

## LLC Operating Agreement Potential Double Tax Trap

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The IRS recently ruled that the provisions of an LLC operating agreement resulted in the company's violating the "one class of stock" rule which caused the company's S Election to be ineffective. This can result in a double layer of income taxes on net income. As is often the case, a company's accountant will recommend that an LLC elect to be taxed as a corporation and file an S Election to avoid the double level of taxes that occurs with a C Corporation. Because the company's LLC operating agreement contained tax sensitive provisions appropriate for an LLC electing to be taxed as a partnership rather than to be taxed as an S corporation, the provisions of the operating agreement were deemed to create a second class of stock which caused the S Election to be invalid (resulting in it being taxed as a C Corp).

It is critical that business owners discuss entity selection with their CPA and attorney and select the best of potentially 3 available elections for the particular business of the LLC. The provisions of the LLC operating agreement must be carefully drafted to match the selected tax elections. It is dangerous for small business owners to form limited liability companies without professional advice and to use cookie cutter on-line form operating agreements. If you have any questions about LLCs, please contact [David Rattigan](#) or any member of Barley Snyder's [Business Practice Group](#).

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