formed. *See Formation of Texas Entities FAQs, Series LLCs*, TEX. SECRETARY ST., http://www.sos.state.tx.us/corp/formationfaqs.shtml#LLC (last visited Nov. 19, 2013) (outlining the process by which a series LLC is formed and noting that a standard LLC Certificate of Formation, with additional language, is used to form a series LLC).

196. *See* Paul D. Carman et al., *First Steps—Proposed Regulations on Series LLCs Provide Clarity*, 113 J. TAX'N 324, 325 (acknowledging a split of authority as to whether single series LLCs are considered separate legal entities); R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug 26–27, 2010, at 1, 2 (summarizing that series LLCs are less like separate legal entities for state law purposes and more like a division within a corporation); Allan G. Donn et al., *Limited Liability Entities: 2012 Update: Series LLCs*, *in* A.L.I.–C.L.E.: LIMITED LIABILITY ENTITIES: 2012 UPDATE, Apr. 10, 2012, at 123, 134 (showing that Texas state statutes give significant rights to individual series without clarifying whether they are separate legal entities); *see also* Jennifer Avery et al., *Series LLCs: Nuts and Bolts, Benefits and Risks, and the Uncertainties That Remain*, 45 TEX. J. BUS. L. 9, 15 (2012) (concluding that Texas does not treat each series as a separate legal entity

the 83rd Texas legislative session, the Texas Legislature amended the TBOC to add section 101.622, which states: "For purposes of this chapter and Title 1, a series has the rights, powers, and duties provided by this subchapter to the series but is not a separate domestic entity or organization."[197] This new provision appears to clarify that each separate series of a series LLC organized in Texas or otherwise operating in Texas is not to be treated as a separate entity for Texas state law purposes. But even if each series is not a separate legal entity for Texas state law purposes, such a conclusion does not change the conclusion reached above that each series is, in fact, a legal entity for Texas franchise tax purposes.[198]

Significantly, the "catch-all" clause in TTC section 171.0002(a) is expressed as "or *other* legal entity" rather than "or *a* legal entity."[199] Use of the word "other" signifies that all entities deemed taxable entities in the TTC section 171.0002(a) enumerated list—those entities listed prior to the "catch-all" clause—are themselves considered legal entities for Texas franchise tax purposes.[200] This is because of the definition of "other."[201]

for state law purposes based on the comparison of such statutes to those of Illinois, which explicitly does recognize each series as a separate legal entity for state law purposes); Adrienne Randle Bond & Allen Sparkman, *The Series LLC: A New Planning Tool*, 45 TEX. J. BUS. L. 57, 59 (2012) (explaining the rights of each series within a series LLC according to state law); Bernie R. Kray, Comment, *Respecting the Concept and Limited Liability of a Series LLC in Texas*, 42 ST. MARY'S L.J. 501, 526–27 (2011) (noting the uncertainty of whether Texas courts will treat an individual series LLC as a separate legal entity from the series LLC). *But see* Philip D. Weller et al., *Modern Real Estate Transactions: Series LLCs*, *in* THE A.L.I.–C.L.E.: MODERN REAL ESTATE TRANSACTIONS, July 18–20, 2012, at 777, 780–81 ("One consideration in using a Texas Series LLC is the impact of [s]ection 101.609[,] which provides that the entire limited liability company chapter of the TBOC applies to a series and its associated members and managers—this provision would seem to elevate each series of a Texas limited liability company to somewhat of an entity status, which is apparently contrary to the effect of the Delaware Act."); *see also* 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, 321 (2009) (recognizing the uncertainty of whether an individual series LLC rises to the level of being an independent legal entity).

197. BUS. ORGS. § 101.622 (West Supp. 2013); Tex. S.B. 847, 83d Leg., R.S. (2013).

198. *Compare* TAX § 171.0002(a) (including other legal entities in definition of "taxable entity"), *and id.* § 171.0001(11–a) (insinuating that a legal entity is an entity "given recognition as the possessor of rights, privileges, or responsibilities"), *with* BUS. ORGS. § 101.601(a)(1) (permitting each series of a series LLC to have "separate rights, powers, or duties").

199. TAX § 171.0002(a) (emphasis added).

200. *See id.* (listing "a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, [and] holding company" prior to "other legal entity").

201. *See* BLACK'S LAW DICTIONARY 1101 (6th ed. 1990) (providing that when "other" follows an enumerated list, it indicates "other such like").

Black's Law Dictionary defines the term "other" following an enumeration of particular classes to mean "other such like," which must include "only others of like kind and character."[202] Therefore, the implication of "other" in the enumerated list of TTC section 171.0002(a) is that the term "legal entity" must not be restricted to mean separate legal entity for Texas state law purposes, because there are entities included in the enumerated list of TTC section 171.0002(a) that are not separate legal entities for state law purposes.[203] For reference, TTC [s]ection 171.0002(a) states:

> Except as otherwise provided by this section, "taxable entity" means a partnership, limited liability partnership, corporation, banking corporation, savings and loan association, limited liability company, business trust, professional association, business association, joint venture, joint stock company, holding company, or other legal entity.[204]

Notably, a business association may not be a separate legal entity for state law purposes.[205] Furthermore, a business trust may not be a separate legal entity for state law purposes.[206]

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202. *Id.*

203. *See* TAX § 171.0002(a) (allowing entities which may not be separate legal entities under state law in the definition of "taxable entity").

204. *Id.*

205. For example, a business association could exist as an unincorporated nonprofit association that is not governed by a statutory unincorporated nonprofit association act. *See generally* MARILYN E. PHELAN & ROBERT J. DESIDERIO, NONPROFIT ORGANIZATIONS LAW AND POLICY 29-30 (3d ed. 2008) (discussing the varying issues that a business association would face as an unincorporated nonprofit association). A business association that obtains an exemption from the federal income tax under section 501(c)(6) of the Internal Revenue Code can also obtain an exemption from the Texas franchise tax. TAX § 171.063 (West 2008). A for-profit business association, such as a Better Business Bureau, would likely be incorporated.

206. *See* Asalya Akhmerova & William Price, *Should Illinois Have a Statutory Business Trust Act?*, 100 ILL. B.J. 164, 164 (2012) ("A common law business trust arises from a private action. As a result, the trust must transact business, sue, and be sued in the name of the trustee and in the trustee's capacity as such. By contrast, a statutory business trust is an entity, separate from its trustees and beneficial owners, with the capacity to sue and be sued, own property, and transact business in its own name. A statutory business trust is formed by filing a certificate of trust with a public official, typically the Secretary of State."); Wendy S. Goffe, *Oddball Trusts and the Lawyers Who Love Them or Trusts for Politicians and Other Animals*, 45 REAL PROP. TR. & EST. J. 543, 559–60 ("The common law commercial trust, also referred to as a business trust, emerged in the seventeenth century . . . . Generally, a common law business trust is an unincorporated business organization created by an instrument that defines how a trustee must hold and manage property for the benefit and profit of its beneficial owners . . . . At least thirty states have enacted business trust statutes because of the many limitations of the common law business trust and the common-law limitations on fiduciaries." (footnotes omitted)).

Because the term "other" following an enumerated list means "other such like," in order for the term "legal entity" in TTC section 171.0002 to be limited to a legal entity for state law purposes, the enumerated list within that section would need to contain only entities that are considered separate legal entities for state law purposes.[207] As discussed above, TTC section 171.0002 is not drafted in such a way.[208] Alternatively, the "catch-all" phrase in TTC section 171.0002 could have been phrased as "or *a* legal entity" rather than "or *other* legal entity."[209] Use of the word "a" rather than "other" would arguably signify that the term "legal entity" means something distinct and different from the enumerated list.[210] However, the catch-all phrase in TTC section 171.0002 is not phrased in that manner.[211]

Further supporting the conclusion that the term "legal entity" for Texas franchise tax purposes is not limited to entities that are recognized as separate legal entities for state law purposes is the inclusion of general partnerships in the definition of "taxable entity" in certain circumstances.[212]

Based on the foregoing, TTC section 171.0002(a) supports treating each series of a series LLC as a taxable entity for Texas franchise tax purposes, and any argument made by the comptroller that the term "legal entity" for Texas franchise tax purposes should be narrowly construed to include only entities that are separate legal entities for Texas state law purposes should fail.

B. *Comptroller's Policy Creates Constitutional Nexus Concerns*

1. Nexus Requirement: In General

As discussed in Part IV, the Texas franchise tax is imposed on taxable entities that are organized in Texas or otherwise doing business in Texas.[213] This means that a taxable entity must have a sufficient amount

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207. *Compare* BLACK'S LAW DICTIONARY 1101 (6th ed. 1990) (explaining that "other" means "other such like" when following an enumerated list), *with* TAX § 171.0002(a) (providing for "other legal entities," but containing entities that may not be independent legal entities for state law purposes in the definition of "taxable entity").

208. TAX. § 171.0002(a).

209. *Id.* (emphasis added).

210. *Id.*

211. *Id.*

212. *Id.* § 171.0002(b)(2).

213. *Id.* § 171.001 (West 2008).

of contacts with Texas—rising to the level of "doing business"—in order to be subject to the Texas franchise tax.[214] That is, from the State's perspective, there must be jurisdiction to tax.[215] The concept of a state having jurisdiction to tax by way of the taxpayer having a sufficient amount of contacts with such state is oftentimes called "nexus."[216]

The nexus requirement involves Due Process Clause and Commerce Clause concerns under the United States Constitution.[217] Imposition of a tax must satisfy both the Due Process Clause and Commerce Clause before such tax can be imposed.[218]

With respect to the Due Process Clause, the United States Supreme Court has stated "that due process requires some definite link, some minimum connection, between a state and the person, property, or transaction it seeks to tax."[219] The Supreme Court has further summarized the Due Process Clause concept as one of "notice."[220]

Under the Commerce Clause, the imposed tax must satisfy what is known as the *Complete Auto* test, which was articulated by the Supreme Court in *Complete Auto Transit, Inc. v. Brady*.[221] Pursuant to *Complete Auto*, a tax must satisfy a four-prong test in order to avoid a Commerce Clause challenge.[222] The four-prong test requires that a tax: (1) be "applied to an

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214. *Id.*

215. *See generally* WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION 22 (9th ed. 2009) ("A threshold question in analyzing any state or local tax is whether the government imposing the tax has the jurisdiction to do so.").

216. *See generally id.* at 22–102 (analyzing the different ways to create a nexus).

217. *See id.* at 23 ("Yet unlike the question of personal jurisdiction, a state tax jurisdiction generally implicates not only due process concerns but also Commerce Clause concerns."); *see also* U.S. CONST. art. I, § 9, cl. 3 (Commerce Clause); U.S. CONST. amend. XIV, § 1 (Due Process Clause).

218. *See* WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION 22 (9th ed. 2009) (emphasizing the Due Process Clause and the Commerce Clause as legal implications for jurisdictions to tax); John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient in State Presence*, 4 J. MULTISTATE TAX'N 18, 18 (1994) (stating that a taxation system applied to an interstate business must satisfy the Due Process Clause and Commerce Clause); Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 30 (2008) ("Nexus must exist under both the Due Process Clause and Commerce Clause before a state can tax an out-of-state corporation.").

219. Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954); *see also* WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION 22–23 (9th ed. 2009) (explaining that there must be some minimum link between the state and the taxable entity).

220. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 325 (1992) (relating that the Due Process Clause's minimum contacts requirement is simply a proxy for notice); Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (discussing notice as the summarization of due process).

221. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

222. *See id.* (listing four factors to uphold a tax against a Commerce Clause challenge).

activity with a substantial nexus with the taxing State," (2) be "fairly apportioned," (3) "not discriminate against interstate commerce," and (4) be "fairly related to the services provided by the State."[223] The first prong of the *Complete Auto* test, the Commerce Clause nexus requirement, is also commonly called the "substantial nexus" requirement.[224] The substantial nexus requirement under the Commerce Clause is distinguishable from the Due Process Clause's nexus requirement.[225] The Supreme Court has stated that the Commerce Clause's "'substantial-nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce."[226]

Because the two nexus tests focus on different concerns, courts have observed that "a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with the State as required by the Commerce Clause."[227]

For Texas franchise tax purposes, the nexus requirement is statutorily set forth in TTC section 171.001.[228] Specifically, subsection (a) of TTC section 171.001 states that "[a] franchise tax is imposed on each taxable entity that does business in this state or that is chartered or organized in this state."[229] Subsection (b) of TTC section 171.001 further states that the Texas franchise tax "extends to the limits of the United States Constitution and the federal law adopted under the United States Constitution."[230]

Comptroller Rule 3.586 gives additional nexus guidance by providing a non-exhaustive list of specific "nexus-creating activities" that subject a

223. *Id.*; *see Quill Corp.*, 504 U.S. at 313 (reiterating the four prongs of the *Complete Auto* analysis).

224. See Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 31 ("Under the Commerce Clause, a taxpayer is required to have 'substantial nexus' with a state for the state to have taxing jurisdiction over the taxpayer." (footnote omitted)). The three other prongs of the *Complete Auto* test are beyond the scope of this article.

225. *See Quill Corp.*, 504 U.S. at 313 (differentiating between the contact requirements of the Due Process Clause and the nexus requirements of the Commerce Clause).

226. *Id.*

227. *Id.*

228. TEX. TAX CODE ANN. § 171.001 (West 2008).

229. *Id.* § 171.001(a).

230. *Id.* § 171.001(b). Comptroller Rule 3.586, titled "Margin: Nexus," tracks Texas Tax Code section 171.001 by stating that "[a] taxable entity is subject to franchise tax in this state when it has sufficient contacts with this state to be taxed without violating the United States Constitution." 34 TEX. ADMIN. CODE § 3.586(b) (2013) (Comptroller of Pub. Accounts, Tax Administration).

taxable entity to the Texas franchise tax.[231] This non-exhaustive list includes the following:

(1) Engaging in advertising activities in Texas;[232]
(2) Consigning goods in Texas;[233]
(3) Performing a contract in Texas;[234]
(4) Delivering goods into Texas;[235]
(5) Having employees or representatives conducting the taxable entity's business in Texas;[236]
(6) Entering into a franchising agreement with persons or entities located in Texas;[237]
(7) Serving as a holding company in Texas;[238]
(8) Leasing tangible personal property used in Texas;[239]
(9) Maintaining inventory in Texas;[240]
(10) Engaging in loan production activities in Texas;[241]
(11) Serving as a general partner of a general or limited partnership that does business in Texas;[242]
(12) Having a place of business in Texas;[243]
(13) Storing goods in Texas;[244]
(14) Assembling, processing, or manufacturing goods in Texas;[245]
(15) Engaging in real estate activities in Texas;[246]
(16) Providing services in Texas;[247]

231. *See* 34 ADMIN. § 3.586(c) (identifying specific activities that create sufficient contact with Texas to allow the franchise tax to be imposed); *see also Texas Nexus Questionnaire*, TEX. COMPTROLLER OF PUB. ACCTS., http://www.cpa.state.tx.us/taxinfo/taxforms/ap-114.pdf (last visited Nov. 19, 2013) (providing a simple fill-in-the-blank and check-the-box form to assist entities in determining if they satisfy Texas's nexus requirements).

232. 34 ADMIN. § 3.586(c)(1).

233. *Id.* § 3.586(c)(2).

234. *Id.* § 3.586(c)(3).

235. *Id.* § 3.586(c)(4).

236. *Id.* § 3.586(c)(5).

237. *Id.* § 3.586(c)(7).

238. *Id.* § 3.586(c)(8).

239. *Id.* § 3.586(c)(10).

240. *Id.* § 3.586(c)(9).

241. *Id.* § 3.586(c)(11).

242. *Id.* § 3.586(c)(12).

243. *Id.* § 3.586(c)(13).

244. *Id.* § 3.586(c)(14); *see also id.* § 3.586(c)(17) (relating to the shipment of materials to be held until ready to ship).

245. *Id.* § 3.586(c)(14).

246. *Id.* § 3.586(c)(15). Specifically, engaging in real estate activities includes "holding, acquiring, leasing, or disposing of any property located in Texas." *Id.*

247. *Id.* § 3.586(c)(16).

(17) Conducting theatrical performances or shows, sporting events, or other like events in Texas;[248]
(18) Engaging in solicitation activities in Texas;[249]
(19) Retaining a telephone number that is answered in Texas;[250] and
(20) Engaging in transportation activities within Texas.[251]

As observed from the above list, many activities create a Texas franchise tax nexus.[252] However, notably, two types of passive activities do not. First, owning a limited partner interest in a limited partnership does not, in and of itself, create nexus for Texas franchise tax purposes.[253] Likewise, owning a membership interest in an LLC, by itself, does not create a Texas franchise tax nexus.[254] Second, qualification of a foreign entity in Texas with the Texas Secretary of State alone does not create nexus for Texas franchise tax purposes.[255]

2. Nexus and Series LLCs

The comptroller's policy of aggregating all series into a single taxable entity for Texas franchise tax purposes creates constitutional nexus concerns because not all series of a series LLC may be engaged in nexus-creating activities in Texas.[256] For example, assume a series LLC is formed in Delaware and has four series. Series 1 and Series 2 own real property located in Texas. Series 3 and Series 4 own real property located

248. *Id.* § 3.586(c)(18).

249. *Id.* § 3.586(c)(19).

250. *Id.* § 3.586(c)(20).

251. *Id.* § 3.586(c)(21).

252. *See id.* § 3.586 (enumerating twenty-one activities that create a nexus with Texas, but specifically providing that the list is non-exhaustive).

253. *See* Tex. Comptroller Priv. Ltr. Rul. 200005299L (May 12, 2000), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open20/200005299l.html (discussing situations in which state franchise taxes would be inapplicable); Tex. Comptroller Priv. Ltr. Rul. 200004345L (Apr. 13, 2000), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open20/200004345l.html (showing the instances where a state franchise tax is not appropriate).

254. *See* Tex. Comptroller Priv. Ltr. Rul. 200606695L (June 1, 2006), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open30/200606695l.html (noting that holding an interest in an LLC does not automatically create a nexus with the state); Tex. Comptroller Priv. Ltr. Rul. 990355L (Mar. 16, 1999), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open17/9903582l.html (stating that having an interest in an LLC does not necessarily create a nexus with the state).

255. Rylander v. Bandag Licensing Corp., 18 S.W.3d 296, 300 (Tex. App.—Austin 2000, pet. denied) (showing that when a foreign company only interacts with the state through interstate commerce, a nexus is not created).

256. *See* 34 ADMIN. § 3.586 (providing a list of activities that establish a nexus with Texas).

in California and Florida, respectively, and do not engage in any nexus-creating activities in Texas.[257]

The comptroller's policy of aggregating all series of a series LLC into a single taxable entity for Texas franchise tax purposes means that Series 3 and 4 in the above example, as well as Series 1 and 2, are subject to the Texas franchise tax.[258] This result is correct for Series 1 and 2 because Series 1 and 2 own real property located in Texas, which is a Texas nexus-creating activity.[259] However, Series 3 and 4 are not engaged in any Texas nexus-creating activities.[260] This result creates constitutional concerns as Series 3 and 4 are being subjected to the Texas franchise tax even though Series 3 and 4 have no association with Texas.[261]

The comptroller's position on this nexus issue is that if nexus exists for any one series of a series LLC, then it causes all series of the series LLC, as

257. Because Series 1 and Series 2 are conducting business in Texas—holding real property located in Texas—these series will qualify as doing business in Texas. *See id.* § 3.586(c)(15) (recognizing the holding of real estate in Texas as a nexus-creating activity). According to the policy adopted by the Texas Secretary of State, Series 1 and Series 2 cannot individually obtain a foreign qualification in Texas. *See Foreign or Out-of-State Entities Frequently Asked Questions*, TEX SECRETARY ST., http://www.sos.state.tx.us/corp/foreignfaqs.shtml#reg7 (last visited Nov. 19, 2013) (clarifying that an individual series cannot register as a legal entity in Texas, but the larger LLC can and must register in order for any underlying series to conduct business in Texas). Instead, the Texas Secretary of State requires the wrapper LLC to obtain what is known as a Registration of a Foreign Series Limited Liability Company in its name, irrespective of all individual series not needing the Texas foreign qualification. *See Application for Registration of a Foreign Series Limited Liability Company*, TEX. SECRETARY ST., http://www.sos.state.tx.us/corp/forms/313_boc.pdf (last visited Nov. 19, 2013) (requiring the larger LLC to register as a legal entity rather than each individual series). From a nexus standpoint, even though the Texas foreign qualification can be said to apply to Series 3 and 4 because it is issued in the name of the wrapper LLC rather than issued individually to Series 1 and 2, foreign registration, in and of itself, is not a Texas-nexus creating activity. *See Rylander*, 18 S.W.3d at 300 (contending that the "passive possession of a license to do business in Texas" did not establish a sufficient nexus for franchise tax purposes).

258. *Compare* 34 ADMIN. § 3.586(b) (mandating that an entity have sufficient contact with Texas to be subject to the franchise tax), *with* Tex. Comptroller Priv. Ltr. Rul. No. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (stating that the series of a series LLC are not identified separately for tax purposes).

259. *See* 34 ADMIN. § 3.586(c)(15) (describing holding property as a nexus-creating activity for taxation in the state).

260. *Compare id.* (protecting entities from being taxed in violation of the United States Constitution), *with* Quill Corp v. North Dakota, 504 U.S. 298, 313 (1992) (outlining the minimum contacts requirement of the Due Process Clause and the substantial nexus requirement of the Commerce Clause, both of which must be met for a state tax on an out-of-state entity to be constitutional).

261. *See Quill Corp.*, 504 U.S. at 313 (mandating that for a state tax to be imposed on an out-of-state entity, the entity must have both minimum contacts and a substantial nexus to the taxing state for the tax to pass constitutional challenge).

well as the wrapper LLC, to have nexus in Texas.[262] The basis for the comptroller's nexus position is unclear. It cannot be common ownership because there could be cases where series are not commonly owned and, furthermore, the comptroller has previously indicated that common ownership is not a basis for attributing nexus.[263]

There are two perceived rationales for the comptroller's nexus position: (1) attributional nexus or (2) direct nexus under the conclusion that a series is analogous to a division of a corporation.[264] Each of these rationales is discussed separately below. Neither has merit.

a. Attributional Nexus

Attributional nexus "refers to the concept that a state can assert nexus over an entity on the premise that the entity has an economic, legal, or operation relationship with another entity already subject to taxation."[265] In effect, when attributional nexus applies, even though an out-of-state entity does not have a sufficient amount of presence in a state to be subject to a tax based on its own "direct" activities, a state can still assert its taxing jurisdiction by attributing the in-state nexus of another entity to the out-of-state entity.[266]

262. *Compare* Tex. Comptroller Priv. Ltr. Rul. No. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html ("[T]he series LLC as a whole is a taxable entity and must file a single franchise tax report."), *with* 34 ADMIN. § 3.586(b) (imposing a franchise tax on a taxable entity with sufficient contacts with Texas).

263. Tex. Comptroller Priv. Ltr. Rul. No. 200408781L (Aug. 31, 2004), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open10/200408781l.html (contending that common ownership does not necessarily create attributional nexus).

264. *See* Tex. Comptroller Priv. Ltr. Rul. 201005250L (May 24, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005250l.html (comparing an individual series to a division of a corporation); John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 (illustrating attributional nexus as a means for a state to assert jurisdiction over an out-of-state entity for the action of another in-state entity). Economic nexus is not discussed as a perceived rationale because the comptroller's office has previously indicated that it does not plan on adopting an economic nexus policy. *See, e.g.*, Brad Brookner, *Briefing Summary of Annual Briefing with the Texas Comptroller of Public Accounts*, TEX. TAX LAW., Winter 2012 at 1, 6–7, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=QFwiTouZyd0%3d&tabid=80 (dispelling the contention that the comptroller plans to seek economic nexus legislation).

265. Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32.

266. *See* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 ("Even though a corporation *itself* does not have a sufficient presence in a taxing state, the state may assert jurisdiction by attributing the presence of another entity to the corporation.").

The underlying theories behind attributional nexus generally involve: (i) agency relationships, (ii) alter ego issues, and (iii) the existence of a unitary business.[267] As discussed below, none of these theories should cause attributional nexus to apply on a per se basis to series of a series LLC, which is effectively what the comptroller's position currently does.

First, the agency theory of attributional nexus involves conferring nexus upon an out-of-state entity if such out-of-state entity has an agent located within the taxing state.[268] Generally, an agency relationship exists if the in-state agent can impose a legal duty on the out-of-state entity.[269] Therefore, in order to impose a tax on an out-of-state entity, a state generally must show that the out-of-state entity has authority and control over the in-state agent.[270] Furthermore, courts have held that an agency relationship "will not be assumed from the mere fact that one does an act for another."[271] Rather, an agency relationship only exists when the parties have executed an agreement that creates a fiduciary relationship primarily control by the principal.[272] However, an agency relationship has been implied when common ownership exists.[273]

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267. *See* Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (discussing the key attributional nexus theories); John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19–20 (stating that the theories behind attributional nexus include agency, alter ego, and the unitary relationship). *See generally* Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios, at 1430.04 (listing all three theories as subchapter headings under the applications of attributional nexus).

268. *See, e.g.*, Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 ("In state taxation, the agency theory may confer nexus upon an out-of-state entity if an in-state person acts as an agent representing the interests of its out-of-state principal." (footnote omitted)).

269. *See, e.g.*, *id.* ("An agency relationship generally exists if the agent (the in-state person) has the right to impose a legal obligation on its principal (the out-of-state corporation).")

270. *See, e.g.*, *id.* (stressing the requisites a state must show for attributional nexus to attach).

271. *Id.*

272. *E.g.*, *id.* ("The existence of an agency relationship between two parties is dependent on specific factual elements: the manifestation by the principal that the agent shall act for him; the agent's acceptance of the task; and the understanding that the principle is in control of the task."). *See generally* Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios at 1430.04 (acknowledging that the court noticed "[a] true agency relationship results only if there is an agreement for the creation of a fiduciary relationship with control by the principal" (footnote omitted)).

273. *See* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 ("Common ownership may imply that an agency relationship exists." (footnote omitted)).

Based on the foregoing, the agency theory of attributional nexus should not cause nexus to be per se attributed amongst all series of a series LLC.[274] That is to say, simply because a series LLC exists does not mean there is an "automatic" agency relationship among all series.

For example, assume a series LLC with three series. Series 1 is managed by A and has two members, A and B. Series 2 is managed by B and has two members, B and C. Series 3 is also managed by B and has three members, A, B, and C. Series 1 operates a winery. Series 2 operates a hotel. Series 3 owns various pieces of real estate for investment purposes. The managers are unrelated and the wrapper LLC owns no assets of its own. While Series 1, 2, and 3 have overlapping ownership, they are managed by different individuals/entities and also have different business purposes. Series 1, 2, and 3 are effectively separate entities that do not interact with one another from an operational standpoint. Thus, conferring nexus on all series simply because some series have nexus in Texas does not make sense under the agency theory of attributional nexus.[275] The only situation in which the agency theory should attribute nexus amongst series is when, in fact, an agency relationship exists.[276]

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274. *Compare* Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32–34 (examining agency nexus, alter ego or affiliate nexus, and economic nexus—the underlying theories and the factors courts have considered in determining when a specific relationship exists), *with* TEX. BUS. ORGS. CODE ANN. § 101.602 (West 2012) (shielding each series from the obligations and duties incurred by other series), *and* Tex. Comptroller Priv. Ltr. Rul. 200408781L (Aug. 31, 2004), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open10/200408781l.html (indicating that Texas does not recognize common ownership as a means of extending attributional nexus to out-of-state entities).

275. *See, e.g.*, Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32–34 (recognizing the need for a fiduciary relationship created by an agreement to establish a true agency relationship).

276. For example, assuming Series 1 has no direct Texas nexus and Series 2 has Texas nexus, Texas nexus could be properly conferred to Series 1 by Series 2 if Series 1 and Series 2 entered into an agreement where Series 2 acts as an agent for Series 1 by selling and promoting wines produced by Series 1 at the hotel operated by Series 2. *See* Tex. Comptroller Priv. Ltr. Rul. 200401316L (Jan. 9, 2004), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open09/20040131 6l.html (establishing that nexus is created when a corporate beneficiary has control over a trust that is doing business in Texas); Tex. Comptroller Priv. Ltr. Rul. 9609798L (Sept. 27, 1996), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open11/9609798l.html (finding that nexus is created if an entity has direct or indirect control of a Trust that is doing business in Texas); Tex. Comptroller Priv. Ltr. Rul. 9312L1276G08 (Dec. 17, 1993), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open29/9312164l.html (implying that nexus would exist if an entity represented another entity with third parties or managed the first entity). *But cf.* Tex. Comptroller Priv. Ltr. Rul. No. 9702413L (Feb. 14, 1997), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open12/9702413l.html (failing to find that nexus is created when a foreign corporation does not own a majority interest in a trust and does not have control over the trust or trustee). There is no implied agency from a parent/subsidiary

Turning next to the alter ego theory, this form of attributional nexus is conceptually similar to the theory of "piercing the corporate veil."[277] In short, the alter ego theory of attributional nexus is based on an out-of-state entity being dominated by an in-state entity.[278] Mere ownership alone generally does not create an alter ego affiliation.[279] Courts have considered the following factors as relevant in determining whether an alter ego relationship exists: (i) common directors; (ii) common officers; (iii) personnel overlap; (iv) level of autonomy of the entities; (v) identical or similar trade names; and (vi) public persona as to separate or not separate relationship of the entities.[280] Furthermore, courts have indicated that one factor alone is not sufficient to establish an alter ego relationship.[281]

As with the agency theory of attributional nexus, the alter ego theory should not apply to confer nexus amongst series of a series LLC unless, in fact, a sufficient number and level of alter ego factors exist.[282] That is to

relationship. *See* Tex. Comptroller Priv. Ltr. Rul. 9903584L (Mar. 24, 1999), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open17/9903584l.html (concluding that specific parent partnership does not meet nexus requirements).

277. *E.g.*, Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (analogizing the alter ego theory to the theory of piercing the corporate veil); *accord* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 ("[A]lter ego theory of attributional nexus closely resembles the general corporate law concept of 'piercing the corporate veil.'").

278. *E.g.*, Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (stating that the alter ego requires complete control over the other entity); *accord* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 (emphasizing that control, not ownership, is the central factor in determining an alter ego relationship).

279. *E.g.*, John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19 ("Generally, mere ownership of one entity by another does not create an alter ego relationship unless the owner exercises significant control over the other entity.").

280. *E.g.*, *id.* 19–20 (listing factors commonly considered when determining control); *see also* Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32–33 (listing required factors for an alter ego relationship); Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios, at 1430.04 (describing factors relevant to existence of an alter ego relationship).

281. *See* Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios at 1430.04 (detailing situations where courts found only one connection to be insufficient to establish the finding of an alter ego relationship).

282. *Compare* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19–20 (clarifying the factors necessary to confer alter ego status), *with* TEX. BUS. ORGS. CODE ANN. § 101.602(a) (West 2012)

say, the existence of a series LLC, in and of itself, should not be enough to attribute nexus under the alter ego theory. Indeed, there could be cases where no alter ego factors exist amongst the various series of a series LLC. Accordingly, logic must dictate that the existence of a series LLC does not per se create an alter ego relationship for nexus purposes.

Another way to establish attributional nexus is under the unitary theory.[283] This theory of attributional nexus has been labeled by some as controversial.[284] It has only recently been applied to assert taxing jurisdiction.[285] Generally, the unitary theory of attributional nexus confers nexus among related entities based solely on such entities being part of a unitary business.[286] The unitary theory of attributional nexus is different from the agency and alter ego theories because the foreign entity subjected to taxation need not: (i) have an agency relationship with an in-state entity; or (ii) have merged its identity with an in-state entity.[287] Under the unitary theory, a foreign entity could be subject to a tax in a state where it does not have any direct or indirect connection except for its role of being part of a unitary business with some other member that does have nexus in the taxing state.[288]

(prohibiting the enforcement of the obligations and duties of one series or the general LLC against another series).

283. *See* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 19–20 (including the three ways attributional nexus can be found); Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios, at 1430.04 (describing the unitary theory as a developing area of attributional nexus). There is also a theory of affiliated nexus that can confer attributional nexus, which some describe as being a subset of agency nexus. *See, e.g.*, Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios, at 1430.04 (including affiliation nexus as a form of agency nexus). Others describe affiliated nexus as akin to alter ego nexus. *See, e.g.*, Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (linking affiliated nexus theory with alter ego theory). For the same reasons discussed herein regarding agency and alter ego, the affiliate theory for attributing nexus should not apply to series LLCs.

284. *See, e.g.*, Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios, at 1430.04 (describing unitary theory as "one that can rightly be labeled 'controversial'").

285. *See, e.g.*, *id.* (distinguishing the recent application of unitary theory toward issues of tax jurisdiction).

286. *See, e.g.*, *id.* (explaining that the unitary theory allows entities to be subject to a state's taxes simply for having a working relationship with an entity located within the state).

287. *See id.* (outlining the difference between agency and alter ego theories and unitary theory); *see also* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 20 (providing the key differences between unitary theory and agency and alter ego theories).

288. *See, e.g.*, Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt.

Under the Texas franchise tax, TTC section 171.103(b) forecloses the use of the unitary theory of attributional nexus.[289] Specifically, TTC section 171.103(b) provides that "[a] combined group shall include in its gross receipts computed under [s]ubsection (a) the gross receipts of each taxable entity that is a member of the combined group and that has a nexus with this state for the purposes of taxation."[290] Because TTC section 171.103(b) specifically indicates that a member of a combined group—which would be required to be part of a unitary business in order to be part of the combined group—may, in fact, not have nexus with Texas, logic dictates that a unitary relationship does not, in and of itself, create nexus.[291] Otherwise, TTC section 171.103(b) would be superfluous.

Based on the foregoing, if the comptroller's rationale for concluding that the existence of Texas nexus for one series carries over to all series is based on attributional nexus, then the comptroller is effectively saying that the existence of a series LLC per se creates an agency relationship, alter ego relationship, unitary business relationship, or a combination thereof amongst all series. As discussed above, that clearly is not the case.[292] Attributional nexus should only apply to confer nexus when appropriate facts exist, which will not be the case for all series LLCs.[293] Thus, it is

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(BNA) State Tax Portfolios at 1430.04 ("Under unitary jurisdictional theory, an out-of-state entity could presumably be subject to tax in a state that it has no direct or indirect connection with, save for its role in the overall 'unitary business.'"); *see also* John P. Barrie & Carole L. Iles, *Attributional Nexus: Taxing Corporations That Lack Sufficient In-State Presence*, J. MULTISTATE TAX'N, Mar.–Apr. 1994, at 18, 20 (contending that under the unitary theory, an entity could come under the taxing jurisdiction of a state for only having a working relationship with an in-state entity).

289. *See* TEX. TAX CODE ANN. § 171.103(b) (West 2008) (mandating that each member of a combined group have nexus with Texas in order to be included in the groups tax margin).

290. *Id.*

291. *See id.* (requiring each combined group member to have nexus with Texas in order for its receipts to be included in the group's taxable margin and, thus, indicating that belonging to a combined group does not itself constitute a nexus-creating activity).

292. *Compare* Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax Mgmt. (BNA) State Tax Portfolios at 1430.04 (investigating the various requirements of agency theory, alter ego theory, and unitary theory of attributional nexus), *with* Christina Berger, *Nexus and the Need for Clarification: The Rise of Economic and Attributional Nexus*, J. ST. TAX'N, Mar.–Apr. 2008, at 29, 32 (acknowledging the typical requirement of an agreement establishing a fiduciary relationship before a true agency relationship exists), *and* TEX. BUS. ORGS. CODE ANN. § 101.602(a) (West 2012) (preventing the liabilities of the general LLC or an individual series from being enforced on another series and indicating that being a member of a common series LLC does not by itself insinuate that two series are alter egos), *and* TAX § 171.103(b) (implying that membership in a combined group does not, of itself, create a nexus with Texas).

293. *See generally* Arthur R. Rosen, *Jurisdictional Limitation: Attributional Nexus*, 1430 1st Tax

unlikely that attributional nexus is a viable theory for the comptroller to utilize in the event of a constitutional nexus challenge to its policy concerning series LLCs.

b. Division Treatment

The comptroller might also assert that its policy of taxing all series of a series LLC as a single taxable entity passes constitutional nexus muster under the theory that the series within a series LLC are analogous to divisions of a corporation.[294] For example, if a corporation operates through multiple divisions, instead of through multiple subsidiaries, then there is no separation of activities for nexus purposes and a nexus-creating activity of a single division would generally establish nexus for the entire corporation.[295]

The question, then, is whether the series of a series LLC should be considered akin to divisions for Texas franchise tax nexus purposes.[296] One example supporting division treatment is that series do not gain their existence from a separate filing with the Texas Secretary of State.[297] Rather, the wrapper LLC files a single certificate of formation and series are created through the wrapper LLC company agreement without the

Mgmt. (BNA) State Tax Portfolios at 1430.04 (exploring the factors that allow attributional nexus to be attributed to an entity).

294. *Cf.* Tex. Comptroller Priv. Ltr. Rul. 201005250L (May 24, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005250l.html (concluding that each series of a series LLC is not a separate entity for Texas sales and use tax purposes, but rather that "the LLC as a whole is the responsible entity[,] and the series are simply regarded as divisions or departments of the corporation").

295. *See, e.g.*, Nat'l Geographic Soc'y v. Cal. Bd. of Equalization, 430 U.S. 551, 562 (1977) (affirming a use tax imposed on the retail side of National Geographic because the organization maintained two advertising offices within the state and disregarding the fact the two offices were unrelated to the retail side of the company).

296. *See, e.g.*, R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 3 ("This division versus entity construct forms the basis for many of the questions that provide hesitation for the use of series LLCs other than in tightly controlled circumstances where management and ownership are relatively uniform.").

297. *See* BUS. ORGS. § 101.601(a) (allowing individual series to only be created through the company agreement); R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 2 (explaining the dichotomy of filing with the Secretary of State versus LLC agreements); *Formation of Texas Entities FAQs, Series LLCs*, TEX. SECRETARY ST., http://www.sos.state.tx.us/corp/formationfaqs.shtml#LLC (last visited Nov. 19, 2013) (requiring only a single certificate of formation for a series LLC).

need for any separate filings.[298] Another example supporting division treatment is TBOC section 101.613(a), which provides that the wrapper LLC, rather than a series, makes distributions to the owners of each series.[299] On the other hand, TBOC section 101.605 provides that each series can, among other things, own its own assets, sue, and be sued—powers that divisions do not have.[300] Moreover, TBOC section 101.602(a)(1) creates a liability shield for each individual series, further supporting the conclusion that series are nothing like divisions of a corporation.[301] Thus, series may be more akin to subsidiaries.[302] With respect to this "division versus subsidiary" comparison, it has been stated:

> For purposes of analogy, the series is sometimes compared to either a division, but one which affords limited liability, or a subsidiary, but without requiring the creation of a separate state law entity. While at times helpful, both of the analogies are in the end incomplete, with the risk that they can be misleading.[303]

Overall, while it seems series of a series LLC share some characteristics with divisions of a corporation, they certainly cannot be equated to divisions.[304] Indeed, both the existence of a liability shield and the ability to hold assets in the series' own name are characteristics indicating the

298. *See* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 2 (explaining how to create an LLC without state filing); *see also* BUS. ORGS. § 101.601 (stating the statutory requirements for creation of a series).

299. BUS. ORGS. § 101.613(a); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 12–13 (distinguishing the series' inability to make distributions with the other abilities granted to each series).

300. *See* BUS. ORGS. § 101.605 (West Supp. 2013) (enumerating the general powers of series); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 8 (flushing out the language of the general powers of series and demonstrating how the separate powers of a series creates difficulties for its constituent divisions).

301. BUS. ORGS. § 101.602(a)(1) (West 2012); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 5 (stating that this provision "implicates the entity/division issue and implies that the assets of series are not assets of the LLC[, which] differentiates a series from an unincorporated division of a corporation or even a separately incorporated subsidiary of a corporation").

302. *See, e.g.*, Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (comparing and contrasting the definitions of division and subsidiary against the series).

303. *Id.*

304. *See id.* (highlighting specific differences between a series and a division). *But see* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 2 (discussing the existence of numerous "indicators that series are not themselves separate legal entities (as we would generally consider an LLC, partnership, or corporation); rather, they are more akin to a division of a corporation").

polar opposite of a division.[305] Thus, treating series as divisions for nexus determination purposes under the Texas franchise tax does not seem appropriate. Even if it is appropriate, the comptroller's policy of treating a series LLC as a single taxable entity still must fail due to the definition of "taxable entity" in TTC section 171.0002(a), as discussed in Part VII, A above.[306]

C. *Comptroller's Policy Results in Inconsistent Treatment of Combined Groups and Series LLCs*

In addition to creating constitutional nexus concerns and lacking statutory support, the comptroller's policy of treating a series LLC as a single taxable entity for Texas franchise tax purposes also results in similarly situated taxpayers—series LLC and combined groups—being treated inconsistently.[307] A series LLC and a combined group are similar when (1) a series LLC has series that are commonly owned and engaged in a unitary business; and (2) a combined group consists of various LLCs.[308] The comptroller's policy of treating a series LLC as a single taxable entity, while treating the commonly owned LLC structure as multiple taxable entities comprising a combined group, leads to significantly differing tax consequences.

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305. *Compare* BUS. ORGS. § 101.605 (West Supp. 2013) (granting statutory power to a series to "acquire, sell, and hold title to assets of the series, including real property, personal property, and intangible property"), *and id.* § 101.602(a)(1), (2) (West 2012) (protecting each series from the liabilities and obligations of other series), *with* Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (indicating divisions lack the ability to contract for themselves and lack the shield from liabilities of the parent corporation).

306. *Compare* TEX. TAX. CODE ANN. § 171.0002(a) (West Supp. 2013) (allowing for other legal entities to be taxable entities), *and id.* § 171.0001(11–a) (implying legal entities are entities "given recognition as the possessor of rights, privileges, or responsibilities"), *with* BUS. ORGS. § 101.601(a)(1) (granting individual series "separate rights, powers, or duties"). If individual series are considered independent legal entities, then they should not be likened to divisions which are not legal entities. *See* Thomas E. Rutledge, *The Man Who Tells You He Understands Series Will Lie to You About Other Things As Well*, J. PASSTHROUGH ENTITIES, Mar.–Apr. 2013, at 69, 70 (indicating that divisions do not possess separate rights, duties, and powers).

307. *See, e.g.*, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 9, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=B6UhOGMuuP4%3d&tabid=80 ("The most significant con to treating a series LLC as a single entity is that it would result in the inconsistent treatment of series LLCs and combined groups.").

308. For Texas franchise tax purposes, a combined group, by definition, would be commonly owned and unitary. TAX § 171.1014. Not all series LLCs will be commonly owned and engaged in a unitary business, but some will.

One example of inconsistent treatment results from TTC section 171.103(b), which is commonly known as the *Joyce* rule.[309] TTC section 171.103(b) provides that "[a] combined group shall include in its gross receipts computed under [s]ubsection (a) the gross receipts of each taxable entity that is a member of the combined group and that has a nexus with this state for the purposes of taxation."[310] The *Joyce* rule is a beneficial rule because it can lower the amount of a combined group's apportioned income, which then lowers the overall amount of Texas franchise tax due for the combined group.[311]

For example, assume a combined group consists of four taxable entities—A, B, C, and D. A and B have nexus with Texas while C and D do not. They each have $10,000,000 in total revenue, and the combined group will take the 30% standard deduction.[312] Further, assume that all receipts are Texas gross receipts.[313] The amount of Texas franchise tax due for the combined group under this example would be $140,000.[314] In

309. *See In re* Joyce, Inc., No. 66-SBE-070 at 215, 220 (Cal. State Bd. of Equalization, Nov. 23, 1966), *available at* http://www.boe.ca.gov/legal/pdf/66-sbe-070.pdf (determining that each member of a combined group must have nexus with the taxing state in order for the member's gross receipts to be included in the groups taxable margin calculations); Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 986 (2007) (discussing how combined groups "apportion the gross margin of combined groups that contain members which lack tax nexus with Texas" as under the *Joyce* rule). *See generally* TAX § 171.103(b) (West 2008) (requiring an entity to have nexus with Texas in order for its receipts to be included in the combined groups tax calculations).

310. TAX § 171.103(b).

311. *See* Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 984 (2007) (discussing the tax effect of excluding non-nexus members from the apportionment formula); *see also* TAX § 171.103(b) (excluding non-nexus members from the numerator of the apportioning margin calculation).

312. *See* TAX § 171.101(a)(1)(A)(i) (West Supp. 2013) (implying a 30% deduction by only requiring 70% of total revenue to be included in the taxable margin calculation); *In re* Nestle USA, Inc., 387 S.W.3d 610, 615 (Tex. 2012) (stating that the standard deduction may also be called the "[g]eneral [d]eduction: the greater of either the [c]ost of [g]oods [s]old, [c]ompensation, or 30%"); Eric. L. Stein, *Calculating the Compensation Deduction*, *in* U.T.-C.L.E.: 2008 TEXAS MARGIN TAX, Dec. 4–5, 2008, at 1, 1 (referring to the 30% reduction in revenue as the "standard deduction").

313. *See* TAX § 171.103(a) (West 2008) (including only receipts from business done within Texas in the calculation of the numerator of the apportionment margin formula).

314. Computed as $40,000,000 (the total revenue) minus $12,000,000 (the 30% standard deduction), which equals $28,000,000 (the taxable margin). *See id.* § 171.101(a)(1)(A) (West Supp. 2013) (providing for a minimum 30% reduction of total revenue when calculating taxable margin). $28,000,000 is then multiplied by 0.5 (Texas's apportionment formula, computed from $20,000,000—gross receipts from in-state business, divided by $40,000,000—gross receipts from entire business), which totals $14,000,000. *See id.* § 171.106(a) (creating a formula for apportioning an entity's taxable margin); *see also id.* § 171.103(a) (West 2008) (indicating gross receipts for an entity's in-state business for apportionment calculations); *Id.* § 171.105(a) (determining gross receipts for an

contrast, if a series LLC were used where A, B, C, and D were each a separate series but affiliated and engaged in unitary operations, then the amount of Texas franchise tax due would be $280,000.[315] Because A, B, C, and D are effectively the same from an operational and governance standpoint in each of these structures, there is no perceived policy reason for allowing the *Joyce* rule to apply to the combined group structure, but not to the series LLC structure.[316]

Another example of inconsistent treatment is when entities are "affiliated"—as defined in TTC section 171.0001(1)—but not "engaged in a unitary business," or when entities are "engaged in a unitary business"—as defined in TTC section 171.0001(17)—but are not "affiliated."[317] In these situations, unaffiliated unitary entities or otherwise affiliated entities not engaged in unitary operations would not be included in a combined group and, instead, would be treated as separate taxable entities for Texas franchise tax purposes.[318] This results in such entities being able to independently choose their deduction elections.[319] In contrast, the comptroller's position of always treating a series LLC as a single taxable

entity's entire business for apportionment calculations). $14,000,000 is then multiplied by the 1% rate, yielding the Texas franchise tax amount of $140,000. *See id.* § 171.002 (West Supp. 2013) (establishing a franchise tax rate of one percent of a non-retail or non-wholesale entity's taxable margin).

315. Computed as $40,000,000 (the total revenue) minus $12,000,000 (the 30% standard deduction), which equals $28,000,000 (the taxable margin). *See id.* § 171.101(a)(1)(A) (establishing how to calculate taxable margin). $28,000,000 is then multiplied by 1.0 (Texas's apportionment, computed from $40,000,000—gross receipts from in-state business, divided by $40,000,000—gross receipts from entire business), which totals $28,000,000. *See id.* § 171.106(a) (creating a formula for entities to apportion their taxable margin); *see also id.* § 171.103(a) (West 2008) (providing factors for calculating gross receipts for an entity's in-state business for apportionment calculations); *Id.* § 171.105(a) (clarifying factors for calculating gross receipts for an entity's entire business for apportionment calculations). $28,000,000 is then multiplied by the 1% rate, yielding a Texas franchise tax amount of $280,000. *See id.* § 171.002 (West Supp. 2013) (imposing a franchise tax rate of one percent of a non-retail or non-wholesale entity's taxable margin). The additional Texas franchise tax amount results from the *Joyce* rule being inapplicable to series LLCs that have non-nexus series. *See id.* § 171.103(a), (b) (West 2008) (allowing receipts of combined group members without nexus to Texas to be excluded from the in-state gross receipts calculation).

316. *See generally* Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 986 (2007) (discussing the implications of applying the *Joyce* rule to combined groups).

317. *See* TAX § 171.0001(1), (17) (West Supp. 2013) (defining affiliated group and unitary business).

318. *See id.* § 171.0001(7) (defining combined group as entities that are both "part of an affiliated group [and are] engaged in a unitary business").

319. *See id.* § 171.101(a) (permitting a taxable entity to choose which deduction they wish to take in order to determine its taxable margin).

entity leads to a result wherein all series of a series LLC are effectively treated as being unitary and affiliated with one another even when, in reality, they might not be.[320] Thus, the comptroller's position per se takes away the ability of a non-affiliated or non-unitary series to independently choose a deduction election that creates dissimilar treatment as compared to combined group structures.[321]

Another example of inconsistent treatment results with respect to the computation of tax between combined groups and series LLCs.[322] There are special rules for combined groups regarding the calculation of total revenue,[323] the calculation of the cost of goods sold deduction,[324] and the calculation of the compensation deduction.[325] For example, with respect to computing the total revenue of a combined group, items of total revenue received from a member of the combined group must be subtracted.[326] This reduction in total revenue for items paid and received by combined group members reduces the amount of Texas franchise tax ultimately owed by the combined group because the reduction lowers the Texas franchise tax base.[327] In contrast, there is no comparable rule

320. *Compare* Tex. Comptroller Priv. Ltr. Rul. 201005250L (May 24, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005250l.html ("Each series within a [s]eries LLC is not recognized as a separate entity for Texas sales and use tax purposes. Instead, the LLC as a whole is the responsible entity[,] and the series are simply regarded as divisions or departments of the corporation."), *with* TAX § 171.0001(1) (defining an "'[a]ffiliated group' [as] a group of one or more entities in which a controlling interest is owned by a common owner or owners, either corporate or noncorporate, or by one or more of the member entities"), *and* TAX § 171.0001(17) (defining a "'[u]nitary business' [as] a single economic enterprise that is made up of separate parts of a single entity or of a commonly controlled group of entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts").

321. *Compare* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (considering all series of a series LLC as a single taxable entity and not allowing individual series to file independent tax reports), *with* TAX § 171.1014(d) (West Supp. 2013) (authorizing a combined group to elect either subtracting the cost of all goods sold or subtracting the compensation of its members from the group's taxable margin).

322. *See* TAX § 171.1014 (creating special requirments related to the calculating of a combined group's franchise tax).

323. *See id.* § 171.1014(c) (delineating special rules for determining a combined group's total revenue).

324. *See id.* § 171.1012(b) (establishing guidelines for determining the cost of goods sold when such determination is used as a subtraction election).

325. *See id.* § 171.1013(b) (determining compensation when such determination is used as a subtraction election).

326. *Id.* § 171.1014(c)(3).

327. *Id.*

concerning items of total revenue paid between series of a series LLC, even if the series are commonly controlled and engaged in unitary operations like a combined group. This disparity results in a series LLC paying more Texas franchise tax than its combined group counterpart due to the series LLC having a higher tax base.[328] Additionally, the dissimilar treatment creates disparities, with respect to apportionment, between combined groups and series LLCs.[329] This is because TTC section 171.1055(a) provides that receipts excluded from total revenue are also excluded from both the numerator and denominator of the apportionment formula.[330] There is no perceived policy reason for the Texas franchise tax base or the apportionment formula to be computed differently amongst similarly situated taxpayers.

Notably, dissimilar treatment of series LLCs and structures involving multiple traditional LLCs might not rise to the level of being unconstitutional from an equal and uniform protection standpoint because taxpayers have the ability to choose one structure over the other rather than being forced to use either a series LLC or traditional LLCs.[331] However, simply because a policy creating dissimilar treatment may not give rise to constitutional equal and uniform protection concerns does not mean such policy is good tax policy.

D. *Comptroller's Policy Creates Inconsistencies with Series Liability Shield*

The comptroller's policy of treating a series LLC as a single taxable entity for Texas franchise tax purposes means the wrapper LLC is the taxpaying entity.[332] The query and potential problem with this is how will

328. *See id.* (allowing combined groups to reduce total revenue); *see also* Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 986 (2007) (highlighting combined groups' ability to include non-nexus members' gross receipts in the denominator of the apportionment formula but not the numerator, which causes a reducing effect).

329. *See* TAX § 171.1055(a) (West 2008) (excluding receipts from taxable margin that were also excluded from total revenue and allowing combined groups to exclude more than other entities); *see also* Cynthia M. Ohlenforst, *The New Texas Margin Tax: More Than a Marginal Change to Texas Taxation*, 60 TAX LAW. 959, 986 (2007) (discussing the distinguishing characteristics of a combined group's revenues and the use of gross receipts against the numerator and denominator of the apportionment factor).

330. TAX § 171.1055(a).

331. *See, e.g.*, Rylander v. 3 Beall Brothers 3, Inc., 2 S.W.3d 562, 566–67 (Tex. App.—Austin 1999, pet. denied) (exploring the equal and uniform requirement of the Texas Constitution). This analysis assumes the comptroller's policy would be promulgated in a Comptroller Rule.

332. *See* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (recognizing the wrapper LLC as the taxable entity instead of its individual series).

the comptroller collect tax from the wrapper LLC when, in many cases, the wrapper LLC will not have any assets of its own?[333] Effectively, the comptroller's policy leads to a situation where the "deemed" taxpayer may not have any cash or other assets with which to pay tax liabilities.[334] Moreover, because of the liability shield granted to each series, the comptroller might not have any ability to initiate collection efforts against any individual series.[335]

Some commentators have indicated that the answer to this problem could lie in the comptroller's ability to cancel the registration of a series LLC for non-payment of Texas franchise tax, which would then cause the rippling effect of terminating the series LLC and each series.[336] A better solution, however, would be for the comptroller to change its policy concerning the taxation of series LLCs so that it aligns with the economics. If each series were treated as a separate taxable entity for Texas franchise tax purposes, then each series would be responsible for the payment of its own Texas franchise taxes.[337] Alternatively, if any, or all, of the series properly comprised a combined group for Texas franchise tax purposes, then the combined group would have joint and several liability for the payment of the combined group's Texas franchise tax.[338] This approach would alleviate any problems associated with the payment of Texas franchise tax, from the series LLC's standpoint, and the collection of Texas franchise tax, from the comptroller's perspective.

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333. *See* TEX. BUS. ORGS. CODE ANN. § 101.603 (West 2012) (permitting an individual series to potentially own all assets).

334. *Compare* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (requiring the wrapper LLC to pay franchise taxes on behalf of all series), *with* BUS. ORGS. § 101.603 (creating a potential situation where the wrapper LLC owns no assets).

335. *See* BUS. ORGS. § 101.602(a)(2) (prohibiting the "debts, liabilities, obligations, and expenses" of the wrapper LLC from being enforced against the assets of an individual series); *see also* R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 5 (questioning how the liability shield will affect the collection of taxes when the wrapper LLC's assets are insufficient).

336. *See, e.g.*, R. Brent Clifton, *Series LLCs*, *in* STATE BAR OF TEXAS, 28TH ANNUAL ADVANCED TAX LAW COURSE, Aug. 26–27, 2010, at 1, 6 (suggesting that the comptroller's ability to cancel the series LLC's registration will provide an incentive for series LLCs to provide for the payment of taxes in the company agreement).

337. *See* TEX. TAX CODE ANN. § 171.001(a) (West 2008) (imposing a tax on all taxable entities that conduct business in Texas); *see also* BUS. ORGS. § 101.602(a)(1) (preventing the debts and liabilities of one series from being imposed on another series).

338. *See* TAX § 171.1014(a), (i) (West Supp. 2013) (allowing affiliated taxable entities involved in a unitary business to be taxed on a combined group basis and to become jointly and severally liable for the tax bill of the group).

E. *Comptroller's Policy Creates Procedural Issues*

The comptroller's policy of aggregating a series LLC into a single taxable entity for Texas franchise tax purposes creates procedural issues for both taxpayers and the comptroller. For example, each series of a series LLC may have different members, and even if series have variations of the same members, such members may have different ownership percentages in each series.[339] If the wrapper LLC is the deemed taxpayer for Texas franchise tax purposes and a membership vote is required with respect to a position to be taken on the Texas franchise tax return, which members are allowed to vote and what percentage is required for a certain vote to carry? Likewise, assume the comptroller conducts an audit and makes a settlement offer, if the wrapper LLC is the deemed taxpayer for Texas franchise tax purposes, what members are required to vote on a settlement offer, and in what percentage?

F. *Comptroller's Policy Will Not Decrease Administrative Burdens*

The comptroller's policy of aggregating all series of a series LLC into a single taxable entity for Texas franchise tax purposes "could be viewed as administratively convenient" in certain respects from both the perspective of the comptroller and taxpayers.[340] For example, if treated as a single taxable entity, the series LLC would file a single Texas franchise tax report.[341] In contrast, if each series were treated as its own taxable entity, then taxpayers would be required to file multiple Texas franchise tax reports each year—one for each series.[342] This could be viewed as administratively burdensome to taxpayers with respect to return preparation, as well as administratively burdensome to the comptroller from a return processing and auditing standpoint.[343]

339. *See* BUS. ORGS. § 101.601 (granting the ability to create series with differing "members, managers, membership interests, or assets").

340. *See, e.g.*, Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 8, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 ("Treating a series LLC as a single taxable entity could be viewed as administratively convenient for both the comptroller and taxpayers because a single Texas Franchise Tax Report (or, if the series LLC were a member of a combined group, a collective entry on the affiliate schedule) would be required rather than the filing of multiple reports/schedules.").

341. *See* TAX § 171.001(a) (West 2008) (requiring each taxable entity that conducts business in Texas to pay a franchise tax).

342. *See id.* (imposing a franchise tax "on each taxable entity that does business in [Texas]").

343. *See* Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of*

Administrative convenience has been held as a valid reason for the promulgation of an administrative rule—a Comptroller Rule.[344] However, a Comptroller Rule must still be consistent with the Texas Franchise Tax Code.[345] That is to say, administrative convenience does not give the comptroller carte blanche authority in the adoption of Comptroller Rules.[346] Specifically, TTC section 111.002(a) states:

> The comptroller may adopt rules that do not conflict with the laws of this state or the constitution of this state or the United States for the enforcement of the provisions of this title and the collection of taxes and other revenues under this title. In addition to the discretion to adopt, repeal, or amend such rules permitted under the constitution and laws of this state and under the common law, the comptroller may adopt, repeal, or amend such rules to reflect changes in the power of this state to collect taxes and enforce the provisions of this title due to changes in the constitution or laws of the United States and judicial interpretations thereof.[347]

Thus, even assuming *in arguendo* that the comptroller's series LLC policy does, in fact, promote administrative convenience, the policy is still inconsistent with TTC section 171.0002 concerning the definition of "taxable entity"[348] and may, in fact, be in violation of constitutional nexus standards.[349] Per TTC section 111.002, Comptroller Rules cannot be

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Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011, TEX. TAX LAW., Spring 2011, at 1, 8, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (noting that the administrative convenience of requiring a single franchise tax report for all series of a series LLC is made irrelevant to the taxpayer, who must file separate federal income tax reports requiring much of the same information).

344. *See* Carmichael v. S. Coal & Coke Co., 301 U.S. 495, 511 (1937) ("Administrative convenience and expense in the collection or measurement of the tax are alone a sufficient justification for the difference between the treatment of small incomes or small taxpayers and that meted out to others."); Bullock v. Hewlett-Packard, 628 S.W.2d 754, 756–57 (Tex. 1982) (upholding a Comptroller Rule issued solely on the basis of administrative convenience). This analysis assumes the comptroller's policy concerning series LLCs would be promulgated in a Comptroller Rule.

345. *See* TAX § 111.002(a) (authorizing the comptroller to promulgate rules so long as they are consistent with the laws and constitutions of Texas and the United States).

346. *See id.* (limiting the comptroller's ability to adopt rules to those that are consistent with existing law).

347. *Id.*

348. *Compare id.* § 171.0002(a) (West Supp. 2013) (conferring the moniker of "taxable entity" onto "other legal entities"), *and id.* § 171.0001(11–a) (inferring that legal entities are entities that have rights, privileges, or responsibilities), *with* TEX. BUS. ORGS. CODE ANN. § 101.601(a)(1) (West 2012) (giving separate series "separate rights, powers, or duties").

349. *Compare* 34 TEX. ADMIN. CODE § 3.586(b) (2013) (Comptroller of Pub. Accounts, Tax Administration) (requiring an entity to have sufficient contact with Texas to be subject to the state

inconsistent with the Texas Franchise Tax Code.[350] Administrative ease cannot trump a statute.[351]

Furthermore, the comptroller's policy concerning series LLCs is likely not any more administratively convenient than a policy where each series of a series LLC is treated as a separate, taxable entity.[352] From the taxpayer's perspective, each series of a series LLC is already treated as a separate entity for federal income tax purposes.[353] Therefore, treating each series as a taxable entity for Texas franchise tax purposes would create little to no additional burden on taxpayers because separate calculations would have already been computed by each series in computing their federal income tax.[354]

From the comptroller's perspective, any administrative convenience will be lost, or at least minimized, by the administrative burdens associated with determining how to collect a tax from the wrapper LLC and how to conduct audits. Additionally, any administrative burdens created by treating each series as a taxable entity are neutralized from the comptroller's perspective for series that will be aggregated and will file a single report under the combined group rules.[355]

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franchise tax), *with* Tex. Comptroller Priv. Ltr. Rul. No. 201005184L (May 5, 2010), *available at* http://aixtcp. cpa.state.tx.us/opendocs/open32/201005184l.html (combining all series of a series LLC for franchise tax purposes without considering nexus with the state).

350. TAX § 111.002(a) (West 2008).

351. *See id.* (requiring Comptroller Rules to comply with current statutes).

352. *See, e.g.*, Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 8, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (countering the efficiency of the current comptroller policy with the reality that taxpayers must already perform similar tax calculations for federal income tax purposes).

353. *See* Prop. Treas. Reg. § 301, 75 Fed. Reg. 55,699, 55,702 (Sept. 14, 2010) (classifying each series of a series LLC as a separate entity for income tax purposes).

354. *See, e.g.*, Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 8, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (comparing the pros and cons of "[t]reating a series LLC as a single taxable entity," including the fact that "taxpayers are already required to separately compute the tax liability for each separate series for purposes of their federal income tax returns").

355. *See* TAX § 171.1014 (West Supp. 2013) (permitting affiliated groups conducting a unitary business to file a single combined franchise tax report); *see also* Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 9, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (commenting that treating each series as a taxable entity would allow affiliated series

VIII. CONCLUSION

The series LLC is the new kid in town.[356] Series LLCs are not yet widely popular as an entity choice, but just as it took many years for traditional LLCs to become widely used, there could also come a day when series LLCs are a "go-to" entity choice.[357]

One development in the law that will aid in this process is greater certainty in state taxation of series LLCs.[358] Texas has provided some guidance with respect to the taxation of series LLCs for Texas franchise tax purposes with the comptroller's issuance of Comptroller Private Letter Ruling 201005184L.[359] The comptroller should be commended for ongoing efforts to provide meaningful and timely guidance to taxpayers.

The question addressed in this article is whether the comptroller made the correct decision in Ruling 201005184L to classify and tax a series LLC as a single taxable entity for Texas franchise tax purposes. For many reasons discussed herein, this author does not believe the comptroller reached the correct conclusion. Rather, this author believes each series of a series LLC should be treated as a separate taxable entity for Texas franchise tax purposes, which would be similar to the treatment adopted by several other states and the treatment adopted for federal income tax purposes.

There are several reasons why separate tax treatment for series LLCs should be adopted as Texas's approach. First, TTC section 171.0002 provides statutory support for the conclusion.[360] Additionally, the comptroller's policy of aggregating a series LLC into a single taxable entity for Texas franchise tax purposes creates constitutional concerns, leads to similarly-situated taxpayers being treated differently, creates procedural

to be treated similarly to combined groups).

356. The series LLC is only seventeen years old—relatively young in business association terms. *See, e.g.*, Dominick T. Gattuso, *Series LLCs: Let's Give the Frog a Little Love*, BUS. L. TODAY, July–Aug. 2008, at 33, 33 (citing Delaware as the first state to pass series LLC legislation in 1996).

357. *See, e.g.*, Carter G. Bishop, *Through the Looking Glass: Status Liability and the Single Member and Series LLC Perspective*, 42 SUFFOLK U. L. REV. 459, 459 (2009) (recalling the slow adoption and hindering tax concerns of early LLC statutes).

358. *Cf., e.g.*, *id.* (crediting the resolution of traditional LLC tax concerns for the later universal adoption of LLC statutes).

359. *See* Tex. Comptroller Priv. Ltr. Rul. 201005184L (May 5, 2010), *available at* http://aixtcp.cpa.state.tx.us/opendocs/open32/201005184l.html (requiring the wrapper LLC to file a single franchise tax report on behalf of all series).

360. *See* TAX § 171.0002(a) (enveloping other legal entities within definition of a taxable entity).

issues, and fails to lessen administrative burdens of either taxpayers or the comptroller.[361]

361. *See, e.g.*, Matthew Larsen, Charolette Noel & Alyson Outenreath, *State Bar of Texas, Section of Taxation Texas Franchise Tax Comments Submitted to the Texas House of Representatives Ways and Means Committee on March 30, 2011*, TEX. TAX LAW., Spring 2011, at 1, 7–10, *available at* http://www.texastaxsection.org/LinkClick.aspx?fileticket=N6UhOGMuuP4%3d&tabid=80 (addressing the various concerns and issues with treating series LLCs as single taxable entities).