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INTERNAL REVENUE SERVICE
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MEMORANDUM FOR ASSOCIATE AREA COUNSEL, SB/SE:2
(WASHINGTON, D.C.)

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SUBJECT: Collection from Limited Liability Companies

This responds to your request for guidance as to the collection of tax liabilities from a Limited Liability Company ("LLC"). In accordance with I.R.C. § 6110(k)(3), this guidance should not be cited as precedent.

ISSUES

1. Who is liable for the tax resulting from the operation of a multi-member LLC?

2. Who is liable for the tax resulting from the operation of a single member LLC?

3. If the Internal Revenue Service ("Service") makes an assessment against a disregarded LLC, is that a valid assessment against the single member owner?

4. If the Service files a Notice of Federal Tax Lien ("NFTL") naming the disregarded LLC as the taxpayer, is that a valid NFTL against the single member owner?

5. Are there state law theories that the Service could use to collect the single member owner's liability from the disregarded LLC?

CONCLUSIONS

1. Determining who is the taxpayer for the liability arising from a multi-member will depend on the LLC's election. If the multi-member LLC elected to be taxed as a corporation, then the LLC is liable for the tax. The members of the LLC may be liable for the trust fund recovery penalty under I.R.C. § 6672, depending on the facts and circumstances of each case. If there has been no corporate election, then the multi-

member LLC is taxed as a partnership, which means that the partners will be liable for the income tax, and the partnership will be liable for the employment tax. But unlike the typical partnership situation where the Service asserts an employment tax liability against the partners who are liable for the debts of the partnership under state law, the Service will not assert an employment tax liability against the members of the LLC because they are not liable for the debts of the LLC under state law. These members, however, may be liable for the trust fund recovery penalty, depending on the facts and circumstances of each case.

2. Again, determining who is the taxpayer for the liability arising from a single member LLC will depend on the LLC's election. If the LLC elected to be taxed as a corporation, then the LLC is liable for the tax. The single member owner of the LLC and others may be liable for the trust fund recovery penalty under section 6672, depending on the facts and circumstances of each case. If there has been no corporate election, then the LLC is disregarded for federal tax purposes and the single member owner is the taxpayer. When the single member owner is the taxpayer, the Service may recover the tax liability from the property and rights to property of the single member owner, but the single member owner under state law has no interest in the assets of the LLC. In short, the Service may not look to the LLC's assets to satisfy the tax liability of the single member owner. The Service, however, may take collection action against the single member owner's ownership interest in the LLC.

3. An assessment made against a disregarded LLC is a valid assessment against the single member owner. In effect, because of the close relationship of the disregarded LLC to the single member owner, an assessment against the disregarded LLC is tantamount to an assessment against the single member owner.

4. A NFTL identifying the disregarded LLC as the taxpayer may be a valid notice against the single member owner, depending on the facts of each case. The Government's position is that a NFTL need not precisely identify the taxpayer; rather, the NFTL is valid if it substantially complies with the filing requirement so that constructive notice is provided to third parties. To avoid litigating this issue, we recommend that the NFTL be filed in the name of the single member owner for the tax liabilities generated by the disregarded LLC.

5. There are a variety of state law theories that the Service could use to collect a single member owner's tax liability from the disregarded LLC: asserting alter ego liability and asserting nominee or transferee liability.

BACKGROUND

An LLC is a hybrid entity created under state law, which has attributes of both a partnership and a corporation. See generally, Uniform Limited Liability Company Act (1995). See also, N.Y. Ltd. Liab. Co. Law §§ 101-1403 (McKinney 2000). The owners of an LLC are the members, who generally are not liable for the debts of the LLC. An LLC may own property in its own name, and members have no interest in such property. The law of most states permit organization of single member LLCs, i.e., LLCs having only one member commonly known as the single member owner.

Treas. Reg. § 301.7701-1 et seq. (commonly referred to as the check-the-box regulation) provides a framework for the federal tax classification of entities. Under the regulation, the classification of an LLC will depend on the number of members in the LLC and any election filed for the LLC. For example, an LLC may be either a multi-member or single member LLC. If it is a multi-member LLC, it may elect to be treated as an association taxable as a corporation. Treas. Reg. § 301.7701-3(a). If no election is made, Treas. Reg. § 301.7701-3(b)(1)(i) provides as a default that the LLC will be treated as a partnership.

Alternatively, if an LLC is a single member LLC, the question is whether it is treated as an association taxable as a corporation or as a disregarded entity. A single member owner could elect to have the LLC classified as a corporation. Treas. Reg. § 301.7701-3(a). If no election is made, Treas. Reg. § 301.7701-3(b)(1)(ii) provides that the LLC will be disregarded as an entity separate from its owner. A disregarded LLC's "activities are treated in the same manner as a sole proprietorship, branch, or division of the owner." Treas. Reg. § 301.7701-2(a).

Because a disregarded LLC is not separate from its owner for federal tax purposes, the single member owner is deemed the taxpayer with respect to liabilities arising from the LLC's business. The Service may collect this tax liability by assessing the single member owner and pursuing administrative collection action, including the filing of a NFTL. In pursuing administrative collection action, collection due process ("CDP") rights under I.R.C. §§ 6320 and 6330 must be accorded the single member owner taxpayer.

There is much confusion concerning collection issues involving LLCs. To respond to Area Counsel's request for guidance, this memorandum addresses collection issues on two levels. First, the discussion below focuses on collection considerations under the Internal Revenue Code. Second, the discussion considers collection options under state law.

DISCUSSION

I. LIABILITY AND COLLECTION UNDER THE INTERNAL REVENUE CODE

A. Multi-Member LLC

In analyzing an LLC's federal tax liability, the first consideration is whether an LLC is a single member LLC or a multi-member LLC. If it is determined that the LLC is a multi-member LLC, the next consideration is whether the LLC is taxed as a corporation or a partnership.

1. LLC taxed as a corporation

Assuming that a multi-member LLC has elected to be treated as an association taxable as a corporation, the Service would apply the general rules of corporate taxation, namely, the LLC is taxed as a corporation and the members would be the equivalent of shareholders in the corporation. To satisfy either the income tax or employment tax liability, the Service could file either a NFTL against the LLC and file suit to foreclose the federal tax lien or levy on the LLC assets. The CDP requirements of I.R.C. §§ 6320 and 6330 must also be met. The Service should not file a NFTL against the members of the LLC, as they are not the taxpayers. If the LLC incurs an employment tax liability, the Service may assert the trust fund recovery penalty against a member who qualifies as a responsible person under section 6672.

2. LLC taxed as a partnership

Most multi-member LLCs are taxed as partnerships, because association status is not elected. Thus, an income tax liability arising from an LLC's activities flows through to its members. If the Service filed a NFTL to collect the income tax liability, a partner's name as the taxpayer is listed on the NFTL.

In regard to employment taxes, an LLC, like a partnership, could incur an employment tax liability as the employer. In that case, if the Service filed a NFTL, the partnership would be listed on the NFTL as the taxpayer.

A major difference, however, exists between a general partner's liability for the partnership's employment taxes and a member's liability when an LLC is treated as a partnership and incurs an employment tax liability: while each general partner is derivatively liable for the full amount of the employment tax liability under state law, no member of the LLC has any liability for the employment tax liability under state law. It must be emphasized that state law creates the difference in treatment between general partners and LLC members, not federal law.

When a partnership incurs an employment tax liability, under state law the general partners are liable for the tax, just as they are liable under state law for other debts of the partnership. See Ballard v. United States, 17 F.3d 116 (5th Cir. 1994); United States v. Hays, 877 F.2d 843, 844 n. 3 (10th Cir. 1989). When the Service files a NFTL in this situation, the Service lists the name of the partnership and the names of the known general partners, so that notice is provided of the federal tax lien encumbering not only the partnership assets but also the general partners' assets. I.R.M. 5.19.4.6.3(6).

In contrast, where an LLC has incurred an employment tax liability as a partnership, there is no state law imposing a derivative liability on the LLC's members. Indeed, quite the opposite occurs: state law explicitly provides that a member is not liable for an LLC's debts. See, e.g., Del. Code Ann. Tit. 6, § 18-303(a). Consequently, the Service cannot collect an employment tax liability from an LLC's member, even though the LLC is treated as a partnership for federal tax purposes, since the members have no derivative state-law employment tax liability. A NFTL for that liability should not be filed against the members, but solely in the name of the partnership as the taxpayer.

Since the members are not liable for the employment tax liability of the LLC taxed as a partnership, the Service may consider asserting the trust fund recovery penalty against members, depending on the facts and circumstances of the case.

B. Single Member LLC

1. Corporate status elected

In a single member LLC situation, one must determine whether an election has been made to have the LLC treated as an association taxable as a corporation for federal tax purposes. If such an election has been made, the LLC will be treated as a separate legal entity that may accrue its own tax liability, and the Service may collect that liability only from the LLC's assets. This is the same result as when a multi-member LLC elects to be treated as a corporation. In essence, just as a sole shareholder is not liable for the corporation's tax liability, the single member owner of the LLC would be similarly insulated from the LLC's federal tax liability. To recover, in part, a Form 941 employment tax liability, the Service may assert the trust fund recovery penalty against any responsible person, which may in some situations include the single member owner. The single member owner, however, is not automatically a responsible person, and the Service will have to examine the facts and circumstances of each case to determine the responsible persons.

2. Disregarded LLC

If the single member owner has not elected to be treated as an association taxable as a corporation, the default provision of the check-the-box regulations provides that the LLC is to be disregarded. In other words, the single member owner is the taxpayer for liabilities arising from the operation of the LLC. This leads to a variety of problems as discussed below.

a. Assessment

As the taxpayer liable for federal income taxes arising from the LLC's operations, the single member owner must file the federal income tax returns from which the Service can make assessments.

The assessment considerations become more complicated in the context of employment taxes because Notice 99-6, 1999-3 I.R.B. 12 provides a single member owner with two choices for filing employment tax returns. The first choice allows a single member owner to calculate, report, and pay the employment tax obligations under its own name and employee identification number ("EIN"). The second choice allows the disregarded LLC to separately calculate, report, and pay the employment tax obligations incurred with respect to employees of the LLC under the name and EIN of the LLC. The Notice states, however, that regardless of the choice made the single member owner of a disregarded LLC is the employer for purposes of employment tax liability.

When a disregarded LLC files employment tax returns in accordance with Notice 99-6, the Service's current practice is to assess employment taxes in the name and/or EIN of the disregarded LLC. The Service's position is that an assessment in the name and EIN of the disregarded LLC is, in substance, an assessment of the single member owner's liability. This is consistent with the notion that "notices containing technical defects are valid where the taxpayer has not been prejudiced or misled by the error and is afforded a meaningful opportunity to litigate his claims." Planned Investments, Inc. v. United States, 881 F.2d 340, 344 (6th Cir. 1989) (citing Marvel v. United States, 719 F.2d 1507 (10th Cir. 1983); Allan v. United States, 386 F. Supp. 499 (N.D. Tex. 1975), aff'd without published opinion, 514 F.2d 1070 (5th Cir. 1975)). Given the close relationship between a disregarded LLC and its single member owner, any reference in an assessment to a disregarded LLC as the taxpayer is tantamount to an identification of the single member owner as the taxpayer. In substance, a disregarded LLC is a trade name by which the company's single member owner conducts business, as in Marvel v. United States, supra.

Regardless of whether an assessment of a disregarded LLC contains the name and/or taxpayer identification number of the single member owner, such an assessment is valid against the single member owner. We recommend that if the name of the company's single member owner is available, the name should be added to the assessment. Adding the single member owner's name to an assessment should not be viewed as a supplemental assessment under section 6204. Section 6204 is applicable only if the original assessment is imperfect or incomplete in a material aspect. The addition of the single member owner's name to the assessment does not mean that the assessment against the single member LLC is imperfect or incomplete in a material respect. In addition, it is not necessary to add the single member owner's social security number (SSN) or EIN to the assessment. See Moore v. United States, 93-2 U.S.T.C. (CCH) ¶ 50,495 (E.D. Cal. 1993) (Service not required to identify a taxpayer by SSN when making an assessment); United States v. Indianapolis Baptist Temple, 61 F. Supp.2d 836 (S.D. Ind. 1999) (EIN does not have to be used in making an assessment). Note, however, that the sole owner of a single member disregarded LLC with employees is required to have an EIN. See IRM 3.13.2.12.2.13(11).

b. <u>The taxpayer's property and rights to property</u>

Given a valid assessment and notice and demand upon the single member owner, the taxpayer, the Service would have a tax lien that it could enforce against the taxpayer's property and rights to property. But this raises another difficult question as to whether the single member owner taxpayer's property and rights to property include the LLC's assets. As discussed below, we conclude that the taxpayer's property and rights to property do not encompass the LLC's property.

I.R.C. § 6321 provides that if any taxpayer neglects or refuses to pay the tax liability after demand, the amount shall be a lien in favor of the United States upon all of the taxpayer's property and rights to property. I.R.C. § 6331(a) authorizes the Service to collect a tax liability by levy upon a taxpayer's property or rights to property after a taxpayer's CDP rights are satisfied. I.R.C. § 7403(a) authorizes the Government to file suit to foreclose the federal tax lien on property.

In <u>Drye v. United States</u>, 528 U.S. 49 (1999), the Supreme Court has articulated a two-prong test to determine a taxpayer's property and rights to property. <u>See also</u>, <u>United States v. National Bank of Commerce</u>, 472 U.S. 713 (1985), <u>Aquilino v. United States</u>, 363 U.S. 509 (1960), and <u>United States v. Bess</u>, 357 U.S. 51 (1958). First, a taxpayer's interests or rights must be determined under state law. Second, one must determine whether such interests or rights are property or rights to property under the Internal Revenue Code. If under the first prong, it is determined that a taxpayer has no interest or rights under state law, it follows that the taxpayer has no property or rights to property under the Internal Revenue Code.

Applying the above analysis to the single member owner of a disregarded LLC, the critical determination is defining the single member owner's property and rights to property. Under the <u>Drye</u> test, the single member owner has no property or rights to property in the LLC's assets. That is because, under the first prong of the <u>Drye</u> test, one looks to state law to determine a taxpayer's interest, and, under state law, the taxpayer has no interest in the LLC's property. Thus, as a general rule, even though the LLC's activities are treated in the same manner as a sole proprietorship, branch, or division of its single member owner for federal tax liability purposes, the Service cannot satisfy the single member owner's tax liability from the disregarded LLC's assets. Under the Internal Revenue Code, however, the Service may either levy upon the member's ownership interest in the disregarded LLC and sell that interest, or the Service may file suit to foreclose the federal tax lien against the ownership interest.

c. <u>Filing the NFTL</u>

Another problem is filing a NFTL in the disregarded LLC situation. When an LLC is disregarded, the single member owner is the taxpayer. <u>Therefore, the NFTL should be filed against the single member owner</u>. It cannot be overemphasized that the disregarded LLC is not the taxpayer with respect to any tax liabilities arising from a disregarded LLC's activities. Also, one must note the distinction between the arising of the federal tax lien and filing of a NFTL. After assessment and the taxpayer's failure to pay following demand for payment, the Service has an assessment lien that relates back to the assessment date. I.R.C. §§ 6321 and 6322. This lien is frequently referred to as the "secret assessment lien" because there is no requirement that it be publicly filed in order for it to exist.

Recognizing that "secret assessment liens" impede commerce, Congress provided in I.R.C. § 6323(a) that the "secret assessment lien" shall not be valid against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until a NFTL that meets the requirements of section 6323(f) has been filed. Section 6323(f)(3) specifies that the form and content of the NFTL shall be prescribed by the Secretary. A NFTL "must identify the taxpayer, the tax liability giving the rise to the lien, and the date the assessment arose." Treas. Reg. § 301.6323(f)-1(d)(2).

Although the regulations under section 6323 include certain requirements for a valid NFTL, certain mistakes in the NFTL will not invalidate the NFTL. For example, the Court of Appeals for the Eighth Circuit has indicated that a NFTL filed against a husband and the business he operated with his wife was valid against the wife, even though the wife was not named in the NFTL. <u>Tony Thornton Auction Service, Inc. v. United States</u>, 791 F.2d 635 (8th Cir. 1986). In <u>Tony Thornton</u>, Joe and Mary Davis operated a restaurant under the trade name "Davis Family Restaurant." After Joe and Mary Davis failed to pay substantial employment taxes, the Service made assessments and filed NFTLs against "Joe W. Davis and either 'Daviss Restaurant' or 'Davis's Restaurant'." 791 F.2d at 636. The NFTLs did not list Mary Davis as a taxpayer, nor did the NFTLs identify the business as a partnership. In an ensuing interpleader action, a judgment lien creditor argued that the NFTLs were not valid against Mary Davis because she was not listed on the NFTLs. The Eighth Circuit rejected the judgment lien creditor's argument and held that the Service had substantially complied with the identification requirement by listing her husband's name and the trade name of the business. In this regard, the Eighth Circuit elaborated on the identification requirement as follows:

> [t]he essential purpose of the filing of the lien is to give constructive notice of its existence. The test is not absolute perfection in compliance with the statutory requirement for filing the tax lien, but whether there is substantial compliance sufficient to give constructive notice and to alert one of the government's claim.

<u>Tony Thornton</u>, 791 F.2d at 639 (<u>citing</u> <u>United States v. Sirico</u>, 247 F.Supp. 421, 422 (S.D.N.Y. 1965)). Thus, the Eight Circuit concluded that a reasonable and diligent title searcher would have revealed the existence of the NFTLs filed under the names "Joe W. Davis" and either "Daviss Restaurant" or "Davis's Restaurant" and would have determined that Mary Davis was a partner in the Davis Family Restaurant.

The guiding legal principle is that the name on the NFTL must be sufficient to put a third party on notice of a lien outstanding against the taxpayer. 1/ See also IRM 5.17.2.3.5(6). Such a determination will depend on the facts and circumstances in each particular case. While a third party may not be certain that a limited liability company is a disregarded entity, the substantial compliance test does not require that the taxpayer be precisely identified. Instead, the substantial compliance test is met when the third party examining the public record is alerted to the possibility of the federal tax lien.
See Tony Thornton, 791 F.2d at 639. See also Whiting-Turner/A.L. Johnson v. P.D.H. Development, Inc., 2000-1 U.S.T.C. (CCH) ¶ 50,342 (M.D. Ga. 2000) (holding that, where the Service filed a NFTL under a name substantially identical to the taxpayer's name, a reasonable title searcher must take additional steps to discover the identity of the taxpayer). See also IRM 5.12.1.29.2(1); IRM 5.12.1.29.3.

d. Applying the substantial compliance test

The facts and circumstances of each case will determine whether the Service has met the substantial compliance test when it erroneously files a NFTL in the name of the disregarded LLC, as discussed below.

Hypothetical number one: Assume that John Doe LLC is a disregarded LLC and the operation of disregarded LLC created a federal tax liability. Also assume that the Service filed a NFTL in the name of John Doe LLC, where the name of the disregarded LLC is similar to that of the sole owner. After the Service filed a NFTL, John Doe applied for a mortgage on his home to Bank 2, which checked the in the state recording office for any federal tax liens filed against John Doe. Not finding any federal tax liens recorded against John Doe, Bank 2 took a mortgage on the home. Subsequently, Bank learned of federal tax lien filed against John Doe LLC, and now Bank 2 claims that its mortgage primes the NFTL as to the home.

The question in this hypothetical is whether the NFTL has met the substantial compliance test. On the one hand, the Government could argue that the NFTL primes the later mortgage lien on the home. The NFTL identifies the business as an LLC and provides a link to the taxpayer's name, which the diligent title searcher must investigate. See Thornton, 791 F.2d at 639 (holding that NFTL met the substantial compliance test as to Mary Davis even though NFTL did not identify Mary Davis, NFTL did not indicate that the restaurant was operated as a partnership, and state law did not require that partnership agreements identifying the general partners be filed with the

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1/ Some courts have rejected the substantial compliance test and instead require that the NFTL must give the taxpayer's correct name in order to meet the identification requirement. See, e.g., In re Focht, 99-1 U.S.T.C. ¶ 50,277 (W.D. Pa. 1999); Davis v. United States, 705 F. Supp. 446 (C.D. Ill. 1989).

state). See also, Hudgins, v. Internal Revenue Service, 132 B.R. 115 (E.D. Va. 1991), aff'd as modified and remanded, 967 F.2d 973 (4th Cir. 1992) (holding that a NFTL filed against "Hudgins Masonry, Inc." met the substantial compliance test, as a diligent title searcher would have searched and discovered that the corporation had been terminated under state law and that the tax liability was actually that of "Michael Hudgins."). It is reasonable to assume that John Doe could be an individual having some link to the limited liability company. Thus, a third party could search the limited liability company records of the secretary of state to determine the identity of the sole owner. Also, state records might identify the business address of the limited liability company, where further inquiries could be addressed. From these links to the single member owner, the diligent title searcher may be able to determine that the LLC is a disregarded. 2/ The burden rests on the diligent title searcher to investigate and do more than merely rely on the information available in the county records office. See American Surety Co. v. Sunberg, 363 P.2d 99, 103 (Wash. 1961) (NFTL filed against "Oscar Sundberg and Sons" was valid as to all the members of the partnership even though the NFTL did not identify the business as a partnership, did not identify Carl and Thor Sundberg as general partners, and state law did not require that partnership agreements identifying the general partners be filed with the state). Contra, In re Focht, 243 B.R. 263 (W.D. Pa. 1999) (rejecting Thornton and holding that NFTL did not meet the substantial compliance test as to a general partner who was not listed on the NFTL). The burden on the diligent title searcher in this hypothetical is arguably lighter than the burden in the Thornton and Sunberg cases because the NFTL identifies John Doe and identifies the type of business.

On the other hand, Bank 2 could plausibly argue that the substantial compliance test has not been met because the county records do not identify John Doe LLC as a disregarded LLC for federal tax purposes, and it has no duty to search any further. See Focht, 243 B.R. at 265 (county records did not indicate that federal tax lien encumbered property of "Ronald D. Focht," where NFTL filed only against "Country Fochts Restaurant & Bakery" and "Lois E. Focht, General Partner"). Nothing in section 6323(f), which provides for the filing of a NFTL, requires a third party to check multiple locations to determine if a NFTL has been filed on a taxpayer's home. See I.R.C. § 6323(f)(1)(A)(i) (providing that NFTL shall be filed in the case of real property in the one office within the state).

[redacted]

2/ To determine if a single member LLC is a disregarded LLC, Bank 2 could ask the taxpayer to sign a written consent allowing the Service to disclose the status of the LLC to Bank 2. See Temp. Treas. Reg. § 301.6103-1T (providing procedures for a taxpayer to consent to a disclosure of return information to a third party).

Hypothetical number two: Assume the name of the LLC is “Eagle LLC” and the name of the single member owner is John Jones. We would conclude that the NFTL listing “Eagle LLC” as the taxpayer fails to substantially comply with the notice requirements of section 6323(f). A diligent title searcher would have no reason to believe a link existed between “Eagle LLC” and John Jones, and would not investigate any further. Thus, the NFTL filed against Eagle LLC would be invalid against John Jones. Once it is determined that the NFTL contains an error that essentially invalidates the NFTL, the Service should refile the NFTL with the correct name of the taxpayer if the period of limitations on collection is still open. In the above example, the Service would need to refile a NFTL against John Jones to protect the government’s priority interest, as “[t]he sine qua non of § 6323 is notice to subsequent takers of the existence of the IRS lien.” Davis v. United States, 705 F. Supp. 446, 453 (C.D. Ill. 1989).

Hypothetical number three: Taking the preceding example one step further, John Jones may ask the Service to release the NFTL filed against “Eagle LLC.” We do not think that the Service could release the tax lien in this situation, because a release of lien is only warranted in the following circumstances: (1) the liability for the amount assessed (with interest) has been fully satisfied or has become legally unenforceable; or (2) a bond is furnished to the Service guaranteeing payment of the amount assessed (with interest) within the period of limitations on collection. I.R.C. § 6325(a)(1), (2). In this example, no bond has been furnished, so that method for releasing the lien does not exist. Also, because John Jones has not fully paid his tax liability, the tax lien cannot be released under the theory it has been fully satisfied. Finally, because the statute of limitations on collection has not expired for the valid assessment lien against John Jones, the Service cannot release the tax lien under the theory that lien has become legally unenforceable. 3/

The Service in this situation, however, may withdraw the NFTL without extinguishing the underlying assessment lien. Withdrawal of a NFTL is warranted if the Service determines that one of the following conditions is met: (1) the filing of the NFTL was premature or otherwise not in accordance with administrative procedures; (2) the taxpayer has entered into an installment agreement under I.R.C. § 6159, unless the agreement provides otherwise; (3) withdrawal of the NFTL will facilitate collection of the liability; or (4) withdrawal of the NFTL is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States. I.R.C. § 6323(j)(1)(A)-(D); IRM 5.17.2.3.6(2)(a)-(d). The Service must provide a copy of the withdrawal to the taxpayer. I.R.C. § 6323(j)(1). Thus, if the NFTL lists “Eagle LLC” as the taxpayer and the name of the sole owner is John Jones, the Service may withdraw the NFTL, as it fails to comply with the Service’s administrative procedures, and may refile the NFTL, reflecting John Jones as the taxpayer.

3/ If the Service released the federal tax lien, the underlying assessment lien would be extinguished. I.R.C. § 6325(f)(1)(A)

d. Trust fund recovery penalty

When an LLC is disregarded, the single member owner is not only the taxpayer but also the employer for employment taxes. See I.R.C. § 3401(d) (definition of 'employer"). As the employer, the single member owner is liable for both the trust fund and non-trust fund portions of the tax. Since section 6672 recovers only the liability for trust fund taxes, asserting section 6672 against the single member owner will not recover the non-trust fund liability. Consequently, the Service will generally not be asserting a section 6672 liability against the single member owner when trust fund and non-trust fund liabilities exist. The Service, however, may assert the trust fund recovery penalty against other responsible persons in a disregarded LLC situation, e.g., bookkeepers and managers.

II. DISREGARDED LLCs: LIABILITY AND COLLECTION UNDER STATE LAW

A. Alter ego

The Service can rely on state law principles permitting a creditor to disregard a corporate business entity by "piercing the corporate veil." If the corporate veil is pierced, the corporation and the taxpayer-owner are considered alter egos, and the liabilities of the owner may be collected from the corporation, or vice versa. See, e.g., Miller v. Alamo, 134 F.3d 910 (8th Cir. 1998); Wolfe v. United States, 798 F.2d 1241 (9th Cir. 1986); Avco Delta Corp. Canada Ltd. v. United States, 540 F.2d 258 (7th Cir. 1976).

The alter ego theory has been asserted in the corporate context when facts show that there is such a unity of interest and ownership between the subject taxpayer and corporation that the individuality or separateness of the taxpayer and the corporation has ceased. Generally there are facts that show that adhering to the fiction of a separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote an injustice. See I.R.M. 5.12.1.18.2. It is well established that a corporate entity can be pierced where the entity is being used to evade the payment of taxes. Wolfe v. United States, supra, 798 F.2d at 1244; Valley Finance, Inc. v. United States, 629 F.2d 162, 171-72 (D.C. Cir. 1980), cert. denied, 451 U.S. 1018 (1981).

One court has recognized that the concept of piercing the corporate veil can be used to disregard an entity organized as an LLC. See Hollowell v. Orleans Regional Hospital, 1998 U.S. Dist. LEXIS 8184 (E.D. La. 1998), aff'd, 217 F.3d 379 (5th Cir. 2000). The court stated that:

> [T]he “veil” of protection afforded [the LLC] by its Limited Liability Company form may be “pierced” if in fact [the LLC] was operating as the “alter ego” of [the LLC’s members] or if [the LLC’s members] were committing fraud or deceit on third parties through [the LLC].”

1998 U.S. Dist. LEXIS 8184 at 12.

There is an extensive discussion of this issue in a 1994 law review article, Fox, “Piercing the Veil of Limited Liability Companies,” 62 GEO. WASH. L. REV. 1143 (1994). 4/ This article discusses some of the factors which have been used to disregard corporate entities: occurrences of fraud; inadequate capitalization of the corporate entity; failure to adhere to corporate formalities (such as commingling of funds); and abuse of the corporate entity so as to amount to complete dominance by the shareholder or shareholders. Id. at 1155. The article concludes that the failure to adhere to the corporate formalities factor may be difficult to apply in the LLC context since an LLC by its very nature does not involve the formalities of a corporation. Id. at 1172. The article also concludes that lack of separateness should not be a factor because LLCs are intended to be managed by their members. Id. at 1174. However, the article suggests that inadequate capitalization can alone be a sufficient reason for piercing the LLC veil. Id. at 1176.

Likewise the Service can, on a case-by-case basis, consider judicial collection of a tax liability of a member of a single member LLC from the LLC’s assets, where there are sufficient grounds for “piercing the LLC veil.” Such grounds would include where the taxpayer is using the LLC form to shield assets from the Service, such as where income earned by the taxpayer is being paid directly to the LLC. Although it will be helpful to establish that the taxpayer and the LLC are not practically operating as separate entities, we believe that the most influential factor in litigation may be that the LLC is being used to evade the payment of taxes.

Moreover, the fact that the LLC is disregarded under the “check-the-box” regulations for purposes of computing the taxpayer’s tax liability may make the courts amenable to applying the alter ego/piercing the corporate veil concepts to the LLC. Arguably, where due to the “check-the-box” regulations the individual taxpayer is responsible for reporting and paying all income earned by the LLC, and the individual arranges his business affairs so that the LLC, rather than the individual taxpayer, has the assets to pay the tax liability, this could be significant factor supporting piercing the LLC veil.

4/ See also Comment, “Limited Liability Companies: Issues in Member Liability,” 44 UCLA L. REV. 1541 (1997); R. Thompson, “The Limits of Liability in the New Limited Liability Entities,” 32 WAKE FOREST L. REV. 1 (1997); R. Maizes, “Limited Liability Companies: A Critique,” 70 ST. JOHN’S L. REV. 575 (1996); W. Gazur & N. Goff, “Assessing the Limited Liability Company,” 41 CASE W. RES. L. REV. 387 (1991).

If sufficient grounds exist for piercing the LLC veil, then any tax lien against the individual taxpayer-member-owner attaches to the property of the LLC because the LLC is an alter ego of the taxpayer-member-owner. See G.M. Leasing Corp. v. United States, 429 U.S. 338, 350-51 (1977); see also Shades Ridge Holding Co. v. United States, 888 F.2d 725 (11th Cir. 1989), cert. denied sub nom. Fiorella v. United States, 494 U.S. 1027 (1990). The Service can file alter ego liens against the LLC to collect the tax liability of the taxpayer-member-owner, or file a lien foreclosure suit to collect from the assets of the LLC. See I.R.M. 5.12.1.33.

B. Nominee liability

In an appropriate case the Service might assert nominee liability to satisfy the individual taxpayer's tax liability. A nominee theory involves the determination of the true beneficial ownership of property. E.g., United States v. Webb, 595 F.2d 203 (4th Cir. 1979). Where it can be shown that property nominally held by one other than the taxpayer is the taxpayer's property, administrative collection action against such property is authorized. Accordingly, "property held in the name of a nominee is subject to lien, not for taxes of the nominee ... but for those of the true owner ...." W. Plumb, Federal Tax Liens at 19 n. 48 (3d ed. 1972) (citing, inter alia, United States v. Lewis, 272 F. Supp. 993 (N.D. Ill. 1967) and United States v. Johnson, 200 F. Supp. 589 (D. Ariz. 1961)). Moreover, specific property in which a third party has legal title may be levied upon as a nominee of the taxpayer if the taxpayer in fact has beneficial ownership of the property. Oxford Capital Corp. v. United States, supra. See, e.g., Towe Antique Ford Foundation v. Internal Revenue Service, 791 F. Supp. 1450, 1454 (D. Mont. 1992), aff'd without opinion, 768 F.2d 686 (5th Cir. 1985).

There are no particular elements required for a determination of nominee liability. However, the courts have identified many factors which, based upon the totality of the facts and circumstances, may indicate that actual ownership of the property rests in the taxpayer: (1) no consideration or inadequate consideration paid by the nominee; (2) property placed in the name of the nominee in anticipation of a suit or occurrence of liabilities while the transferor continues to exercise control over the property; (3) close relationship between transferor and the nominee; (4) failure to record conveyance; (5) retention of possession by the transferor; (6) exercise of dominion or control by the taxpayer; and (7) expenses of the property paid by the taxpayer. See United States v. Miller Brothers Construction Co., 505 F.2d 1031 (10th Cir. 1974); Towe Antique Ford Foundation v. Internal Revenue Service, supra.

Although nominee liability and alter ego are distinct legal theories, many of the elements that might support piercing the LLC veil–such as the pervasive control of the taxpayer and failure to observe business formalities–also might support liability under a nominee theory. However, under a nominee theory, only the property being held by the nominee in a nominee capacity may be attached. Under an alter ego theory, all of the assets of the alter ego may be levied upon to satisfy the tax liabilities of a delinquent taxpayer.

C. Transferee liability

Finally, in cases where a member-owner of an LLC transferred property to the LLC, the Service might be able to assert transferee liability to satisfy the member's tax liability. There are two fundamental elements to transferee liability: (1) there must be a transfer of the taxpayer's property to a third party; and (2) the taxpayer-transferor must be liable for the tax at the time of transfer and at the time transferee liability is asserted. T. Peyser, Transferee Liability 628 T.M. A-4(1) (1998).

Generally, transferee liability is based upon a fraudulent conveyance under state law. A fraudulent conveyance arises where property is conveyed, or alienated or placed beyond the reach of ordinary process by a debtor in fraud of creditors. Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors. Uniform Fraudulent Conveyance Act § 7. Moreover, every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration. Id. § 4.

All the facts and circumstances are considered in determining whether a fraudulent conveyance exists. Some of the elements or badges to which courts look in making this determination are: (1) the insolvency of the grantor; (2) inadequate consideration; (3) transfer of all of the debtor's property; (4) transfer made in anticipation of a suit or occurrence of liabilities; (5) close relationship between the parties to the transfer; (6) conveyance not in usual course of business; (7) failure to record conveyance by transferee; (8) retention of possession by grantor; (9) reservation of interest, trust, or benefit by grantor; (10) security in excess of debt; (11) secrecy or haste in transaction; and (12) assessment of real property taxes in name of grantor.

Assuming the presence of a transfer between the member-owner and the LLC, many of the factors which tend to support piercing the LLC veil–such as pervasive control by the individual taxpayer over the LLC–also tend to support transferee liability. The Service may rely on alternate theories provided the precise distinctions between the theories are recognized and there are facts to support each theory. Transferee liability can be asserted administratively pursuant to I.R.C. § 6901.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS

The above discussion asserts that an assessment against a disregarded LLC is a valid assessment against the single member owner. [redacted]

Also, as previously discussed, if the Service files a NFTL that does not accurately identify the taxpayer, a court may not apply the substantial compliance test. If a court does apply the substantial compliance test, there is no certainty that a NFTL filed against an LLC will be treated as a valid notice against a single member owner.

cc: Division Counsel (SB/SE)