

## What is a Limited Liability Company?

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A Limited Liability Company (*LLC*) is a relatively new business structure allowed by state statute.

LLCs are popular because, similar to a corporation, owners have limited personal liability for the debts and actions of the LLC. Other features of LLCs are more like a partnership, providing management flexibility and the benefit of pass-through taxation.

Owners of an LLC are called members. Since most states do not restrict ownership, members may include individuals, corporations, other LLCs and foreign entities. There is no maximum number of members. Most states also permit “single member” LLCs, those having only one owner.

A few types of businesses generally cannot be LLCs, such as banks, insurance companies and nonprofit organizations. Check your state’s requirements and the federal tax regulations for further information.<sup>1</sup>

There are special rules for foreign LLCs, which are not covered in this publication.



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<sup>1</sup> Treasury Regulation Section 301.7701-1,-2,-3



# Tax Issues for Limited Liability Companies



*What You  
Should  
Know About  
Limited Liability  
Companies . . .*



## What Kind of Tax Return Do I File?

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### 1. Single member LLCs.

Generally, when an LLC has only one member, the fact that it is an LLC is ignored or “disregarded” for the purpose of filing a federal tax return.<sup>1</sup>

Remember, this is only a mechanism for tax purposes. It doesn’t change the fact that the business is legally a Limited Liability Company.

- If the only member of the LLC is an **individual**, the LLC income and expenses are reported on Form 1040, Schedule C, E, or F.
- If the only member of the LLC is a **corporation**, the LLC income and expenses are reported on the corporation’s return, usually Form 1120 or Form 1120S.

If you prefer to file as a corporation instead of as a “disregarded entity” Form 8832 must be submitted. Otherwise, you don’t need to file Form 8832.

Single-member LLCs may not file a partnership return.

### 2. Multiple Member LLCs

Most LLCs with more than one member file a partnership return, Form 1065. If you would rather file as a corporation, Form 8832 must be submitted.<sup>1</sup> You don’t need to file a Form 8832 if you want to file as a partnership.

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<sup>1</sup> Treasury Regulations Section 301.7701-1,-2,-3

## How do I handle Employment Taxes?

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Employment tax requirements apply to LLCs in much the same way as other types of businesses.

### Information Reporting

- Employees of all LLCs are subject to withholding taxes.
- Forms W-2 and Forms 1099 must be filed when required.

As a member, your liability for LLC debts are limited by state law. However, you may be held personally liable in situations involving unpaid employee withholdings if you are found to be the person responsible for making the payments.<sup>2</sup>

### Self-Employment Taxes

#### 1. LLCs filing Schedule C or F

- Members are subject to self-employment taxes on earnings.

#### 2. LLCs filing Partnership Returns

- Generally, members pay self-employment tax on their share of partnership earnings.
- There is a special rule for members who are the equivalent of limited partners. They pay self-employment tax only if the LLC pays them for services.

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<sup>2</sup> Internal Revenue Code Section 6671 and 6672

## Employer Identification Numbers (EINs)

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- General information on EINs is provided in Publication 1635.
- Notice 99-6<sup>3</sup> provides special guidance for single-member LLCs when an EIN is needed to report employment tax liabilities.

### Are there any Pitfalls?

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There are two common situations where unintentional errors may occur:

1. If you convert an existing business, such as a corporation, into an LLC there may be tax implications, such as:
  - The conversion may result in a taxable gain;
  - Employment tax wage bases may be affected.
2. Special rules may apply when your LLC has an operating loss:
  - The amount of loss you can deduct may be limited because of your limited liability for LLC debts.<sup>4</sup>
  - Passive Activity Loss limitation may restrict the amount of loss you can deduct.<sup>5</sup>

If either of these situations applies to you, professional advice may be needed.

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<sup>3</sup> Notice 99-6, 1999-3.I.R.B 12

<sup>4</sup> Internal Revenue Code Section 465

<sup>5</sup> Internal Revenue Code Section 469

## What If I Need More Help?

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Here are some places where you can find out more about federal tax issues for Limited Liability Companies:

- Tax Assistance by telephone: 1-800-829-1040
- Order forms by telephone: 1-800-829-3676
- IRS on the Internet: [www.irs.gov](http://www.irs.gov)
- Publication 15 (*Employer’s Tax Guide*)
- Publication 334 (*Tax Guide for Small Business*)
- Publication 541 (*Partnerships*)
- Publication 542 (*Corporations*)
- Publication 1635 (*Understanding Your EIN*)
- Form 8832 (*Entity Classification Election*)