



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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MEMORANDUM FOR VIRGINIA-WEST VIRGINIA DISTRICT COUNSEL
(RICHMOND)

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Ability to Levy upon Single Member LLC
for Tax Liability of Owner

ISSUE: Can the Service levy on the assets of a one-member Limited Liability Company solely owed by an individual taxpayer to satisfy the tax liability of the taxpayer?

CONCLUSIONS: 1. The Service can only collect from the property of the taxpayer to satisfy taxpayer's liability. The mere fact that the LLC entity is disregarded for federal tax purposes does not entitle the Service to disregard the entity for purposes of collection.

2. Depending on the facts of the case, the Service may have several collection options including collecting the taxpayer's distributive interest in the LLC, or collecting from the assets of the LLC on the basis that it is the alter ego of the taxpayer.

FACTS: The individual taxpayer (hereinafter, taxpayer X) is the sole member of a single-member limited liability company (hereinafter, LLC Y) formed under the laws of West Virginia. The Revenue Officer issued a notice of levy on a business for which taxpayer X is performing services and was told that pursuant to the taxpayer's instructions payments are being made to LLC Y rather than taxpayer X. The question has been raised whether the Service can file a lien against LLC Y on the ground that the LLC entity is disregarded for federal tax purposes because it has a single owner.

LAW AND ANALYSIS: Pursuant to West Virginia law, an LLC is a legal entity distinct from its members. W. Va. Code § 31B-2-201 (1996). An LLC may be organized by one or more members. W. Va. Code § 31B-2-202(a)(1996). A member is not a co-owner of, and has no transferable interest in, property of the LLC. W. Va. Code § 31B-5-501(a) (1996). However, an interest in the distributions due to a member from the LLC (the "distributive interest") is personal property of the member and may be transferred. W. Va. Code § 31B-5-501(b) (1996).

The “check-the-box” regulations determine how a business entity is to be classified for federal tax purposes. A business entity with a single owner which is not classified as a corporation under the regulations may elect to be classified as an association (and, thus, taxed like a corporation) or to be disregarded as an entity separate from its owner. Treas. Reg. § 301.7701-3(a). If no election is made, the entity is disregarded as an entity separate from its owner. Treas. Reg. § 301.7701-3(b)(1). Thus, if the owner is an individual all income is reported on the individual's returns in the same manner an individual would report the income of a sole proprietorship, and the individual is the employer for purposes of employment taxes. ^{1/}

If a person liable to pay any tax refuses to pay the tax after demand, the amount due shall be a lien in favor of the United States upon all property and rights to property belonging to such person. I.R.C. § 6321. If a person liable to pay any tax neglects or refuses to pay within 10 days after notice and demand, after the pre-levy notices required by I.R.C. §§ 6330 and 6331(d) are given, the Service may collect such tax by levy upon all property and rights to property belonging to such person or on which there is a lien. I.R.C. § 6331(a).

State law controls in determining the nature of a person's interest in property for purposes of determining whether the tax lien or levy attaches. United States v. National Bank of Commerce, 472 U.S. 713 (1985); Aquilino v. United States, 363 U.S. 509 (1960); United States v. Bess, 357 U.S. 51 (1958). In this case, the individual taxpayer X is the “person” liable for tax pursuant to the check-the-box regulations. Assuming that the LLC is a valid entity under state law, pursuant to the state LLC statutes taxpayer X has no property interest in property of LLC Y. Thus, the Service could not serve a levy on a third party to seize a debt owed to LLC Y to collect the tax liability of taxpayer X since the property of LLC Y does not belong to taxpayer X. Cf. Rev. Rul. 73-24, 1973 C.B. 602 (since a partnership checking account is an asset and property of the partnership and not an asset or property of the individual partner, the checking account is not subject to levy to satisfy a tax assessed against an individual partner).

We conclude that this result is not changed by the fact that the business entity LLC Y is disregarded as an entity separate from taxpayer X for federal tax purposes under the regulation. The regulation does not alter the provisions of sections 6321 and 6331, which only permit collection from the property of the person liable for the tax. The “person” liable for the tax in this case is the individual taxpayer X. The “person” taxpayer X does not own the property of LLC Y pursuant to state law. Thus, we do not

^{1/} The Service has announced temporary procedures whereby it will permit single owners of disregarded entities to fulfill their employment tax obligations by the reporting and payment of the employment tax liabilities by the disregarded entity. Notice 99-6, 1999-3 I.R.B. 1. The Notice cautions, however, that if this method is chosen, the owner retains ultimate responsibility for the employment tax obligations incurred with respect to employees of the disregarded entities.

believe that it is inconsistent to disregard an LLC entity for purposes of determining federal tax liability, but to recognize the LLC as a valid entity for determining what property the taxpayer has an ownership interest in under state law. This result follows from the general principal that state law determines what property a taxpayer has an interest in for purposes of tax collection.

However, there are collection options available to the Service. First, because taxpayer X has a transferable distributional interest in LLC Y pursuant to the West Virginia statutes, this distributional interest is property of taxpayer X that can be reached by the tax lien and levy. The Service can levy on LLC Y to reach the distributions due to taxpayer X. Thus, for example, if the taxpayer is supporting himself from the net income of the LLC, then the distributional interest should be such net income, and the tax lien and levy should attach to such income.

We also conclude that depending on the facts of the case, the Service can file alter ego liens against the LLC in reliance on state law principles permitting a creditor to disregard a business entity. This has been done in cases involving corporations based on the concept of "piercing the corporate veil." If the corporate veil is pierced, the corporation is considered an alter ego of the taxpayer/owner. See, e.g., 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); Miller v. Alamo, 134 F.3d 910 (8th Cir. 1998). A corporate entity can be pierced where the entity is being used to evade the payment of taxes. Wolfe, supra, 798 F.2d 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 a LLC. Hollowell v. Orleans Regional Hospital, 1998 U.S. Dist. Lexis 8184 (E.D. La. 1998). 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). 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 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 concludes that inadequate capitalization can alone be a sufficient reason for piercing the LLC veil. Id. at 1176.

We conclude that the Service can, on a case-by-case basis, consider 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. The fact that the LLC is disregarded for purposes of computing the taxpayer's tax liability will probably make the courts receptive to such an approach. Thus, 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 sufficient grounds for piercing the LLC veil.

If sufficient grounds exist for piercing the LLC veil in this case, then the tax lien against taxpayer X attaches to the property of LLC Y because LLC Y is an alter ego of taxpayer X. See G. M. Leasing Corp. v. United States, 429 U.S. 338, 350-51 (1977); Shades Ridge Holding Co., Inc. v. United States, 888 F.2d 725 (11th Cir. 1989), cert. denied Fiorella v. United States, 494 U.S. 1027 (1990). The Service can, thus, file alter ego liens against LLC Y to collect the tax liability of taxpayer X, or can file a lien foreclosure suit to collect from the assets of LLC Y. See IRM 5.12.1.33. The filing of an alter ego lien requires legal review by district counsel. Id.

We, thus, conclude, that the mere fact that an LLC entity is disregarded as an entity separate from the taxpayer for federal tax purposes does not entitle the Service to collect from the property of the LLC entity as if it does not exist. State law still controls for purposes of determining the taxpayer's interest in property. However, based on the facts of each particular case, the Service may have various collection options including collecting from the taxpayer's distributive interest, and collecting from the assets of the LLC on the ground that it is an alter ego of the taxpayer. Whether these options are available must be determined on a case by case basis. We have insufficient facts to comment on whether these options are available in your specific case.

Please contact this office at (202) 622-3620 if you have any questions or comments concerning this memorandum.