

JOURNAL

Newsletter of the Fairfax Bar Association www.fairfaxbar.org May/June 2010

2010-2011 FBA ELECTIONS

Pursuant to FBA Bylaw Amendments approved by the FBA membership, when the election for at large Directors under Article VI(1) and Vice President under Article II(2) are uncontested, such elections will not be held, and instead, such candidates shall assume office beginning July 1 of the FBA's next fiscal year.

Candidate for Vice President (Uncontested)

Jay B. Myerson

Law Offices of Jay B. Myerson



Vision for the FBA: The FBA membership has remained relatively static at approximately 2,000 members for many years, despite the significant growth in the number of attorneys in Fairfax County. This is, at least in part, attributable to the growth in the number of professional associations attracting the time and financial commitment of local practitioners. More recently, the weak economy has not helped our efforts to grow. The FBA needs to expand its membership base so that I can continue to provide leadership and services to the local Bar, Bench, and to the greater Fairfax Community.

As part of the FBA's service to the various constituencies, the FBA needs to work with our Bench to identify and pursue options that will ensure meaningful and timely access to justice for the residents of Fairfax County in this period of budget shortfalls and cutbacks.

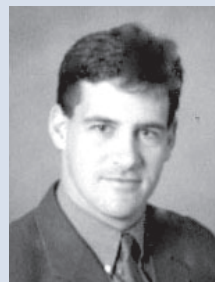
Finally, in recent years there has been a societal reduction in knowledge of basic civics. Concern over this lack of fundamental knowledge has been recognized by Justice Sandra Day O'Connor and others, who are working together on a program known as Our Courts, 21st Century Civics. It is my hope that the FBA will work in conjunction with the Fairfax County Public Schools and the Fairfax Law Foundation to enhance learning opportunities related to civics for students in Fairfax County. This effort should start with a partnership to bring Law Day into Fairfax County Public Schools.

Involvement in the FBA includes: Board of Directors (served as Treasurer and Delegate in the American Bar Association's House of Delegates); Conciliation Program 2001-2007 (Chair and Co-Chair); General District Court Committee 1990-1997; Lawyer Referral Service Committee 1993-1997. Other community involvement includes American Inns of Court; George Mason American Inn of Court; American Bar Association; Virginia Israel Advisory Board Member, to name a few.

Board of Directors (Uncontested) *see Director Candidate bios on page 11*



David L. Marks
Leiva & Marks, P.L.C.



Michael J. Shevlin
Shevlin Smith



John M. Tran
DiMuroGinsberg, P.C.

PITFALLS

OF COMMONLY-USED TAX TERMINOLOGY

By *Tiffany L. Burton, Esq.*
Chair, FBA Tax Section
Attorney, Rees Broome, PC

Limited liability companies provide convenient, flexible business vehicles to accomplish a wide variety of client objectives. The considerable popularity of LLCs among business owners is attributable in part to the fact that LLCs provide owners with a great deal of flexibility in arranging their relative economic rights and structuring how the entity will be taxed. From a tax standpoint, the owners are generally permitted to choose whether to have the LLC taxed as a partnership, a C corporation, or an S corporation. Additionally, of course, owners are provided with liability protection under state law.

However, the flexibility that makes LLCs so popular can also make them complicated and dangerous. Typical LLC operating agreements are inundated with tax terminology and references—and many seemingly unimportant terms in common provisions may have significant consequences for a client's business deal. Care must be taken to align the parties' actual intentions regarding the business deal with the "true" meaning of the operating agreement.

By default, a Virginia LLC with more than one member will be taxed as a partnership, which enjoys a single level of taxation. The company may then *elect* to be taxed as a corporation or, if eligible, as an S corporation (which enjoys a single level of tax similar to the advantage enjoyed by partnerships). However, under prior law, rather than an elective regime, the particular characteristics of the LLC—which made the company either "look" more like a partnership or a corporation—were determinative of whether the company would be taxed as a more desirable partnership (with a single level of tax) or as a corporation (with a double level of tax).

As a result of those rules, attorneys designed LLC operating agreements to eliminate "corporate" characteristics. For example, one mechanism was to provide that the LLC would dissolve upon the death or dissolution of a member, unless the remaining members voted to continue the company. Such clauses, in almost all instances, were originally created for tax reasons. Despite the change in the law regarding how LLCs are now regarded for tax purposes, automatic dissolution clauses are still frequently found in LLC operating agreements. On more than one occasion, the remaining members of an LLC (and the operation of the company) have continued after the death of a member with no consideration given to this obscure and unnecessary requirement, only to face significant difficulties when disagreements later arise among remaining member or liability issues arise with respect to third parties.

Another common area of "tax pitfalls" arises as a result of the tax flexibility that is provided in recognition of the deference given to tax allocation provisions of an operating agreement so long as such allocations have "substantial economic effect." While a term of art, Treasury Regulations provide a safe harbor for an operating agreement's allocation provisions as having "substantial economic effect" where the operating agreement calls for (i) maintenance of capital accounts, (ii) liquidation in accordance with positive capital account balances, and (iii) either an unlimited deficit restoration obligation or a qualified income offset provision.

Accordingly, many operating agreements call for maintenance of capital accounts "in accordance with Regulations §1.704-1(b)(2)(iv)" or some similar maintenance requirement. Such a capital account maintenance requirement—in accordance with the Treasury Regulations—is often included even where the agreement is not a "safe-harbor agreement." Thus, complicated capital account maintenance provisions are included even when capital accounts are not used in determining economic rights (e.g., where everything is split 50/50 with no reference to capital accounts), or where the maintenance rules are contrary to the parties' intentions (e.g., capital accounts are used to determine voting or economic rights in instances not consistent with the renegotiated deal).

Additionally, you will sometimes see the "safe-harbor" tax provisions in operating agreements for LLCs that have elected S corporation status. This seemingly thoughtful attempt to meet the "substantial economic effect" criterion can cause significant complications, including the potential loss of S corporation status for tax purposes.

In short, many of the "standard" provisions in an LLC operating agreement carry unrealized tax and business implications that are difficult—but vitally important—to understand. Reflexive recopying of inapplicable provisions from a previous agreement can all too often unwittingly bring about a result entirely opposite from the one the clients actually want to achieve.

If you find this article (or taxation in general) interesting—or find neither interesting but have accepted that taxes, like death, are unavoidable—and you would like to become more involved in the Northern Virginia tax community, please consider the FBA Tax Section. We would love to have you join us. ■