



Internal Revenue Bulletin: 2010-45

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REG-119921-09

Notice of Proposed Rulemaking Series LLCs and Cell Companies

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AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Notice of proposed rulemaking.

SUMMARY:

This document contains proposed regulations regarding the classification for Federal tax purposes of a series of a domestic series limited liability company (LLC), a cell of a domestic cell company, or a foreign series or cell that conducts an insurance business. The proposed regulations provide that, whether or not a series of a domestic series LLC, a cell of a domestic cell company, or a foreign series or cell that conducts an insurance business is a juridical person for local law purposes, for Federal tax purposes it is treated as an entity formed under local law. Classification of a series or cell that is treated as a separate entity for Federal tax purposes generally is determined under the same rules that govern the classification of other types of separate entities. The proposed regulations provide examples illustrating the application of the rule. The proposed regulations will affect domestic series LLCs; domestic cell companies; foreign series, or cells that conduct insurance businesses; and their owners.

DATES:

Written or electronic comments and requests for a public hearing must be received by December 13, 2010.

ADDRESSES:

Send submissions to: CC:PA:LPD:PR (REG-119921-09), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-119921-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking portal at www.regulations.gov (IRS REG-119921-09)

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, Joy Spies, (202) 622-3050; concerning submissions of comments, Oluwafunmilayo (Funmi) Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

1. Introduction

A number of states have enacted statutes providing for the creation of entities that may establish series, including limited liability companies (series LLCs). In general, series LLC statutes provide that a limited liability company may establish separate series. Although series of a series LLC generally are not treated as separate entities for state law purposes and, thus, cannot have members, each series has "associated" with it specified members, assets, rights, obligations, and investment objectives or business purposes. Members' association with one or more particular series is comparable to direct ownership by the members in such series, in that their rights, duties, and powers with respect to the series are direct and specifically identified. If the conditions enumerated in the relevant statute are satisfied, the debts, liabilities, and obligations of one series generally are enforceable only against the assets of that series and not against assets of other series or of the series LLC.

Certain jurisdictions have enacted statutes providing for entities similar to the series LLC. For example, certain statutes provide for the chartering of a legal entity (or the establishment of cells) under a structure commonly known as a protected cell company, segregated account company or segregated portfolio company (cell company). A cell company may establish multiple accounts, or cells, each of which has its own name and is identified with a specific participant, but generally is not treated under local law as a legal entity distinct from the cell company. The assets of each cell are statutorily protected from the creditors of any other cell and from the creditors of the cell company.

Under current law, there is little specific guidance regarding whether for Federal tax purposes a series (or cell) is treated as an entity separate from other series or the series LLC (or other cells or the cell company, as the case may be), or whether the company and all of its series (or cells) should be treated as a single entity.

Notice 2008-19, 2008-1 C.B. 366 requested comments on proposed guidance concerning issues that arise if arrangements entered into by a cell constitute insurance for Federal income tax purposes. The notice also requested comments on the need for guidance concerning similar segregated arrangements that do not involve insurance. The IRS received a number of comments requesting guidance for similar arrangements not involving insurance, including series LLCs and cell companies. These comments generally recommended that series and cells should be treated as separate entities for Federal tax purposes if they are established under a statute with provisions similar to the series LLC statutes currently in effect in several states. The IRS and Treasury Department generally agree with these comments. See §601.601(d)(2)(ii)(b).

2. Entity Classification for Federal Tax Purposes

A. Regulatory framework

Sections 301.7701-1 through 301.7701-4 of the Procedure and Administration Regulations provide the framework for determining an organization's entity classification for Federal tax purposes. Classification of an organization depends on whether the organization is treated as: (i) a separate entity under §301.7701-1, (ii) a "business entity" within the meaning of §301.7701-2(a) or a trust under §301.7701-4, and (iii) an "eligible entity" under §301.7701-3.

Section 301.7701-1(a)(1) provides that the determination of whether an entity is separate from its owners for Federal tax purposes is a matter of Federal tax law and does not depend on whether the organization is recognized as an entity under local law. Section 301.7701-1(a)(2) provides that a joint venture or other contractual arrangement may create a separate entity for Federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. However, a joint undertaking merely to share expenses does not create a separate entity for Federal tax purposes, nor does mere co-ownership of property where activities are limited to keeping property maintained, in repair, and rented or leased. *Id.*

Section 301.7701-1(b) provides that the tax classification of an organization recognized as a separate entity for tax purposes generally is determined under §§301.7701-2, 301.7701-3, and 301.7701-4. Thus, for example, an organization recognized as an entity that does not have associates or an objective to carry on a business may be classified as a trust under §301.7701-4.

Section 301.7701-2(a) provides that a business entity is any entity recognized for Federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under §301.7701-3) that is not properly classified as a trust or otherwise subject to special treatment under the Internal Revenue Code (Code). A business entity with two or more members is classified for Federal tax purposes as a corporation or a partnership. See §301.7701-2(a). A business entity with one owner is classified as a corporation or is disregarded. See §301.7701-2(a). If the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. However, §301.7701-2(c)(2)(iv) and (v) provides for an otherwise disregarded entity to be treated as a corporation for certain Federal employment tax and excise tax purposes.

Section 301.7701-3(a) generally provides that an eligible entity, which is a business entity that is not a corporation under §301.7701-2(b), may elect its classification for Federal tax purposes.

B. Separate entity classification

The threshold question for determining the tax classification of a series of a series LLC or a cell of a cell company is whether an individual series or cell should be considered an entity for Federal tax purposes. The determination of whether an organization is an entity separate from its owners for Federal tax purposes is a matter of Federal tax law and does not depend on whether the organization is recognized as an entity under local law. Section 301.7701-1(a)(1). In *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943), the Supreme Court noted that, so long as a corporation was formed for a purpose that is the equivalent of business activity or the corporation actually carries on a business, the corporation remains a taxable entity separate from its shareholders. Although entities that are recognized under local law generally are also recognized for Federal tax purposes, a state law entity may be disregarded if it lacks business purpose or any business activity other than tax avoidance. See *Bertali v. Commissioner*, 103 T.C. 501 (1994); *Aldon Homes, Inc. v. Commissioner*, 33 T.C. 582 (1959).

The Supreme Court in *Commissioner v. Culbertson*, 337 U.S. 733 (1949), and *Commissioner v. Tower*, 327 U.S. 280 (1946), set forth the basic standard for determining whether a partnership will be respected for Federal tax purposes. In general, a partnership will be respected if, considering all the facts, the parties in good faith and acting with a business purpose intended to join together to conduct an enterprise and share in its profits and losses. This determination is made considering not only the stated intent of the parties, but also the terms of their agreement and their conduct. *Madison Gas & Elec. Co. v. Commissioner*, 633 F.2d 512, 514 (7th Cir. 1980); *Luna v. Commissioner*, 42 T.C. 1067, 1077-78 (1964).

Conversely, under certain circumstances, arrangements that are not recognized as entities under state law may be treated as separate entities for Federal tax purposes. Section 301.7701-1(a)(2). For example, courts have found entities for tax purposes in some co-ownership situations where the co-owners agree to restrict their ability to sell, lease or encumber their interests, waive their rights to partition property, or allow certain management decisions to be made other than by unanimous agreement among co-owners. *Bergford v. Commissioner*, 12 F.3d 166 (9th Cir. 1993); *Bussing v. Commissioner*, 89 T.C. 1050 (1987); *Alhouse v. Commissioner*, T.C. Memo. 1991-652. However, the Internal Revenue Service (IRS) has ruled that a co-ownership does not rise to the level of an entity for Federal tax purposes if the owner employs an agent whose activities are limited to collecting rents, paying property taxes, insurance premiums, repair and maintenance expenses, and providing tenants with customary services. Rev. Rul. 75-374, 1975-2 C.B. 261. See also Rev. Rul. 79-77, 1979-1 C.B. 448, (see §601.601(d)(2)(ii)(b)).

Rev. Proc. 2002-22, 2002-1 C.B. 733, (see §601.601(d)(2)(ii)(b)), specifies the conditions under which the IRS will consider a request for a private letter ruling that an undivided fractional interest in rental real property is not an interest in a business entity under §301.7701-2(a). A number of factors must be present to obtain a ruling under the revenue procedure, including a limit on the number of co-owners, a requirement that the co-owners not treat the co-ownership as an entity (that is, that the co-ownership may not file a partnership or corporate tax return, conduct business under a common name, execute an agreement identifying any or all of the co-owners as partners, shareholders, or members of a business entity, or otherwise hold itself out as a partnership or other form of business entity), and a requirement that certain rights with respect to the property (including the power to make certain management decisions) must be retained by co-owners. The revenue procedure provides that an organization that is an entity for state law purposes may not be characterized as a co-ownership under the guidance in the revenue procedure.

The courts and the IRS have addressed the Federal tax classification of investment trusts with assets divided among a number of series. In *National Securities Series-Industrial Stocks Series v. Commissioner*, 13 T.C. 884 (1949), *acq.*, 1950-1 C.B. 4, several series that differed only in the nature of their assets were created within a statutory open-end investment trust. Each series regularly issued certificates representing shares in the property held in trust and regularly redeemed the certificates solely from the assets and earnings of the individual series. The Tax Court stated that each series of the trust was taxable as a separate regulated investment company. See also Rev. Rul. 55-416, 1955-1 C.B. 416, (see §601.601(d)(2)(ii)(b)). But see *Union Trusteed Funds v. Commissioner*, 8 T.C. 1133 (1947), (series funds organized by a state law corporation could not be treated as if each fund were a separate corporation).

In 1986, Congress added section 851(g) to the Code. Section 851(g) contains a special rule for series funds and provides that, in the case of a regulated investment company (within the meaning of section 851(a)) with more than one fund, each fund generally is treated as a separate corporation. For these purposes, a fund is a segregated portfolio of assets the beneficial interests in which are owned by holders of interests in the regulated investment company that are preferred over other classes or series with respect to these assets.

C. Insurance company classification

Section 7701(a)(3) and §301.7701-2(b)(4) provide that an arrangement that qualifies as an insurance company is a corporation for Federal income tax purposes. Sections 816(a) and 831(c) define an insurance company as any company more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. See also §1.801-3(a)(1), (“[T]hrough its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code.”). Thus, an insurance company includes an arrangement that conducts insurance business, whether or not the arrangement is a state law entity.

3. Overview of Series LLC Statutes and Cell Company Statutes

A. Domestic statutes

Although §301.7701-1(a)(1) provides that state classification of an entity is not controlling for Federal tax purposes, the characteristics of series LLCs and cell companies under their governing statutes are an important factor in analyzing whether series and cells generally should be treated as separate entities for Federal tax purposes.

Series LLC statutes have been enacted in Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, Utah and Puerto Rico. Delaware enacted the first series LLC statute in 1996. Del. Code Ann. Tit. 6, section 18-215 (the Delaware statute). Statutes enacted subsequently by other states are similar, but not identical, to the Delaware statute. All of the statutes provide a significant degree of separateness for individual series within a series LLC, but none provides series with all of the attributes of a typical state law entity, such as an ordinary limited liability company. Individual series generally are not treated as separate entities for state law purposes. However, in certain states (currently Illinois and Iowa), a series is treated as a separate entity to the extent provided in the series LLC’s articles of organization.

The Delaware statute provides that a limited liability company may establish, or provide for the establishment of, one or more designated series of members, managers, LLC interests or assets. Under the Delaware statute, any such series may have separate rights, powers, or duties with respect to specified property or obligations of the LLC or profits and losses associated with specified property or obligations, and any such series may have a separate business purpose or investment objective. Additionally, the Delaware statute provides that the debts, liabilities, obligations, and expenses of a particular series are enforceable against the assets of that series only, and not against the assets of the series LLC generally or any other series of the LLC, and, unless the LLC agreement provides otherwise, none of the debts, liabilities, obligations, and expenses of the series LLC generally or of any other series of the series LLC are enforceable against the assets of the series, provided that the following requirements are met: (1) the LLC agreement establishes or provides for the establishment of one or more series; (2) records maintained for any such series account for the assets of the series separately from the other assets of the series LLC, or of any other series of the series LLC; (3) the LLC agreement so provides; and (4) notice of the limitation on liabilities of a series is set forth in the series LLC’s certificate of formation.

Unless otherwise provided in the LLC agreement, a series established under Delaware law has the power and capacity to, in its own name, contract, hold title to assets, grant liens and security interests, and sue and be sued. A series may be managed by the members of the series or by a manager. Any event that causes a manager to cease to be a manager with respect to a series will not, in itself, cause the manager to cease to be a manager of the LLC or of any other series of the LLC.

Under the Delaware statute, unless the LLC agreement provides otherwise, any event that causes a member to cease to be associated with a series will not, in itself, cause the member to cease to be associated with any other series or with the LLC, or cause termination of the series, even if there are no remaining members of the series. Additionally, the Delaware statute allows a series to be terminated and its affairs wound up without causing the dissolution of the LLC. However, all series of the LLC terminate when the LLC dissolves. Finally, under the Delaware statute, a series generally may not make a distribution to the extent that the distribution will cause the liabilities of the series to exceed the fair market value of the series’ assets.

The series LLC statutes of Illinois, 805 ILCS 180/37-40 (the Illinois statute), and Iowa, I.C.A. §489.1201 (the Iowa statute) provide that a series with limited liability will be treated as a separate entity to the extent set forth in the articles of organization. The Illinois statute provides that the LLC and any of its series may elect to consolidate their operations as a single taxpayer to the extent permitted under applicable law, elect to work cooperatively, elect to contract jointly, or elect to be treated as a single business for purposes of qualification to do business in Illinois or any other state.

In addition, under the Illinois statute, a series’ existence begins upon filing of a certificate of designation with the Illinois secretary of state. A certificate of designation must be filed for each series that is to have limited liability. The name of a series with limited liability must contain the entire name of the LLC and be distinguishable from the names of the other series of the LLC. If different from the LLC, the certificate of designation for each series must list the names of the members if the series is member-managed or the names of the managers if the series is manager-managed. The Iowa and Illinois statutes both provide that, unless modified by the series LLC provisions, the provisions generally applicable to LLCs and their managers, members, and transferees are applicable to each series.

Some states have enacted series provisions outside of LLC statutes. For example, Delaware has enacted series limited partnership provisions (6 Del. C. §17-218). In addition, Delaware’s statutory trust statute permits a statutory trust to establish series (12 Del. C. §3804). Both of these statutes contain provisions that are nearly identical to the corresponding provisions of the Delaware series LLC statute with respect to the ability of the limited partnership or trust to create or establish separate series with the same liability protection enjoyed by series of a Delaware series LLC.

All of the series LLC statutes contain provisions that grant series certain attributes of separate entities. For example, individual series may have separate business purposes, investment objectives, members, and managers. Assets of a particular series are not subject to the claims of creditors of other series of the series LLC or of the series LLC itself, provided that certain record-keeping and notice requirements are observed. Finally, most series LLC statutes provide that an event that causes a member to cease to be associated with a series does not cause the member to cease to be associated with the series LLC or any other series of the series LLC.

However, all of the state statutes limit the powers of series of series LLCs. For example, a series of a series LLC may not convert into another type of entity, merge with another entity, or domesticate in another state independent from the series LLC. Several of the series LLC statutes do not expressly address a series’ ability to sue or be sued, hold title to property, or contract in its own name. Ordinary LLCs and series LLCs generally may exercise these rights. Additionally, most of the series LLC statutes provide that the dissolution of a series LLC will cause the termination of each of its series.

B. Statutes with respect to insurance

The insurance codes of a number of states include statutes that provide for the chartering of a legal entity commonly known as a protected cell company, segregated account company, or segregated portfolio company. See, for example, Vt. Stat. Ann. tit. 8, chap. 141, §§6031-6038 (sponsored captive insurance companies and protected cells of such companies); S.C. Code Ann. tit. 38, chap. 10, §§38-10-10 through 39-10-80 (protected cell insurance companies). Under those statutes, as under the series LLC statutes described above, the assets of each cell are segregated from the assets of any other cell. The cell may issue insurance or annuity contracts, reinsure such contracts, or facilitate the securitization of obligations of a sponsoring insurance company. Rev. Rul. 2008-8, 2008-1 C.B. 340, (see §601.601(d)(2)(ii)(b)), analyzes whether an arrangement entered into between a protected cell and its owner possesses the requisite risk shifting and risk distribution to qualify as insurance for Federal income tax purposes. Under certain domestic insurance codes, the sponsor may be organized under a corporate or unincorporated entity statute.

Series or cell company statutes in a number of foreign jurisdictions allow series or cells to engage in insurance businesses. See, for example, The Companies (Guernsey) Law, 2008 Part XXVII (Protected Cell Companies), Part XXVIII (Incorporated Cell Companies); The Companies (Jersey) Law, 1991, Part 18D; Companies Law, Part XIV (2009 Revision) (Cayman Isl.) (Segregated Portfolio Companies); and Segregated Accounts Companies Act (2000) (Bermuda).

Explanation of Provisions

1. In General

The proposed regulations provide that, for Federal tax purposes, a domestic series, whether or not a juridical person for local law purposes, is treated as an entity formed under local law.

With one exception, the proposed regulations do not apply to series or cells organized or established under the laws of a foreign jurisdiction. The one exception is that the proposed regulations apply to a foreign series that engages in an insurance business.

Whether a series that is treated as a local law entity under the proposed regulations is recognized as a separate entity for Federal tax purposes is determined under §301.7701-1 and general tax principles. The proposed regulations further provide that the classification of a series that is recognized as a separate entity for Federal tax purposes is determined under §301.7701-1(b), which provides the rules for classifying organizations that are recognized as entities for Federal tax purposes.

The proposed regulations define a *series organization* as a juridical entity that establishes and maintains, or under which is established and maintained, a series. A series organization includes a series limited liability company, series partnership, series trust, protected cell company, segregated cell company, segregated portfolio company, or segregated account company.

The proposed regulations define a *series statute* as a statute of a State or foreign jurisdiction that explicitly provides for the organization or establishment of a series of a juridical person and explicitly permits (1) members or participants of a series organization to have rights, powers, or duties with respect to the series; (2) a series to have separate rights, powers, or duties with respect to specified property or obligations; and (3) the segregation of assets and liabilities such that none of the debts and liabilities of the series organization (other than liabilities to the State or foreign jurisdiction related to the organization or operation of the series organization, such as franchise fees or administrative costs) or of any other series of the series organization are enforceable against the assets of a particular series of the series organization. For purposes of this definition, a "participant" of a series organization includes an officer or director of the series organization who has no ownership interest in the series or series organization, but has rights, powers, or duties with respect to the series.

The proposed regulations define a series as a segregated group of assets and liabilities that is established pursuant to a series statute by agreement of a series organization. A series includes a cell, segregated account, or segregated portfolio, including a cell, segregated account, or segregated portfolio that is formed under the insurance code of a jurisdiction or is engaged in an insurance business. However, the term "series" does not include a segregated asset account of a life insurance company, which consists of all assets the investment return and market value of which must be allocated in an identical manner to any variable life insurance or annuity contract invested in any of the assets. See §1.817-5 (e). Such an account is accorded special treatment under subchapter L. See generally section 817(a) through (c).

Certain series statutes provide that the series liability limitation provisions do not apply if the series organization or series does not maintain records adequately accounting for the assets associated with each series separately from the assets of the series organization or any other series of the series organization. The IRS and the Treasury Department considered whether a failure to elect or qualify for the liability limitations under the series statute should affect whether a series is a separate entity for Federal tax purposes. However, limitations on liability of owners of an entity for debts and obligations of the entity and the rights of creditors to hold owners liable for debts and obligations of the entity generally do not alter the characterization of the entity for Federal tax purposes. Therefore, the proposed regulations provide that an election, agreement, or other arrangement that permits debts and liabilities of other series or the series organization to be enforceable against the assets of a particular series, or a failure to comply with the record keeping requirements for the limitation on liability available under the relevant series statute, will not prevent a series from meeting the definition of "series" in the proposed regulations. For example, a series generally will not cease to be an entity under the proposed regulations simply because it guarantees the debt of another series within the series organization.

The proposed regulations treat a series as created or organized under the laws of the same jurisdiction in which the series is established. Because a series may not be a separate juridical entity for local law purposes, this rule provides the means for establishing the jurisdiction of the series for Federal tax purposes.

Under §301.7701-1(b), §301.7701-2(b) applies to a series that is recognized as a separate entity for Federal tax purposes. Therefore, a series that is itself described in §301.7701-2(b)(1) through (8) would be classified as a corporation regardless of the classification of the series organization.

The proposed regulations also provide that, for Federal tax purposes, ownership of interests in a series and of the assets associated with a series is determined under general tax principles. A series organization is not treated as the owner of a series or of the assets associated with a series merely because the series organization holds legal title to the assets associated with the series. For example, if a series organization holds legal title to assets associated with a series because the statute under which the series organization was organized does not expressly permit a series to hold assets in its own name, the series will be treated as the owner of the assets for Federal tax purposes if it bears the economic benefits and burdens of the assets under general Federal tax principles. Similarly, for Federal tax purposes, the obligor for the liability of a series is determined under general tax principles.

In general, the same legal principles that apply to determine who owns interests in other types of entities apply to determine the ownership of interests in series and series organizations. These principles generally look to who bears the economic benefits and burdens of ownership. See, for example, Rev. Rul. 55-39, 1955-1 C.B. 403, (see §601.601(d)(2)(ii)(b)). Furthermore, common law principles apply to the determination of whether a person is a partner in a series that is classified as a partnership for Federal tax purposes under §301.7701-3. See, for example, *Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Commissioner v. Tower*, 327 U.S. 280 (1946).

The IRS and the Treasury Department considered other approaches to the classification of series for Federal tax purposes. In particular, the IRS and the Treasury Department considered whether series should be disregarded as entities separate from the series organization for Federal tax purposes. This approach would be supported by the fact that series are not generally considered entities for local law purposes (except, for example, potentially under the statutes of Illinois and Iowa, where a series may be treated as a separate entity to the extent set forth in the articles of organization). Additionally, while the statutes enabling series organizations grant series significant autonomy, under no current statute do series possess all of the attributes of independence that entities recognized under local law generally possess. 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. In addition, the dissolution of a series organization generally will terminate all of its series.

The IRS and the Treasury Department believe that, notwithstanding that series differ in some respects from more traditional local law entities, domestic series generally should be treated for Federal tax purposes as entities formed under local law. Because Federal tax law, and not local law, governs the question of whether an organization is an entity for Federal tax purposes, it is not dispositive that domestic series generally are not considered entities for local law purposes. Additionally, the IRS and the Treasury Department believe that, overall, the factors supporting separate entity status for series outweigh the factors in favor of disregarding series as entities separate from the series organization and other series of the series organization. Specifically, managers and equity holders are "associated with" a series, and their rights, duties, and powers with respect to the series are direct and specifically identified. Also, individual series may (but generally are not required to) have separate business purposes and investment objectives. The IRS and the Treasury Department believe these factors are sufficient to treat domestic series as entities formed under local law.

Although some statutes creating series organizations permit an individual series to enter into contracts, sue, be sued, and/or hold property in its own name, the IRS and the Treasury Department do not believe that the failure of a statute to explicitly provide these rights should alter the treatment of a domestic series as an entity formed under local law. These attributes primarily involve procedural formalities and do not appear to affect the substantive economic rights of series or their creditors with respect to their property and liabilities. Even in jurisdictions where series may not possess these attributes, the statutory liability shields would still apply to the assets of a particular series, provided the statutory requirements are satisfied.

Furthermore, the rule provided in the proposed regulations would provide greater certainty to both taxpayers and the IRS regarding the tax status of domestic series and foreign series that conduct insurance businesses. In effect, taxpayers that establish domestic series are placed in the same position as persons that file a certificate of organization for a state law entity. The IRS and the Treasury Department believe that the approach of the proposed regulations is straightforward and administrable, and is preferable to engaging in a case by case determination of the status of each series that would require a detailed examination of the terms of the relevant statute. Finally, the IRS and the Treasury Department believe that a rule generally treating domestic series as local law entities would be consistent with taxpayers' current ability to create similar structures using multiple local law entities that can elect their Federal tax classification pursuant to §301.7701-3.

The IRS and the Treasury Department believe that domestic series should be classified as separate local law entities based on the characteristics granted to them under the various series statutes. However, except as specifically stated in the proposed regulations, a particular series need not actually possess all of the attributes that its enabling statute permits it to possess. The IRS and the Treasury Department believe that a domestic series should be treated as a separate local law entity even if its business purpose, investment objective, or ownership overlaps with that of other series or the series organization itself. Separate state law entities may have common or overlapping business purposes, investment objectives and ownership, but generally are still treated as separate local law entities for Federal tax purposes.

The proposed regulations do not address the entity status for Federal tax purposes of a series organization. Specifically, the proposed regulations do not address whether a series organization is recognized as a separate entity for Federal tax purposes if it has no assets and engages in no activities independent of its series.

Until further guidance is issued, the entity status of a foreign series that does not conduct an insurance business will be determined under applicable law. Foreign series raise novel Federal income tax issues that continue to be considered and addressed by the IRS and the Treasury Department.

2. Classification of a Series that is Treated as a Separate Entity for Federal Tax Purposes

If a domestic series or a foreign series engaged in an insurance business is treated as a separate entity for Federal tax purposes, then §301.7701-1(b) applies to determine the proper tax classification of the series. However, the proposed regulations do not provide how a series should be treated for Federal employment tax purposes. If a domestic series is treated as a separate entity for Federal tax purposes, then the series generally is subject to the same treatment as any other entity for Federal tax purposes. For example, a series that is treated as a separate entity for Federal tax purposes may make any Federal tax elections it is otherwise eligible to make independently of other series or the series organization itself, and regardless of whether other series (or the series organization) do not make certain elections or make different elections.

3. Entity Status of Series Organizations

The proposed regulations do not address the entity status or filing requirements of series organizations for Federal tax purposes. A series organization generally is an entity for local law purposes. An organization that is an entity for local law purposes generally is treated as an entity for Federal tax purposes. However, an organization characterized as an entity for Federal income tax purposes may not have an income or information tax filing obligation. For example, §301.6031(a)-(1)(a)(3)(i) provides that a partnership with no income, deductions, or credits for Federal income tax purposes for a taxable year is not required to file a partnership return for that year. Generally, filing fees of a series organization paid by series of the series organization would be treated as expenses of the series and not as expenses of the series organization. Thus, a series organization characterized as a partnership for Federal tax purposes that does not have income, deductions, or credits for a taxable year need not file a partnership return for the year.

4. Continuing Applicability of Tax Law Authority to Series

Notwithstanding that a domestic series or a foreign series engaged in an insurance business is treated as an entity formed under local law under the proposed regulations, the Commissioner may under applicable law, including common law tax principles, characterize a series or a portion of a series other than as a separate entity for Federal tax purposes. Series covered by the proposed regulations are subject to applicable law to the same extent as other entities. Thus, a series may be disregarded under applicable law even if it satisfies the requirements of the proposed regulations to be treated as an entity formed under local law. For example, if a series has no business purpose or business activity other than tax avoidance, it may be disregarded under appropriate circumstances. See *Bertoli v. Commissioner*, 103 T.C. 501 (1994); *Aldon Homes, Inc. v. Commissioner*, 33 T.C. 582 (1959). Furthermore, the anti-abuse rule of §1.701-2 is applicable to a series or series organization that is classified as a partnership for Federal tax purposes.

5. Applicability to Organizations that Qualify as Insurance Companies

Notice 2008-19 requested comments on proposed guidance setting forth conditions under which a cell of a protected cell company would be treated as an insurance company separate from any other entity for Federal income tax purposes. Those who commented on the notice generally supported the proposed guidance, and further commented that it should extend to non-insurance arrangements as well, including series LLCs. Rather than provide independent guidance for insurance company status setting forth what is essentially the same standard, the proposed regulations define the term *series* to include a cell, segregated account, or segregated portfolio that is formed under the insurance code of a jurisdiction or is engaged in an insurance business (other than a segregated asset account of a life insurance company).

Although the proposed regulations do not apply to a series organized or established under the laws of a foreign jurisdiction, an exception is provided for certain series conducting an insurance business. Under this exception, a series that is organized or established under the laws of a foreign jurisdiction is treated as an entity if the arrangements and other activities of the series, if conducted by a domestic company, would result in its being classified as an insurance company. Thus, a foreign series would be treated as an entity if more than half of the series' business is the issuing or reinsuring of insurance or annuity contracts. The IRS and the Treasury Department believe it is appropriate to provide this rule even though the proposed regulations otherwise do not apply to a foreign series because an insurance company is classified as a per se corporation under section 7701(a)(3) regardless of how it otherwise would be treated under §§301.7701-1, 301.7701-2, or 301.7701-3.

The IRS and the Treasury Department are aware that insurance-specific guidance may still be needed to address the issues identified in §3.02 of Notice 2008-19 and insurance-specific transition issues that may arise for protected cell companies that previously reported in a manner inconsistent with the regulations. See §601.601(d)(2)(ii)(b).

6. Effect of Local Law Classification on Tax Collection

The IRS and Treasury Department understand that there are differences in local law governing series (for example, rights to hold title to property and to sue and be sued are expressly addressed in some statutes but not in others) that may affect how creditors of series, including state taxing authorities, may enforce obligations of a series. Thus, the proposed regulations provide that, to the extent Federal or local law permits a creditor to collect a liability attributable to a series from the series organization or other series of the series organization, the series organization and other series of the series organization may also be considered the taxpayer from whom the tax assessed against the series may be collected pursuant to administrative or judicial means. Further, when a creditor is permitted to collect a liability attributable to a series organization from any series of the series organization, a tax liability assessed against the series organization may be collected directly from a series of the series organization by administrative or judicial means.

7. Employment Tax and Employee Benefits Issues

A. In general

The domestic statutes authorizing the creation of series contemplate that a series may operate a business. If the operating business has workers, it will be necessary to determine how the business satisfies any employment tax obligations, whether it has the ability to maintain any employee benefit plans and, if so, whether it complies with the rules applicable to those plans. Application of the employment tax requirements will depend principally on whether the workers are employees, and, if so, who is considered the employer for Federal income and employment tax purposes. In general, an employment relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. See §§31.3121(d)-1(c)(2), 31.3306(i)-1(b), and 31.3401(c)-1(b).

B. Employment tax

An entity must be a person in order to be an employer for Federal employment tax purposes. See sections 3121(b), 3306(a)(1), 3306(c), and 3401(d) and §31.3121(d)-2(a). However, status as a person, by itself, is not enough to make an entity an employer for Federal employment tax purposes. The entity must also satisfy the criteria to be an employer under Federal employment tax statutes and regulations for purposes of the determination of the proper amount of employment taxes and the party liable for reporting and paying the taxes. Treatment of a series as a separate person for Federal employment tax purposes would create the possibility that the series could be an "employer" for Federal employment tax purposes, which would raise both substantive and administrative issues.

The series structure would make it difficult to determine whether the series or the series organization is the employer under the relevant criteria with respect to the services provided. For example, if workers perform all of their services under the direction and control of individuals who own the interests in a series, but the series has no legal authority to enter into contracts or to sue or be sued, could the series nonetheless be the employer of the workers? If workers perform services under the direction and control of the series, but they are paid by the series organization, would the series organization, as the nominal owner of all the series assets, have control over the payment of wages such that it would be liable as the employer under section 3401(d)?

The structure of a series organization could also affect the type of employment tax liability. For example, if a series were recognized as a distinct person for Federal employment tax purposes, a worker providing services as an employee of one series and as a member of another series or the series organization would be subject to FICA tax on the wages paid for services as an employee and self-employment tax on the member income. Note further that, if a domestic series were classified as a separate entity that is a business entity, then, under §301.7701-3, the series would be classified as either a partnership or a corporation. While a business entity with one owner is generally classified as a corporation or is disregarded for Federal tax purposes, such an entity cannot be disregarded for Federal employment tax purposes. See §301.7701-2(c)(2)(iv).

Once the employer is identified, additional issues arise, including but not limited to the following: How would the wage base be determined for employees, particularly if they work for more than one series in a common line of business? How would the common paymaster rules apply? Who would be authorized to designate an agent under section 3504 for reporting and payment of employment taxes, and how would the authorization be accomplished? How would the statutory exceptions from the definitions of employment and wages apply given that they may be based on the identity of the employer? Which entity would be eligible for tax credits that go to the employer such as the Work Opportunity Tax Credit under section 51 or the tip credit under section 45B? If a series organization handles payroll for a series and is also the nominal owner of the series assets, would the owners or the managers of the series organization be responsible persons for the Trust Fund Recovery Penalty under section 6672?

Special administrative issues might arise if the series were to be treated as the employer for Federal employment tax purposes but not for state law purposes. For example, if the series were the employer for Federal employment tax purposes and filed a Form W-2, "Wage and Tax Statement," reporting wages and employment taxes withheld, but the series were not recognized as a juridical person for state law purposes, then administrative problems might ensue unless separate Forms W-2 were prepared for state and local tax purposes. Similarly, the IRS and the states might encounter challenges in awarding the FUTA credit under section 3302 to the appropriate entity and certifying the amount of state unemployment tax paid.

In light of these issues, the proposed regulations do not currently provide how a series should be treated for Federal employment tax purposes.

C. Employee benefits

Various issues arise with respect to the ability of a series to maintain an employee benefit plan, including issues related to those described above with respect to whether a series may be an employer. The proposed regulations do not address these issues. However, to the extent that a series can maintain an employee benefit plan, the aggregation rules under section 414(b), (c), (m), (o) and (t), as well as the leased employee rules under section 414(n), would apply. In this connection, the IRS and Treasury Department expect to issue regulations under section 414(o) that would prevent the avoidance of any employee benefit plan requirement through the use of the separate entity status of a series.

8. Statement Containing Identifying Information about Series

As the series organization or a series of the series organization may be treated as a separate entity for Federal tax and related reporting purposes but may not be a separate entity under local law, the IRS and Treasury Department believe that a new statement may need to be created and required to be filed annually by the series organization and each series of the series organization to provide the IRS with certain identifying information to ensure the proper assessment and collection of tax. Accordingly, these regulations propose to amend the Procedure and Administration Regulations under section 6011 to include this requirement and a cross-reference to those regulations is included under §301.7701-1. The IRS and Treasury Department are considering what information should be required by these statements. Information tentatively being considered includes (1) the name, address, and taxpayer identification number of the series organization and each of its series and status of each as a series of a series organization or as the series organization; (2) the jurisdiction in which the series organization was formed; and (3) an indication of whether the series holds title to its assets or whether title is held by another series or the series organization and, if held by another series or the series organization, the name, address, and taxpayer identification number of the series organization and each series holding title to any of its assets. The IRS and Treasury Department are also considering the best time to require taxpayers to file the statement. For example, the IRS and Treasury Department are considering whether the statement should be filed when returns, such as income tax returns and excise tax returns, are required to be filed or whether it should be a stand-alone statement filed separately by a set date each year, as with information returns such as Forms 1099. A cross-reference to these regulations was added to the Procedure and Administration Regulations under section 6071 for the time to file returns and statements. The proposed regulations under section 6071 provide that the statement will be a stand-alone statement due March 15th of each year. In addition, the IRS and Treasury Department are considering revising Form SS-4, "Application for Employer Identification Number," to include questions regarding series organizations.

Proposed Effective Date

These regulations generally apply on the date final regulations are published in the **Federal Register**. Generally, when final regulations become effective, taxpayers that are treating series differently for Federal tax purposes than series are treated under the final regulations will be required to change their treatment of series. In this situation, a series organization that previously was treated as one entity with all of its series may be required to begin treating each series as a separate entity for Federal tax purposes. General tax principles will apply to determine the consequences of the conversion from one entity to multiple entities for Federal tax purposes. See, for example, section 708 for rules relating to partnership divisions in the case of a series organization previously treated as a partnership for Federal tax purposes converting into multiple partnerships upon recognition of the series organization's series as separate entities. While a division of a partnership may be tax-free, gain may be recognized in certain situations under section 704(c)(1)(B) or section 737. Sections 355 and 368(a)(1)(D) provide rules that govern certain divisions of a corporation. The division of a series organization into multiple corporations may be tax-free to the corporation and to its shareholders; however, if the corporate division does not satisfy one or more of the requirements in section 355, the division may result in taxable events to the corporation, its shareholders, or both.

The regulations include an exception for series established prior to publication of the proposed regulations that treat all series and the series organization as one entity. If the requirements for this exception are satisfied, after issuance of the final regulations the series may continue to be treated together with the series organization as one entity for Federal tax purposes. Specifically, these requirements are satisfied if (1) The series was established prior to September 14, 2010; (2) The series (independent of the series organization or other series of the series organization) conducted business or investment activity or, in the case of a foreign series, more than half the business of the series was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies, on and prior to September 14, 2010; (3) If the series was established pursuant to a foreign statute, the series' classification was relevant (as defined in §301.7701-3(d)), and more than half the business of the series was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies for all taxable years beginning with the taxable year that includes September 14, 2010; (4) No owner of the series treats the series as an entity separate from any other series of the series organization or from the series organization for purposes of filing any Federal income tax returns, information returns, or withholding documents for any taxable year; (5) The series and series organization had a reasonable basis (within the meaning of section 6662) for their claimed classification; and (6) Neither the series nor any owner of the series nor the series organization was notified in writing on or before the date final regulations are published in the **Federal Register** that classification of the series was under examination (in which case the series' classification will be determined in the examination).

This exception will cease to apply on the date any person or persons who were not owners of the series organization (or series) prior to September 14, 2010, own, in the aggregate, a 50 percent or greater interest in the series organization (or series). For this purpose, the term *interest* means (i) in the case of a partnership, a capital or profits interest and (ii) in the case of a corporation, an equity interest measured by vote or value. This transition rule does not apply to any determination other than the entity status of a series, for example, tax ownership of a series or series organization or qualification of a series or series organization conducting an insurance business as a controlled foreign corporation.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the regulations will not have a significant economic impact on a substantial number of small entities. The regulations require that series and series organizations file a statement to provide the IRS with certain identifying information to ensure the proper assessment and collection of tax. The regulations affect domestic series LLCs, domestic cell companies, and foreign series and cells that conduct insurance businesses, and their owners. Based on

information available at this time, the IRS and the Treasury Department believe that many series and series organizations are large insurance companies or investment firms and, thus, are not small entities. Although a number of small entities may be subject to the information reporting requirement of the new statement, any economic impact will be minimal. The information that the IRS and the Treasury Department are considering requiring on the proposed statement should be known by or readily available to the series or the series organization. Therefore, it should take minimal time and expense to collect and report this information. For example, the IRS and the Treasury Department are considering requiring the following information: (1) The name, address, and taxpayer identification number of the series organization and each of its series and status of each as a series of a series organization or as the series organization; (2) The jurisdiction in which the series organization was formed; and (3) An indication of whether the series holds title to its assets or whether title is held by another series or the series organization and, if held by another series or the series organization, the name, address, and taxpayer identification number of the series organization and each series holding title to any of its assets. The IRS and the Treasury Department request comments on the accuracy of the statement that the regulations in this document will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically directly to the Federal eRulemaking portal at www.regulations.gov.

The IRS and the Treasury Department request comments on the proposed regulations. In addition, the IRS and the Treasury Department request comments on the following issues:

- (1) Whether a series organization should be recognized as a separate entity for Federal tax purposes if it has no assets and engages in no activities independent of its series;
- (2) The appropriate treatment of a series that does not terminate for local law purposes when it has no members associated with it;
- (3) The entity status for Federal tax purposes of foreign cells that do not conduct insurance businesses and other tax consequences of establishing, operating, and terminating all foreign cells;
- (4) How the Federal employment tax issues discussed and similar technical issues should be resolved;
- (5) How series and series organizations will be treated for state employment tax purposes and other state employment-related purposes and how that treatment should affect the Federal employment tax treatment of series and series organizations (comments from the states would be particularly helpful);
- (6) What issues could arise with respect to the provision of employee benefits by a series organization or series; and
- (7) The requirement for the series organization and each series of the series organization to file a statement and what information should be included on the statement.

All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.6011-6 also issued under 26 U.S.C. 6011(a). * * *

Section 301.6071-2 also issued under 26 U.S.C. 6071(a). * * *

Par. 2. Section 301.6011-6 is added to read as follows:

§301.6011-6 Statements of series and series organizations.

(a) *Statement required.* Each series and series organization (as defined in paragraph (b) of this section) shall file a statement for each taxable year containing the identifying information with respect to the series or series organization as prescribed by the Internal Revenue Service for this purpose and shall include the information required by the statement and its instructions.

(b) *Definitions—(1) Series.* The term *series* has the same meaning as in §301.7701-1(a)(5)(viii)(C).

(2) *Series organization.* The term *series organization* has the same meaning as in §301.7701-1(a)(5)(viii)(A).

(c) *Effective/applicability date.* This section applies to taxable years beginning after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 3. Section 301.6071-2 is added to read as follows:

§301.6071-2 Time for filing statements of series and series organizations.

(a) *In general.* Statements required by §301.6011-6 must be filed on or before March 15 of the year following the period for which the return is made.

(b) *Effective/applicability date.* This section applies to taxable years beginning after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 4. Section 301.7701-1 is amended by:

1. Adding paragraph (a)(5).
2. Revising paragraphs (e) and (f).

The additions and revisions read as follows:

§301.7701-1 Classification of organizations for Federal tax purposes.

(a) * * *

(5) *Series and series organizations*—(i) *Entity status of a domestic series.* For Federal tax purposes, except as provided in paragraph (a)(5)(ix) of this section, a series (as defined in paragraph (a)(5)(viii)(C) of this section) organized or established under the laws of the United States or of any State, whether or not a juridical person for local law purposes, is treated as an entity formed under local law.

(ii) *Certain foreign series conducting an insurance business.* For Federal tax purposes, except as provided in paragraph (a)(5)(ix) of this section, a series organized or established under the laws of a foreign jurisdiction is treated as an entity formed under local law if the arrangements and other activities of the series, if conducted by a domestic company, would result in classification as an insurance company within the meaning of section 816(a) or section 831(c).

(iii) *Recognition of entity status.* Whether a series that is treated as a local law entity under paragraph (a)(5)(i) or (ii) of this section is recognized as a separate entity for Federal tax purposes is determined under this section and general tax principles.

(iv) *Classification of series.* The classification of a series that is recognized as a separate entity for Federal tax purposes is determined under paragraph (b) of this section.

(v) *Jurisdiction in which series is organized or established.* A series is treated as created or organized under the laws of a State or foreign jurisdiction if the series is established under the laws of such jurisdiction. See §301.7701-5 for rules that determine whether a business entity is domestic or foreign.

(vi) *Ownership of series and the assets of series.* For Federal tax purposes, the ownership of interests in a series and of the assets associated with a series is determined under general tax principles. A series organization is not treated as the owner for Federal tax purposes of a series or of the assets associated with a series merely because the series organization holds legal title to the assets associated with the series.

(vii) *Effect of Federal and local law treatment.* To the extent that, pursuant to the provisions of this paragraph (a)(5), a series is a taxpayer against whom tax may be assessed under Chapter 63 of Title 26, then any tax assessed against the series may be collected by the Internal Revenue Service from the series in the same manner the assessment could be collected by the Internal Revenue Service from any other taxpayer. In addition, to the extent Federal or local law permits a debt attributable to the series to be collected from the series organization or other series of the series organization, then, notwithstanding any other provision of this paragraph (a)(5), and consistent with the provisions of Federal or local law, the series organization and other series of the series organization may also be considered the taxpayer from whom the tax assessed against the series may be administratively or judicially collected. Further, when a creditor is permitted to collect a liability attributable to a series organization from any series of the series organization, a tax liability assessed against the series organization may be collected directly from a series of the series organization by administrative or judicial means.

(viii) *Definitions*—(A) *Series organization.* A *series organization* is a juridical entity that establishes and maintains, or under which is established and maintained, a series (as defined in paragraph (a)(5)(viii)(C) of this section). A series organization includes a series limited liability company, series partnership, series trust, protected cell company, segregated cell company, segregated portfolio company, or segregated account company.

(B) *Series statute.* A *series statute* is a statute of a State or foreign jurisdiction that explicitly provides for the organization or establishment of a series of a juridical person and explicitly permits—

(1) Members or participants of a series organization to have rights, powers, or duties with respect to the series;

(2) A series to have separate rights, powers, or duties with respect to specified property or obligations; and

(3) The segregation of assets and liabilities such that none of the debts and liabilities of the series organization (other than liabilities to the State or foreign jurisdiction related to the organization or operation of the series organization, such as franchise fees or administrative costs) or of any other series of the series organization are enforceable against the assets of a particular series of the series organization.

(C) *Series.* A *series* is a segregated group of assets and liabilities that is established pursuant to a series statute (as defined in paragraph (a)(5)(viii)(B) of this section) by agreement of a series organization (as defined in paragraph (a)(5)(viii)(A) of this section). A series includes a series, cell, segregated account, or segregated portfolio, including a cell, segregated account, or segregated portfolio that is formed under the insurance code of a jurisdiction or is engaged in an insurance business. However, the term *series* does not include a segregated asset account of a life insurance company. See section 817(d)(1); §1.817-5(e). An election, agreement, or other arrangement that permits debts and liabilities of other series or the series organization to be enforceable against the assets of a particular series, or a failure to comply with the record keeping requirements for the limitation on liability available under the relevant series statute, will be disregarded for purposes of this paragraph (a)(5)(viii)(C).

(ix) *Treatment of series and series organizations under Subtitle C — Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24 and 25 of the Internal Revenue Code).* [Reserved.]

(x) *Examples.* The following examples illustrate the principles of this paragraph (a)(5):

Example 1. Domestic Series LLC. (i) *Facts.* Series LLC is a series organization (within the meaning of paragraph (a)(5)(viii)(A) of this section). Series LLC has three members (1, 2, and 3). Series LLC establishes two series (A and B) pursuant to the LLC statute of state Y, a series statute within the meaning of paragraph (a)(5)(viii)(B) of this section. Under general tax principles, Members 1 and 2 are the owners of Series A, and Member 3 is the owner of Series B. Series A and B are not described in §301.7701-2(b) or paragraph (a)(3) of this section and are not trusts within the meaning of §301.7701-4.

(ii) *Analysis.* Under paragraph (a)(5)(i) of this section, Series A and Series B are each treated as an entity formed under local law. The classification of Series A and Series B is determined under paragraph (b) of this section. The default classification under §301.7701-3 of Series A is a partnership and of Series B is a disregarded entity.

Example 2. Foreign Insurance Cell. (i) *Facts.* Insurance CellCo is a series organization (within the meaning of paragraph (a)(5)(viii)(A) of this section) organized under the laws of foreign Country X. Insurance CellCo has established one cell, Cell A, pursuant to a Country X law that is a series statute (within the meaning of paragraph (a)(5)(viii)(B) of this section). More than half the business of Cell A during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. If the activities of Cell A were conducted by a domestic company, that company would qualify as an insurance company within the meaning of sections 816(a) and 831(c).

(ii) *Analysis.* Under paragraph (a)(5)(ii) of this section, Cell A is treated as an entity formed under local law. Because Cell A is an insurance company, it is classified as a corporation under §301.7701-2(b)(4).

* * * * *

(e) *State.* For purposes of this section and §§301.7701-2 and 301.7701-4, the term *State* includes the District of Columbia.

(f) *Effective/applicability dates*—(1) *In general.* Except as provided in paragraphs (f)(2) and (f)(3) of this section, the rules of this section are applicable as of January 1, 1997.

(2) *Cost sharing arrangements.* The rules of paragraph (c) of this section are applicable on January 5, 2009.

(3) *Series and series organizations*—(i) *In general.* Except as otherwise provided in this paragraph (f)(3), paragraph (a)(5) of this section applies on and after the date final regulations are published in the **Federal Register**.

(ii) *Transition rule*—(A) *In general.* Except as provided in paragraph (f)(3)(ii)(B) of this section, a taxpayer's treatment of a series in a manner inconsistent with the final regulations will be respected on and after the date final regulations are published in the **Federal Register**, provided that—

(1) The series was established prior to September 14, 2010;

(2) The series (independent of the series organization or other series of the series organization) conducted business or investment activity, or, in the case of a series established pursuant to a foreign statute, more than half the business of the series was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies, on and prior to September 14, 2010;

(3) If the series was established pursuant to a foreign statute, the series' classification was relevant (as defined in §301.7701-3(d)), and more than half the business of the series was the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies for all taxable years beginning with the taxable year that includes September 14, 2010;

(4) No owner of the series treats the series as an entity separate from any other series of the series organization or from the series organization for purposes of filing any Federal income tax returns, information returns, or withholding documents in any taxable year;

(5) The series and series organization had a reasonable basis (within the meaning of section 6662) for their claimed classification; and

(6) Neither the series nor any owner of the series nor the series organization was notified in writing on or before the date final regulations are published in the **Federal Register** that classification of the series was under examination (in which case the series' classification will be determined in the examination).

(B) *Exception to transition rule.* Paragraph (f)(3)(ii)(A) of this section will not apply on and after the date any person or persons who were not owners of the series organization (or series) prior to September 14, 2010, own, in the aggregate, a fifty percent or greater interest in the series organization (or series). For purposes of the preceding sentence, the term *interest* means—

- (1) In the case of a partnership, a capital or profits interest; and
- (2) In the case of a corporation, an equity interest measured by vote or value.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

Note

(Filed by the Office of the Federal Register on September 13, 2010, 8:45 a.m., and published in the issue of the Federal Register for September 14, 2010, 75 F.R. 55699)

Drafting Information

The principal author of these proposed regulations is Joy Spies, IRS Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

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