BUSINESS ORGANIZATIONS:
Tax and Legal Aspects Compared
LLCs, S Corporations and C Corporations

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LLC OPERATING AGREEMENTS
Select Partnership Taxation Issues

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I. Introduction

Since the enactment of New York's Limited Liability Company Law ("LLC Law") on July 26, 1994, there has been a proliferation of limited liability companies ("LCC" or "Company") formed in New York. The enactment of the LLC Law has been welcomed by tax advisors and their clients because LLC owners, i.e., members, like shareholders of corporations, generally have limited liability for the debts and obligations of the Company, yet for income tax purposes, the Company is not subject to a separate entity level of tax. Instead, single-member LLCs are "disregarded" for income tax purposes, i.e., entity income is combined with other income of the owner, and LLCs with two or more members generally are taxed as partnerships. As a result, there is no "double tax" of both the entity and its owner(s). Accordingly, LLCs are frequently referred to as "hybrid" entities since from a legal standpoint they are similar to corporations with limited liability, but from an income tax standpoint, they are similar to partnerships.

Prior to the LLC Law, owners seeking limited liability had to form limited partnerships (which generally required the formation of a corporate general partner to avoid unlimited liability for the general partner) or corporations. If the owners chose to incorporate, but did not want separate entity level taxation, it was necessary to make an "S-corporation" election. However, there are specific requirements for corporations to be eligible for S-corporation status, including limitations on the number and types of shareholders. S-corporation income tax rules also are not as favorable as partnership taxation rules.

While LLCs are certainly an important entity for consideration for new business ventures, particularly joint ventures with limited duration, real estate investments, and other investment vehicles, the nature of the business and the sophistication of its owners may not warrant the complexity of partnership taxation rules. Quite often, clients and their advisors are unaware of the intricacies and subtleties of partnership tax law which may cause unintended effects upon the tax reporting and the economic relationship of the LLC members. Similarly, many "plain vanilla" LLC Operating Agreements may not contain regulatory "safe harbor" provisions which are necessary for certain allocations of tax items, i.e., income, gain, loss, deductions, credits, to be respected for income tax purposes. Moreover, given the developing nature of the LLC Law and the hybrid nature of LLCs, there is a scant body of case law concerning various legal issues that may arise during the life and termination of an LLC. Accordingly, courts and practitioners may need to rely upon analogous corporate and general partnership legal principles to resolve disputes.

The purpose of this outline is to review some common LLC Operating Agreement provisions and consider how such provisions may differ from the "default" provisions of the LLC Law, as well as the significance of such provisions from a partnership taxation standpoint. While a complete comparison of all LLC Law and partnership taxation requirements is beyond the scope of this outline, the provisions selected should illustrate the impact of the partnership taxation rules upon the formation, operation, and termination of an LLC.

This outline is organized in accordance with the natural progression of an LLC and typical LLC Operating Agreement – Formation, Operation, and Termination. Sample LLC Operating Agreement provisions are contained in text boxes preceded or followed by a discussion of applicable LLC Law and/or partnership taxation rules. Capitalized terms are defined within the outline or in Exhibits A and B, attached.

II. Formation

A. Organizational Provisions

1. Filing

Formation. The Company shall be organized by the filing of Articles of Organization with the New York Department of State pursuant to the provisions of the LLC Law.

LLC Law § 203(d) provides that an LLC is formed upon the filing of the Articles of Organization with the Department of State. Section 203(d) also allows the Articles of Organization to specifically provide that formation does not occur at the time of filing, but instead at some specified date within 60 days subsequent to the date of filing. Section 203(e) lists the following items that must be addressed by the Articles of Organization:

- the name of the LLC;
- the New York State county in which the LLC's office is located (or, if the LLC has more than one office in the State, the county where the principal office is located);
- if the LLC is to have a specific date of dissolution in addition to the events of dissolution set forth in LLC Law § 701, the latest date on which the limited liability company is to dissolve;
- a designation of the Secretary of State as the LLC's agent for serving process against the LLC and state the Post Office address where the Secretary of State is to mail the LLC copies of any process served against it;
- if the LLC will have a registered agent, its name and address in New York and a statement that the registered agent is to be the agent of the LLC upon whom process against the LLC may be served;
- if all or specified members are to be liable in their capacity as members for all or specified debts, obligations or liabilities of the LLC as authorized pursuant to LLC Law § 609, a statement that all or specified members are so liable for such debts, obligations or liabilities in their capacity as members of the limited liability company as authorized pursuant to LLC § 609; and
- any other provisions, not inconsistent with law, that the members elect to include in the Articles or Organization for the regulation of the internal affairs of the LLC, including, but not limited to: (1) the business purpose for which the LLC is formed, (2) a statement of whether there are limitations on the authority of members or managers or a class or classes thereof to bind the LLC, and (3) any provisions that are required or permitted to be included in the LLC's Operating Agreement pursuant to LLC § 417.

Treasury Regulation § 301.7701 ("Treas. Reg." or "Regulation") provides for "default" partnership tax classification of LLCs with multiple members, unless the LLC

elects to be treated as a corporation by "checking the box" on Internal Revenue Service ("IRS") Form 8832, Entity Classification Election. See Treas. Reg. § 301.7701-3(a), (b)(1)(i) (commonly referred to as the "Check the Box" Regulations).

An LLC with one member is generally disregarded for income tax purposes, with all tax consequences of the LLC flowing directly to the sole member, unless the LLC checks the box to be taxed as a corporation. Treas. Reg. § 301.7701-3(b)(1)(ii).

Upon formation, there are other federal and state tax compliance issues that need to be addressed depending upon certain business factors including the date of formation, number of members, nature of the business, and number of employees. For example, a separate tax identification number for an LLC will be necessary if there are two or more members since the Company will be taxed as a partnership. A separate federal tax identification number may also be necessary for certain single-member LLCs depending upon the nature of the business and whether or not the Company will have employees. Similarly, these business factors will determine the income, employment, and sales tax reporting requirements for the Company.

2. Name

Name. The name under which the Company shall conduct its business is _____, LLC.

LLC Law § 204 governs the permissible names of LLCs in New York. Some general rules include: (1) the name must contain "LLC" or "L.L.C." or "Limited Liability Company" (LLC Law § 204(a)); and (2) the name may not contain certain words or phrases, including among several others, "state police," "urban development," "chamber of commerce," "lawyer," "bank," "doctor," and "insurance." (LLC Law § 204(e), (f)). Prior to forming an LLC, the proposed name should be compared to the requirements of LLC Law § 204 (in addition to performing Department of State and trademark searches to confirm permissible names).

A proposed name (that complies with LLC § 204) can be reserved under LLC Law § 205 by delivering an Application for Reservation of Name (Form DOS-1233) to the Department of State together with the statutory filing fee of $20.00. The name will be reserved for 60 days, and the period can be extended by a maximum of two additional 60-day periods. LLC Law § 205(c).

3. Entity Classification

> No Partnership. By formation of the Company, the Members expressly do not intend to form a partnership or limited partnership under New York law. The Members do not intend to be partners to one another, nor to any third party. However, the Members intend for the Company to be taxed in accordance with the federal and state laws governing the taxation of partnerships.

Although the LLC is set up under the LLC Law, this provision further supports the claim that the formation of the Company does not create an otherwise unintended partnership for state law purposes.

For tax purposes, LLCs with multiple members are treated as partnerships unless they elect to be treated as corporations. See supra Part II.A.1. This provision ensures that the LLC will be treated as a partnership for tax purposes.

4. Tax Matters Member

> Tax Matters Member. The Managers shall, for income tax purposes only, designate a Member as the tax matters partner (Member) of the Company pursuant to section 6231(a)(7) of the Code.

A Tax Matters Partner—in the context of an LLC, the Tax Matters Member—is the person that represents the entity in connection with tax audits.

The general rule for LLCs is that only a member-manager may be designated as the Tax Matters Member. Treas. Reg. § 301.6231(a)(7)-2(a). However, where none of the members are managers, any of the members can be selected as Tax Matters Member. Treas. Reg. § 301.6231(a)(7)-2(b)(3).

Under LLC Law § 401, the default rule is that the LLC will be member-managed. However, the Articles of Organization can specify that the LLC will be managed by managers, rather than by members. LLC Law § 401(a). If the Articles of Organization fail to specify manager-management, only members who exercise management powers are deemed to be a member-managers. LLC Law § 401(b). Therefore, if the LLC is member-managed, the only members that may be designated as the Tax Matters Member are those that actually exercise management responsibility over the LLC.

This limitation on the pool of qualified members for designation as Tax Matters Member can be avoided if the Articles of Organization provide for manager-management. See LLC Law §§ 401(a), 408. In that case, any of the members may be designated as Tax Matters Member.

5. Definitions

Most LLC Operating Agreements include numerous terms that are defined either in accordance with the LLC Law, tax law or pursuant to the terms of the Operating Agreement. While some terms may be defined in a section of the Operating Agreement, it is generally preferable for ease of readability to include a separate section or Exhibit to define various terms, particularly tax terminology.

In addition to capitalized terms defined in sample provisions of this outline, Exhibit A, Table of Definitions, attached, contains additional terms commonly be used in an Operating Agreement, or otherwise referred to in this outline. Exhibit B, Regulatory Allocations, attached, contains technical tax provisions that are necessary to comply with certain regulatory safe harbors for allocating tax items.

B. Capitalization

1. General Concepts

The LLC Law provides that, unless the Operating Agreement provides otherwise, capital contributions of each member to the extent received by or promised to the Company (not including defaulted obligations) and not returned to the member are considered when determining certain rights of the members. For instance, the capital contributions of each member are inextricably intertwined with the method for allocating profits and losses (LLC Law § 503) and distributions (LLC Law § 504), liquidation rights (LLC Law § 704(c)), and voting rights (LLC Law § 402(a)).

Therefore, if the Operating Agreement does not provide otherwise, profits and losses and distributions shall be allocated among the members upon the basis of the value of the members' capital contributions. Similarly, under these circumstances, each member shall be entitled to vote in proportion to such member's share of profits in accordance with LLC Law § 503, and the proportionate amount of a member's capital contributions will affect the amount distributed to such member upon liquidation of the Company (LLC Law §§ 704(c) and 504). Accordingly, if this is not the intended results of the members, the Operating Agreement should be drafted to produce a different result.

2. Capital Contributions

> Contributions. The initial capital of the Company shall be the cash and other assets contributed by the Members as set forth in Exhibit __, which amounts shall also represent the Members' initial Capital Account balances. The Members will make additional Capital Contributions in such form and amounts and at such times as shall be determined by the Members in accordance with Section __. No Member shall be entitled to interest on amounts contributed to his or her Capital Account. Except as provided in this Agreement, no Member shall have the right to withdraw any part of his or her Capital Account or receive Property other than cash.

LLC Law § 501 allows a member's contribution to the LLC's capital to be in the form of property, cash, services, or a promissory note or similar future contribution obligation. As noted in Part II.B.1, above, if the Operating Agreement does not provide otherwise, the LLC Law permits deferred contributions in the form of a promissory note or future contribution obligations, to be counted for purposes of determining a member's share of profits and losses, distributions, and voting. However, such deferred contributions are not counted when calculating a member's capital account for tax purposes (see Part III.A.2, below).

Internal Revenue Code § 721(a) ("IRC" or the "Code") provides that neither the contributing members nor the LLC recognize gain or loss upon the members' contributions of property to the LLC in exchange for membership interests. Typically, however, a member who contributes services in exchange for a capital interest must report the value of such interest received as ordinary income. See Treas. Reg. § 1.721-1(b)(1). This is commonly referred to as a "capital shift," since part of the capital contributions by members who contribute property shifts to the capital account of the member who contributes services in exchange for a capital interest in the Company.

The tax consequences related to a contribution of services in exchange solely for a "profits interest," i.e., a member's right to share future profits only with no initial capital account, has not been as clear. Despite tax practitioner arguments to the contrary, courts have generally held that the receipt of a profits interest in exchange for services is a taxable event if the value of the profits interest can be readily ascertained. See Diamond v. Comr., 56 T.C. 530 (1971), aff'd 492 F.2d 286 (7th Cir. 1974); Campbell v. Comr., 943 F.2d 815 (8th Cir. 1991), rev'g in part T.C. Memo 1990-162 (1990).

The Internal Revenue Service (the "Service") issued Revenue Procedure ("Rev. Proc.") 93-27, 1993-2 C.B. 343 (clarified by Rev. Proc. 2001-43, 2001-2 C.B. 191) which generally follows these judicial guidelines by providing that the IRS will not treat the receipt of a profits interest as a taxable event provided that the profits interest (1) does not relate to a substantially certain and predictable stream of income from partnership assets, (2) is not disposed of within two years of receipt, or (3) is not a limited partnership interest in a "publicly traded partnership" within the meaning of Section 7704(b) of the

Code. The Service also issued Prop. Reg. § 1.83-3(l) and Notice 2005-43; 2005-24 I.R.B. 1221 which generally provides that a partner receiving a profits interest in exchange for services may make a safe harbor election under Section 83 of the Code to subject such interest to taxation upon receipt at its current fair market value, i.e., zero. However, in 2012, the Service proposed an amendment to Treas. Reg. § 1.83-3 which did not include the safe harbor contained in Prop. Reg. § 1.83-3(l). See 77 Fed. Reg. 31,783.

Upon the contribution of property, tax characteristics of the property contributed, such as adjusted basis and holding period, carry over to the membership interest received. The member's basis in the membership interest received ("outside basis") is equal to the member's pre-contribution basis in the contributed property, plus any cash contributed and any gain recognized upon contribution. IRC § 722.

The amount of cash contributed (affecting outside basis) will depend upon whether the contributed property was subject to a debt. On the one hand, the contributing member is deemed to receive a cash distribution to the extent that the LLC takes responsibility for the contributing member's debt. See IRC § 752(b). On the other hand, the contributing member is deemed to make a cash contribution to the extent that he or she, as a result of receiving a membership interest, assumes or takes subject to any of the LLC's debt. See id. § 752(a). If the newly incurred debt exceeds the newly relieved debt, then the member's outside basis is increased to the extent of the difference between the two (and vice-versa in the case where the newly relieved debt exceeds the newly incurred debt). See Treas. Reg. §§ 1.722-1 and 1.752-1(f).

Likewise, the LLC's basis in the contributed property ("inside basis") must be tracked. The inside basis is equal to the basis of the assets in the hands of the contributing member immediately prior to the contribution increased by the amount (if any) of any gain recognized by the contributing member at such time. IRC § 723.

Holding periods are carried over (or transferred) much in the same way adjusted basis is. See IRC § 1223(1), (2).

3. Enforcement of Commitments

As stated in Part II.B.2, above, LLC Law § 501 permits deferred capital contributions in the form of a member promissory note or similar future contribution obligation. Accordingly, the LLC members may contemplate that members will make either mandatory or optional future or additional capital contributions after formation of the Company.

A member's obligation or option to make future or additional capital contributions can distort both the tax and economic results of Company operations unless Company assets are revalued and profit and loss sharing ratios are adjusted after such contributions are made. For tax purposes, the promise to make future contributions does not result in an immediate increase of a member's capital account (see Part III.A.2, below). Similarly, future contributions do not increase a member's outside basis (See

IRC § 705 and Treas. Regs. thereunder). This may affect a member's ability to deduct Company tax losses in excess of his or her actual contributions to the Company. See IRC § 704(d) and Treas. Reg. § 1.704-1(b)(2)(ii).

If the members contemplate such future and/or additional capital contributions, the Operating Agreement should address whether optional additional capital contributions will be accepted by the LLC, as well as a method to address non-payment of any mandatory future and/or additional contributions. The following is a sample provision concerning the enforcement of such commitments.

> Enforcement of Commitments. In the event any Member fails to make a Capital Contribution as required by this Agreement, the Managers may take such action, including but not limited to enforcing the capital obligation in a court of law. Each Member expressly agrees to the jurisdiction of such court for the purpose of enforcing the capital obligation. In the event that the capital obligation is satisfied by one or more other Members, those Members who contribute the capital of the defaulting Member shall be entitled to treat the amounts contributed as a loan to the Company which shall bear interest at the prime commercial rate plus three percent.

LLC Law § 502 provides that a member must fulfill any promise to contribute property, cash, or services to the LLC, and that the LLC has the option to force the member to contribute an equal amount in cash if the member fails to contribute.

This sample provision clarifies that the LLC may enforce the obligation to contribute in a New York court, and that the defaulting member will submit to the jurisdiction of the court.

Furthermore, this provision allows other members to satisfy the defaulting member's obligation, with such members treating the amounts transferred to the LLC as a loan with a specified rate of interest.

III. Operation

A. Capital Accounts

1. Generally

> Capital Accounts. The Company shall maintain for each Member a separate Capital Account in accordance with the rules set forth under the definition of "Capital Account" contained in Exhibit __.

In general, the capital of an LLC may be viewed as representing the value, for book accounting purposes, that the members will receive if the Company sold all its assets at book value, paid all its liabilities, and then liquidated. In other words, from a "balance sheet" standpoint, it represents the difference between the Company's assets and its liabilities, and from an "income statement" standpoint, it represents the sum of all capital contributions, plus profits, less losses and distributions to the members. A member's individual capital account is his or her proportional share of the Company capital.

While the determination of the Company's capital and each member's capital account is a fundamental accounting concept for economic purposes, it is also necessary for income tax purposes as discussed in Part III.A.2, below.

2. Capital Account Maintenance

Capital Account: Means, with respect to any Member, the Capital Account maintained for the Member in accordance with the following provisions:

(a) To each Member's Capital Account there shall be credited the Member's Capital Contributions, the Member's distributive share of Profits and any items in the nature of income or gain which are specially allocated pursuant to Exhibit __ of this Agreement, and the amount of any liabilities assumed by the Member or which are secured by any Property distributed to the Member.

(b) To each Member's Capital Account there shall be debited the amount of cash and the Gross Asset Value of any Property distributed to the Member pursuant to any provision of this Agreement, the Member's distributive share of losses and any items in the nature of expenses or losses which are specially allocated pursuant to Exhibit __, and the amount of any liabilities of the Member assumed by the Company or which are secured by any Property contributed by the Member to the Company.

(c) In the event any interest in the Company is transferred in accordance with the terms of this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent it relates to the transferred interest.

(d) In determining the amount of any liability for purposes of subsections (a) and (b) of this definition, there shall be taken into account Code Section 752(c) and any other applicable provisions of the Code and Regulations.

The foregoing provisions and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Regulations Section 1.704-1(b), and shall be interpreted and applied in a manner consistent with such Regulations. In the event the Members shall determine that it is prudent to modify the manner in which the Capital Accounts, or any debits or credits thereto (including, without limitation, debits or credits relating to liabilities which are secured by contributed or distributed Property or which are assumed by the Company or the Members), are computed in order to comply with such Regulations, the Members may make the modification, provided that it is not likely to have a material effect on the amounts distributable to any Member under this Agreement.

This sample definition of "capital account" was referred to in the prior sample provision at Part III.A.1. Recall that the prior sample provision required the maintenance of capital accounts, and that the mechanics of the maintenance of those capital accounts was determined by the definition of "capital account." This sample definition, therefore, provides the procedure for actually maintaining the capital accounts.

The first two subsections ((a) and (b)) of the sample definition of capital account ensure compliance with the safe harbor requirements under Treas. Reg. § 1.704-1(b).

Subsection (d) of the sample definition of capital account ensures that liabilities, "assumed by" or "taken subject to" by the member or LLC, are properly accounted for by the LLC as required by the Regulations and the Code.

If there were any doubt as to the purpose of the definition of capital account, the last paragraph of the definition resolves it: the purpose of the definition, with all the mechanics it prescribes, is to comply with the Regulations' safe harbor. Including such a provision allows the members to adjust the method of maintaining the capital accounts in accordance with the requirements of the Regulations, and ensures that anyone interpreting the agreement will read the definition (and other, related provisions of the Operating Agreement) in light of the requirements of the Regulations.

In summary, the Regulations require certain items to be added to and subtracted from the capital accounts in order for allocations to have economic effect. The following items must be *added* to a member's capital account:

- Money contributed by the member;
- The fair market value of property contributed by the member (net of liabilities that the LLC is considered to have assumed or taken subject to); and
- The LLC's items of income and gain that are allocated to the member. Treas. Reg. § 1.704-1(b)(2)(iv)(b).

Note: For tax purposes, a member's contribution of a promissory note does not increase the member's capital account. Treas. Reg. § 1.704-1(b)(2)(iv)(e)(2). Instead, a member's capital account will only be increased when there is either a taxable disposition of the note by the Company or when principal payments under the note are made. This should be contrasted with the LLC Law's "default" provisions discussed at Part II.B.2, above, which count promissory notes or future obligations to make a capital contribution for purposes of determining profits and loss sharing, distributions, voting, and liquidation rights. Accordingly, these LLC Law provisions do not fully comply with the Treasury Regulations' "substantial economic effect" safe harbor provisions (see Part III.B.1, below) and may conflict with the Company's accounting methods. In addition, if the Company's accounting methods increase a member's capital account by the amount of a promissory note contributed to the Company, such "book" method of accounting will conflict with the "tax" method of accounting under the Treasury Regulation capital account "maintenance rules." (see Part III.B.1, below).

The following items must be *subtracted* from a member's capital account:

- Money distributed to the member (including cash deemed to be distributed for member debts the LLC assumes or takes subject to; see IRC § 752(b)),
- The fair market value of the property distributed to the member, and
- The LLCs items of losses, deductions, and § 705(a)(2)(B) expenditures allocated to the member. Treas. Reg. § 1.704-1(b)(2)(iv)(b).

These basic rules for maintaining capital accounts are just that—basic. There are many other nuances that are treated differently. Therefore, prior to simply including such a provision in an Operating Agreement, counsel experienced in the field of partnership taxation should be consulted, and the Treasury Regulations must be thoroughly studied.

B. Allocations

1. Allocation of Income, Gain, Loss, Deductions and Credits

> Allocation of the Net Profits and Net Losses. Profits and Losses shall be allocated in accordance with the Sharing Ratios set forth in Exhibit __, subject to the Tax and Regulatory Allocations set forth in Exhibit __.

The LLC Law allows the LLC's Operating Agreement to provide how profits and losses will be allocated among the members of the LLC. LLC Law § 503. In the absence of such a provision "providing otherwise," the profits and losses are allocated in accordance with the members' capital contributions (excluding the value of defaulted obligations to contribute). Id.

Under the Code, a partnership, i.e., an LLC, is given great flexibility to allocate the tax benefits and burdens that flow from the Company's operations. In general, a member's share of income, gain, loss, deductions, and credits may be determined by the agreement of the members. IRC § 704(a). In other words, the LLC is not required to allocate those tax items to the members solely based on the members' percentage ownership interests in the LLC. Sample tax and regulatory allocation provisions are attached hereto as Exhibit B.

However, the allocations set forth in an Operating Agreement will be respected for tax purposes only if one of the following three requirements is satisfied:

1. The allocations have "substantial economic effect" under IRC § 704(b)(2) and Treas. Reg. § 1.704-1(b)(2).

2. The allocations are in accordance with the partners' interests in the partnership (taking into account all the facts and circumstances) under Section 704(b) and Treas. Reg. § 1.704-1(b)(3).

3. The allocations are "deemed" to be in accordance with the partners' interests in the partnership under one of the special rules set forth in Treas. Reg. §§ 1.704-1(b)(4) and 1.704-2.

In order for an allocation to have "substantial economic effect" it must fall within the Treasury Regulations safe harbor provisions that require the following:

- The LLC must maintain capital accounts. Treas. Reg. § 1.704-1(b)(2)(ii)(b)(1). This is commonly called the "maintenance requirement."

- The LLC must make liquidating distributions in accordance with positive capital account balances. Treas. Reg. § 1.704-1(b)(2)(ii)(b)(2). This is commonly called the "effectuation requirement."

- Each member has an unconditional obligation to restore any deficit in his or her capital account on liquidation of the membership interest (commonly called the "restoration requirement"), unless the Operating Agreement contains a "loss limitation" or a "qualified income offset." Treas. Reg. §§ 1.704-1(b)(2)(ii)(b)(3), 1.704-1(b)(2)(ii)(d).

- The economic effect of the allocations must be substantial. Treas. Reg. § 1.704-1(b)(2)(iii).

- Some allocations have special requirements, such as allocations that are attributable to property secured by non-recourse debt. For example, in the case of allocations attributable to property secured by nonrecourse debt, the LLC Operating Agreement must contain a "minimum gain chargeback" provision. Treas. Reg. § 1.704-2(b)(2), (f), (g)(2).

As indicated, in order for the allocations to have substantial economic effect, the LLC must maintain a capital account for each member. The sample provision and the definition of "Capital Account" in Part III.A., above, ensures the maintenance of capital accounts in accordance with Treas. Reg. § 1.704-1(b)(2)(ii)(b)(1).

If the allocations do not have substantial economic effect, then the LLC's tax items are allocated to the members in proportion of each member's interest in the Company. IRC § 704(b), or may be "deemed" to be made in accordance with the member's interest in the Company under special rules set forth in Treas. Reg. §§ 1.704-1(b)(4) and 1.704-2. Not surprisingly, the determination of a member's interest in the Company is a *sui generis* inquiry, taking into consideration "all the facts and circumstances." Treas. Reg. § 1.704-1(b)(1)(i). The following are some factors that the IRS will examine to determine members' "economic interests:"

- The members' interests in capital contributions,
- The members' interests in profits and losses,
- The members' interests in cash flow,
- The members' interests in non-liquidating distributions, and
- The members' interests in liquidating distributions of capital. Treas. Reg. § 1.704-1(b)(3)(ii)

Failing to ensure that allocations have substantial economic effect forces allocations to be made according to this difficult determination (the "all the facts and circumstances" determination of a member's economic interest). Therefore, for purposes of ensuring certainty and for purposes of ensuring the best tax consequences possible, the LLC's Operating Agreement should err on the side of falling within the safe harbor under Treas. Reg. § 1.704-1(b). The first step in ensuring that the special allocations in the Operating Agreement comply with the safe harbor rules is by requiring the LLC to maintain capital accounts, as the above sample provisions provide.

2. Tax Allocations

a. 704(c) "Built-in" Gain or Loss Allocation

Tax Allocations.

(a) In accordance with Section 704(c) of the Code and the Regulations thereunder, income, gain, loss, deduction and credit with respect to any Property contributed to the capital of the Company by any Member shall, solely for federal income tax purposes, be allocated among the Members so as to take account of any variation between the adjusted basis of the Property to the Company for federal income tax purposes and its initial Gross Asset Value at the time of contribution to the Company.

(b) In the event the Gross Asset Value of any Company asset is adjusted as provided in the definition of Gross Asset Value, subsequent allocations of income, gain, loss, deduction and credit with respect to the asset shall take account of any variation between the adjusted basis of the asset for federal income tax purposes and its Gross Asset Value in the same manner as under Section 704(c) and the Regulations thereunder.

(c) Any elections or other decisions relating to allocations provided in this Section __ shall be made by the Managers in such manner as will, in the opinion of the Company's accountants, be most advantageous to Members possessing no less than fifty-one (51%) of all Membership Interests. Allocations pursuant to this Section __ are solely for the purposes of federal, state and local taxes and shall not affect, or in any way be taken into account in computing, any Member's Capital Account, share of Profits and Losses, or distributions pursuant to any provision of this Agreement.

At the time of contribution of property, often the fair market value of the property will not equal the member's adjusted basis in the property for tax purposes. If that is the case, then the Operating Agreement must provide for allocating to the member that contributed the property any "built-in" gain or loss resulting from the LLC's future sale of such property. See Treas. Reg. § 1.704-3.

The LLC may use one of four methods to make allocations for contributed property: (1) the traditional method, Treas. Reg. § 1.704-3(b); (2) the traditional method with curative allocations, Treas. Reg. § 1.704-3(c); (3) the remedial allocation method, Treas. Reg. § 1.704(d); or (4) any other reasonable method that ensures that the contributing member receives the benefits or burdens of contributed property that has built-in gain or loss at the time of the contribution. The mechanics of these methods are thoroughly prescribed by the Treasury Regulations.

b. Nonrecourse Debt

> Nonrecourse Deductions. Nonrecourse Deductions for any Fiscal Year shall be specially allocated among the Members in accordance with their Sharing Ratios.

Nonrecourse deductions are deductions attributable to property that secures nonrecourse debt, to the extent that the deductions reduce the property's basis below the nonrecourse loan balance. Generally, nonrecourse deductions cannot have substantial economic effect because no member of the LLC is personally liable in the event of a default—that is, because it is the *lender* that bears the economic risk of loss. Treas. Reg. § 1.704-2(b)(1).

The Regulations nevertheless permit such nonrecourse deductions allocations. All of the following must be satisfied for the nonrecourse deductions allocations to be respected:

- All the requirements for recourse debt allocations are met.
- Nonrecourse deductions allocations are reasonably consistent with allocations that have substantial economic effect of other LLC items attributable to the property securing the nonrecourse debt.
- The LLC Operating Agreement contains a "minimum gain chargeback."
- All other allocations under the Operating Agreement have substantial economic effect. Treas. Reg. § 1.704-2(e).

> Minimum Gain Chargeback. Except as otherwise provided in Section 1.704-2(f) of the Regulations and notwithstanding any other provision of this Exhibit __, if there is a net decrease in Company Minimum Gain during any Company Fiscal Year, each Member shall be specially allocated items of Company income and gain for the year (and, if necessary, subsequent years) in an amount equal to the portion of the Member's share of the net decrease in Company Minimum Gain, determined in accordance with Regulations Section 1.704-2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant to the Regulations. The items to be so allocated shall be determined in accordance with Sections 1.704-2(f)(6) and 1.704-2(j)(2) of the Regulations. This Section __ is intended to comply with the minimum gain chargeback requirement in Section 1.704-2(f) of the Regulations and shall be interpreted consistently therewith.

While a member to whom nonrecourse deductions are allocated escapes actual repayment liability for the nonrecourse debt in the event of the LLC's default, such

member must also have potential gain allocated to him or her. See Treas. Reg. § 1.704-2(f).

Minimum gain is the amount by which the nonrecourse debt exceeds the property's basis. Treas. Reg. § 1.704-2(d)(1). Minimum gain is allocated to the members that were allocated the nonrecourse deductions. See Treas. Reg. § 1.704-2(g)(1).

This sample provision incorporates the Regulations governing minimum gain. Therefore, such a provision satisfies the requirement that, for nonrecourse deductions to be allocated to members, the Operating Agreement must contain a provision that allocates to those members to whom nonrecourse deductions are allocated the portion of minimum gain that results from those allocated nonrecourse deductions.

c. Member Nonrecourse Debt

> Member Nonrecourse Deductions. Any Member Nonrecourse Deductions for any Fiscal Year shall be specially allocated to the Member who bears the risk of loss with respect to the loan to which the Member Nonrecourse Deductions are attributable in accordance with Regulations Section 1.704-2(i)(1).

For example, if a member lends money to the LLC to purchase property, and the debt is only enforceable against the purchased property, then the debt from the perspective of the LLC is nonrecourse. However, the lending member bears the economic risk of loss to the extent that the loan balance exceeds the value of the property.

Deductions that arise from such nonrecourse (from the LLC's perspective) debt are "Member Nonrecourse Deductions." Such deductions must be allocated to the member who bears the economic risk of loss (e.g., the lending member). Treas. Reg. § 1.704-2(i)(1).

This type of Member Nonrecourse Deduction may also arise from a situation where the LLC secures a loan, and a member personally guarantees it. In such a case, the guarantor-member bears the economic risk of loss. See DAVID J. CARTANO, FEDERAL & STATE TAXATION OF LIMITED LIABILITY COMPANIES 154 (2005).

The above sample provision, by incorporating the applicable Regulations by reference, ensures that the required allocations occur.

Member Minimum Gain Chargeback. Except as otherwise provided in Section 1.704-2(i)(4) of the Regulations and notwithstanding any other provision of this Exhibit __ except Section __, if there is a net decrease in Member Nonrecourse Debt Minimum Gain attributable to a Member Nonrecourse Debt during any Company Fiscal Year, each Member who has a share of the Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, determined in accordance with Section 1.704-2(i)(5) of the Regulations, shall be specially allocated items of Company income and gain for the year (and, if necessary, subsequent years) in an amount equal to the portion of the Member's share of the net decrease in Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, determined in accordance with Regulations Section 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant to the Regulations. The items to be so allocated shall be determined in accordance with Sections 1.704-2(i)(4) and 1.704-2(j)(2) of the Regulations. This Section __ is intended to comply with the minimum gain chargeback requirement in Section 1.704-2(i)(4) of the Regulations and shall be interpreted consistently therewith.

Member Minimum Gain is the amount by which the member nonrecourse debt exceeds the book value of the property. See Treas. Reg. § 1.704-2(i)(2).

That "gain" must be allocated to the members of the LLC. A member's share of minimum gain is based on the amount of deductions that caused the book value of the property to fall below the loan balance. Treas. Reg. § 1.704-2(i)(5). If one member received all of the deductions that caused the book value of the property to fall below the loan balance, then the member minimum gain is allocated to that member.

If a member's share of member nonrecourse debt minimum gain decreases in the current year, then the LLC must allocate income or gain to that member in the amount of the decrease. Treas. Reg. § 1.704-2(i)(4).

An increase in the member's share of member nonrecourse debt minimum gain has no tax consequences.

3. Negative Capital Account Balance

a. Qualified Income Offset

> Qualified Income Offset. Except as provided in Section __ of this Exhibit __, in the event that any Member receives an allocation of Loss or any distribution which causes the Member to have an Adjusted Capital Account Deficit at the end of the Fiscal Year, then all items of Company income and gain shall be specially allocated to the Member in an amount and manner sufficient to eliminate to the extent required by the Regulations, the Adjusted Capital Account Deficit of the Member as quickly as possible.

Generally, in order for allocations to have substantial economic effect, a member with a negative capital account balance upon liquidation must be unconditionally required by the Operating Agreement to restore the deficit. See Treas. Reg. § 1.704-1(b)(2)(ii)(b)(3). As mentioned above, as an alternate to this requirement, the Operating Agreement may contain a "qualified income offset" provision. Treas. Reg. § 1.704-1(b)(2)(ii)(d). Such a provision ensures that, in the event that a member's capital account falls below zero, the LLC items of income and gain will be allocated to that member to the extent necessary to eliminate the deficit as quickly as possible.

b. Loss Limitation

> Loss Limitation. Losses allocated pursuant to Section __ hereof shall not exceed the maximum amount of Losses that can be allocated without causing any Member to have an Adjusted Capital Account Deficit at the end of any Allocation Year. In the event some but not all of the Members would have Adjusted Capital Account Deficits as a consequence of an allocation of Losses pursuant to Section __ hereof, the limitation set forth in this Section __ shall be applied on a Member-by-Member basis and Losses not allocable to any Member as a result of such limitation shall be allocated to the other Members in accordance with the positive balances in such Member's Capital Accounts so as to allocate the maximum permissible Losses to each Member under Regulations Section 1.704-1(b)(2)(ii)(d).

If a member is not required by the Operating Agreement to restore a negative capital account balance, the Operating Agreement may contain a "loss limitation" provision to make sure that the allocations have substantial economic effect. See Treas. Reg. § 1.704-1(b)(2)(ii)(d)(3).

The loss limitation provision prevents the LLC from allocating losses to members if allocating such losses will cause a negative capital account balance.

4. Section 754 Adjustments

Code Section 754 Adjustment. To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Code Section 734(b) or Code Section 743(b) is required, pursuant to Regulations Section 1.704-1(b)(2)(iv)(m), to be taken into account in determining Capital Accounts, the amount of the adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis) and the gain or loss shall be specially allocated to the Members in a manner consistent with the manner in which their Capital Accounts are required to be adjusted pursuant to that Section of the Regulations.

Under IRC § 754, an LLC may elect to adjust the basis of its assets for tax purposes in some instances. If the LLC elects, then the LLC must adjust the basis of its assets upon the occurrence of one of two events: (1) the transfer of a member's interest, or (2) the distribution of property to a member.

The adjustments to be made are as follows:

- The LLC must increase its basis in assets in the amount of any gain recognized by the member as a result of a cash distribution (where the cash distributed exceeded the member's outside basis). IRC § 734(b)(1)(A).

- The LLC must decrease its basis in assets in the amount of any loss recognized by the member as a result of the liquidation of the member's interest (where the distributed cash and accounts receivable/inventory are the sole property distributed, and the cash and basis in the accounts receivable/inventory is less than the member's outside basis). IRC § 734(b)(2)(A).

- The LLC must increase the basis in its assets in an amount equal to the difference between the member's basis in received property and the LLC's basis in the same property prior to the distribution. IRC § 734(b)(1)(B).

- The LLC must decrease the basis of its assets by an amount equal to the extent the member's basis in the received property exceeds the LLC's basis in the same property prior to the distribution. IRC § 734(b)(2)(B).

C. Non-liquidating Distributions

> Distributions. From time to time, the Managers shall determine in their reasonable judgment to what extent, if any, the Company's cash on hand exceeds the current anticipated needs, including without limitation, needs for operating expenses, debt service, acquisitions, reserves, and mandatory distributions, if any. To the extent such excess exists, the Managers may make distributions to the Members in accordance with their Sharing Ratios. Such distributions shall be in cash or Property (which must be distributed proportionately), or partly in both, as determined by the Managers.

LLC Law § 508 limits the LLC's ability to make distributions. If the distribution would cause the LLC's liabilities to exceed the fair market value of the LLC's assets, then the distribution is prohibited. LLC Law § 508(a).

In the absence of a provision in the Operating Agreement that governs distribution-sharing, distributions are allocated to members on the basis of their contributions. LLC Law § 504. This sample provision may alter that default allocation – if the sharing ratios of the members are not tied to the members' contributions, then the allocation of distributions will differ from that which would otherwise be prescribed by the default rule in the LLC Law.

If a distribution is one of cash, then the recipient member need not recognize gain on the distribution except to the extent that the cash distributed exceeds the member's outside basis immediately prior to the distribution. IRC § 731(a). To the extent that the distribution does not exceed the member's outside basis, the member's outside basis is reduced. IRC § 733.

If property is distributed in a non-liquidating distribution, then the member typically does not recognize any income or gain. IRC § 731(a). The member's outside basis is reduced by the adjusted basis of the distributed property as in the hands of the LLC. IRC § 733. The member receives a carry-over basis in the distributed property, but only to the extent that it does not exceed his outside basis immediately before the distribution. IRC § 732(a)(1).

The basis adjustment rules for non-liquidating property distributions become slightly more complex when the distribution consists of cash, accounts receivable and inventory, and other property. In such a case, tax consequences are tracked for the cash distributed first, then for the distributed accounts receivable and inventory, and finally for the other property. See CARTANO, supra, at 202.

IV. Liquidation

Distribution of Assets. Upon winding up of the Company, the assets shall be distributed in the following order of priority:

(a) First, to the payment and discharge of all of the Company's debts and liabilities and the expenses of the dissolution;

(b) Second, to the creation of any reserve that the Managers reasonably deem necessary for any contingent or unforeseen liabilities or obligations of the Company;

(c) Third, to Members and to Assignees holding Economic Interests, the balance in their Capital Account computed with adjustments up through the date of distribution. If any Capital Account has a negative balance, the Member or holder of the Economic Interest shall have no obligation to make any Capital Contribution to restore the negative balance, and the negative balance in the Capital Account shall not be considered a debt owed to the Company or to any other person for any purpose whatsoever; and

(d) The balance, if any, to the Members in accordance with their Sharing Ratios.

LLC Law § 704 requires the distributions of assets upon winding up of the LLC to be made in the following priority:

- Creditors,
- Except as provided otherwise in the Operating Agreement, to members and former members in satisfaction of (1) interim distributions required by the Operating Agreement and (2) distributions required as a result of a member's withdrawal from the LLC,
- Except as provided otherwise in the Operating Agreement, to members for the return of their contributions, and
- Except as provided otherwise in the Operating Agreement, to members in proportions in which members share in distributions under LLC Law § 504.

LLC Law § 504 requires distributions to be made as the Operating Agreement provides. In the absence of a specific provision in the Operating Agreement, distributions must be made on the basis of each member's contribution. LLC Law § 504.

However, because the allocations of tax items will be respected only if they have substantial economic effect, this sample provision—by tying distributions to the capital

accounts as adjusted over time—ensures that the distributions upon winding up reflect the benefits and burdens received by each member as a result of those allocations.

The general tax rule is that, if a member has a negative capital account balance, for the allocations to have substantial economic effect, the member must be required to restore any deficit upon liquidation of the LLC. Most LLCs will not include a restoration requirement since it defeats a principal purpose of an LLC – limited liability of its members. However, the Operating Agreement may contain either a loss limitation and/or a qualified income offset to comply with the regulatory safe harbor provisions. See supra Part III.B.3. Although this sample provision eliminates the requirement that the member with a negative capital account balance restore the deficit, i.e., the "restoration requirement," it complies with the "effectuation requirement" by providing that liquidating distributions will be made in accordance with positive capital accounts.

EXHIBIT A

TABLE OF DEFINITIONS

Agreement: The operating agreement of _____, LLC, effective, _____, 2013 as it may be amended pursuant to its terms. The operating agreement reflects the terms for governance of the Company and shall be controlling in all respects when inconsistent with the LLC Law. Where specifically provided, the operating agreement may incorporate by reference sections of the Code or Regulations as well as other governance plans or agreements of the Company or the Members.

Assignee: Transferee of an Economic Interest who has not been admitted as a Member, including a trustee in bankruptcy. The Assignee shall be bound by all restrictions and obligations imposed on Members by this Agreement or by the LLC Law.

Capital Contribution: Any contribution of cash, property or services or the obligation to contribute cash, property or services by or on behalf of a Member or Assignee.

Code: The Internal Revenue Code of 1986, as amended from time to time, including any letter rulings and judicial and administrative interpretations promulgated thereunder.

Company: _____, LLC, a limited liability company formed under the laws of New York State.

Depreciation: Means, for each Fiscal Year or other period, an amount equal to the depreciation, amortization, or other cost recovery deduction allowable with respect to an asset for the year or other period, except that if the Gross Asset Value of an asset differs from its adjusted basis for federal income tax purposes at the beginning of the year or other period, Depreciation shall be an amount which bears the same ratio to the beginning Gross Asset Value as the federal income tax depreciation, amortization, or other cost recovery deduction for the year or other period bears to the beginning adjusted tax basis; provided, however, that if the federal income tax depreciation, amortization or other cost recovery deduction for the year is zero, Depreciation shall be determined with reference to the beginning Gross Asset Value using any reasonable method selected by the Managers.

Economic Interest: A Member's share of the Company's Profits, Losses and distributions of the Company's assets pursuant to this Agreement and the LLC Law, but shall not include any right to participate in the management of the business or affairs of the Company, the right to vote on, consent to, or otherwise participate in any decision or action of the Members.

Fiscal Year: The calendar year unless otherwise established or changed by the Managers, including any period of less than a calendar year in the year of formation or dissolution of the Company.

Gross Asset Value: Means, with respect to any asset, the asset's adjusted basis for federal income tax purposes, except as follows:

(a) The initial Gross Asset Value of any asset contributed by a Member to the Company shall be the fair market value of the asset, as determined by the contributing Member and the Managers;

(b) The Gross Asset Values of all Company assets may, in the sole discretion of the Managers, be adjusted to equal their respective fair market values, as determined by the Managers, as of the following times: (i) the acquisition of an additional interest in the Company by any new or existing Member in exchange for more than a *de minimis* Capital Contribution; (ii) the distribution by the Company to a Member of more than a *de minimis* amount of property as consideration for an interest in the Company; and (iii) the liquidation of the Company within the meaning of Section 1.704-1(b)(2)(ii)(g) of the Regulations; provided, however, that adjustments pursuant to clauses (i) and (ii) above shall be made only if the Managers reasonably determine that the adjustments are necessary or appropriate to reflect the relative Economic Interests of the Members in the Company.

(c) The Gross Asset Value of any Company asset distributed to any Member shall be the fair market value of the asset, as determined by the Managers, on the date of distribution; and

(d) The Gross Asset Values of Company assets shall be increased (or decreased) to reflect any adjustments to the adjusted basis of the assets pursuant to Code Section 734(b) or Code Section 743(b), but only to the extent that the adjustments are taken into account in determining Capital Accounts pursuant to Section 1.704-1(b)(2)(iv)(m) of the Regulations; provided, however, that Gross Asset Values shall not be adjusted pursuant to this subsection (d) to the extent the Managers determine that an adjustment pursuant to subsection (b) of this definition is necessary or appropriate in connection with a transaction that would otherwise result in an adjustment pursuant to this subsection (d).

If the Gross Asset Value of an asset has been determined or adjusted pursuant to subsections (a), (b), (c) or (d) of this definition, the Gross Asset Value shall thereafter be adjusted by the Depreciation taken into account with respect to the asset for purposes of computing Profits and Losses.

Manager: One or more Managers of the Company as determined in accordance with Article __.

Member: Each of the individuals or entities who executes this Agreement as a Member, and who has been admitted as a Member of the Company in accordance with the terms and provisions of the LLC Law and the Agreement and having a Membership Interest in the Company.

Membership Interest: A Member's aggregate rights in the Company including, without limitation, such Member's Economic Interest and the right to participate in the management of the business and affairs of the Company, the right to vote on, consent to, or otherwise participate in any decision or action of or by the Members granted pursuant to this Agreement or the LLC Law.

Membership Units: The units of ownership of the Company which are issued to each Member. The total Membership Units which are issued to all Members as of the date of this Agreement is set forth at Exhibit __.

Profits and Losses: For each Fiscal Year or other period, an amount equal to the Company's taxable income or loss for the year or period, determined in accordance with Code Section 703(a) (for this purpose, all items of income, gain, loss, or deduction required to be stated separately pursuant to Code Section 703(a)(1) shall be included in taxable income or loss), with the following adjustments:

(a) Any income of the Company that is exempt from federal income tax and not otherwise taken into account in computing Profits or Losses pursuant to this definition shall be added to taxable income or loss;

(b) Any expenditures of the Company described in Code Section 705(a)(2)(B) or treated as Code Section 705(a)(2)(B) expenditures pursuant to Section 1.704-1(b)(2)(iv)(I) of the Regulations, and not otherwise taken into account in computing Profits or Losses pursuant to this definition shall be subtracted from taxable income or loss;

(c) In the event the Gross Asset Value of any Company asset is adjusted pursuant to subsection (b) or (d) of the definition of Gross Asset Value, the amount of the adjustment shall be taken into account as gain or loss from the disposition of the asset for purposes of computing Profits and Losses;

(d) Gain or loss resulting from any disposition of property with respect to which gain or loss is recognized for federal income tax purposes shall be computed by reference to the Gross Asset Value of the property disposed of, notwithstanding that the adjusted tax basis of the property differs from its Gross Asset Value;

(e) In lieu of the depreciation, amortization, and other cost recovery deductions taken into account in computing taxable income or loss, there shall be taken into account Depreciation for the Fiscal Year; and

(f) Notwithstanding any other provision of this definition, any items which are specially allocated pursuant to Section ___ shall not be taken into account in computing Profits or Losses.

Property: Any real and personal property, tangible or intangible, owned by the Company from time to time.

Regulations: The Income Tax Regulations promulgated under the Code, as they may be amended from time to time.

Sharing Ratio: With respect to any Economic Interest, the percentage for sharing Profits and Losses and distributions determined by dividing a Member's Membership Units by the total Membership Units of the Company which are issued and outstanding to all Members.

EXHIBIT B

REGULATORY ALLOCATIONS

1.1 Regulatory Allocations. Regulatory Allocations shall be made as follows:

(a) Except as otherwise provided in Section 1.704-2(f) of the Regulations and notwithstanding any other provision of this Section 1.1, if there is a net decrease in Company Minimum Gain during any Fiscal Year, each Member shall be specially allocated items of Company income and gain for the year (and, if necessary, subsequent years) in an amount equal to the portion of the Member's share of the net decrease in Company Minimum Gain, determined in accordance with Regulation Section 1.704-2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant to the Regulations. The items to be so allocated shall be determined in accordance with Sections 1.704-2(f)(6) and 1.704-2(j)(2) of the Regulations. This Section 1.1(a) is intended to comply with the minimum gain chargeback requirement in Section 1.704-2(f) of the Regulations and shall be interpreted consistently therewith.

(b) Except as otherwise provided in Section 1.704-2(i)(4) of the Regulations and notwithstanding any other provision of this Section 1 except Section 1.1(a), if there is a net decrease in Member Nonrecourse Debt Minimum Gain attributable to a Member Nonrecourse Debt during any Fiscal Year, each Member who has a share of the Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, determined in accordance with Section 1.704-2(i)(5) of the Regulations, shall be specially allocated items of Company income and gain for the year (and, if necessary, subsequent years) in an amount equal to the portion of the Member's share of the net decrease in Member Nonrecourse Debt Minimum Gain attributable to the Member Nonrecourse Debt, determined in accordance with Regulation Section 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant to the Regulations. The items to be so allocated shall be determined in accordance with Sections 1.704-2(i)(4) and 1.704-2(j)(2) of the Regulations. This Section 1.1(b) is intended to comply with the minimum gain chargeback requirement in Section 1.704-2(i)(4) of the Regulations and shall be interpreted consistently therewith.

(c) To the extent an adjustment to the adjusted tax basis of any Company asset pursuant to Code Section 734(b) or Code Section 743(b) is required, pursuant to Regulation Section 1.704-1(b)(2)(iv)(m), to be taken into account in determining Capital Accounts, the amount of the adjustment to the Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis) and the gain or loss shall be specially allocated to the Members in a manner consistent with the manner in which their Capital Accounts are required to be adjusted pursuant to that Section of the Regulations.

(d) Any Member Nonrecourse Deductions for any Fiscal Year shall be specially allocated to the Member who bears the risk of loss with respect to the loan to which the Member Nonrecourse Deductions are attributable in accordance with Regulation Section 1.704-2(i)(1).

(e) Nonrecourse Deductions for any Fiscal Year shall be specially allocated among the Members in proportion to their Economic Percentages.

(f) Except as provided in Section 1.1(a) of this Section 1, in the event that any Member receives an allocation of loss or any distribution which causes the Member to have an Adjusted Capital Account Deficit at the end of the Fiscal Year, then all items of Company income and gain shall be specially allocated to the Member in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of the Member as quickly as possible.

(g) The Regulatory Allocations are intended to comply with certain requirements of the Regulations. It is the intent of the Members that, to the extent possible, all Regulatory Allocations shall be offset either with other Regulatory Allocations or with special allocations of other items of Company income, gain, loss or deduction pursuant to this Section 1.1. Therefore, notwithstanding any other provision of Section ___ of the Agreement (other than the Regulatory Allocations), the Executive Committee shall make the offsetting special allocations of Company income, gain, loss or deduction in whatever manner it determines appropriate so that, after the offsetting allocations are made, each Member's Capital Account balance is, to the extent possible, equal to the Capital Account balance such Member would have had if the Regulatory Allocations were not part of the Agreement and all Company items were allocated pursuant to Section ___ of this Agreement.

1.2 Definitions. For purposes of this Exhibit B, the following definitions shall apply:

Adjusted Capital Account Deficit - With respect to any Member, the deficit balance, if any, in the Member's Capital Account as of the end of the relevant Fiscal Year after giving effect to the following adjustments:

(i) credit to such Capital Account any amounts which the Member is obligated to restore or is deemed to be obligated to restore pursuant to the penultimate sentence of Regulations Sections 1.704-2(g)(1) and 1.704-2(i)(5); and

(ii) debit to such Capital Account the items described in Sections 1.704-1(b)(2)(ii)(d)(4), (5) and (6) of the Regulations.

The foregoing definition of Adjusted Capital Account Deficit is intended to comply with the provisions of Section 1.704-1(b)(2)(ii)(d) of the Regulations and shall be interpreted consistently therewith.

Company Minimum Gain - has the meaning set forth in Section 1.704-2(d) of the Regulations for partnership minimum gain, and is provided for in Section 1.1(a).

Member Nonrecourse Debt - has the meaning set forth in Section 1.704-2(b) of the Regulations for partner nonrecourse debt, and is provided for in the definition of Member Nonrecourse Debt Minimum Gain.

Member Nonrecourse Debt Minimum Gain - means an amount, with respect to each Member Nonrecourse Debt, equal to the Company Minimum Gain that would result if the Member Nonrecourse Debt were treated as a Nonrecourse Liability, determined in accordance with Section 1.704-2(i)(3) of the Regulations, and is provided for in Section 1.1(b).

Member Nonrecourse Deductions - has the meaning set forth in Sections 1.704-2(i)(1) and 1.704-2(i)(2) of the Regulations for partner nonrecourse deductions, and is provided for in Section 1.1(d).

Nonrecourse Deduction - has the meaning set forth in Section 1.704-2(b)(1) of the Regulations, and is provided for in Section 1.1(e).

Nonrecourse Liability - has the meaning set forth in Section 1.704-2(b)(3) of the Regulations, and is provided for in the definition of Member Nonrecourse Debt Minimum Gain.

Exhibit C

Form **8832**
(Rev. December 2013)
Department of the Treasury
Internal Revenue Service

Entity Classification Election

► **Information about Form 8832 and its instructions is at *www.irs.gov/form8832*.**

OMB No. 1545-1516

Type or Print	Name of eligible entity making election	**Employer identification number**
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code.	

► Check if: ☐ Address change ☐ Late classification relief sought under Revenue Procedure 2009-41
☐ Relief for a late change of entity classification election sought under Revenue Procedure 2010-32

Part I Election Information

1 **Type of election** (see instructions):

a ☐ Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3.
b ☐ Change in current classification. Go to line 2a.

2a Has the eligible entity previously filed an entity election that had an effective date within the last 60 months?

☐ **Yes.** Go to line 2b.
☐ **No.** Skip line 2b and go to line 3.

2b Was the eligible entity's prior election an initial classification election by a newly formed entity that was effective on the date of formation?

☐ **Yes.** Go to line 3.
☐ **No.** Stop here. You generally are not currently eligible to make the election (see instructions).

3 Does the eligible entity have more than one owner?

☐ **Yes.** You can elect to be classified as a partnership or an association taxable as a corporation. Skip line 4 and go to line 5.
☐ **No.** You can elect to be classified as an association taxable as a corporation or to be disregarded as a separate entity. Go to line 4.

4 If the eligible entity has only one owner, provide the following information:

a Name of owner ► _____
b Identifying number of owner ► _____

5 If the eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and employer identification number of the parent corporation:

a Name of parent corporation ► _____
b Employer identification number ► _____

Part I Election Information (Continued)

6 Type of entity (see instructions):

- **a** ☐ A domestic eligible entity electing to be classified as an association taxable as a corporation.
- **b** ☐ A domestic eligible entity electing to be classified as a partnership.
- **c** ☐ A domestic eligible entity with a single owner electing to be disregarded as a separate entity.
- **d** ☐ A foreign eligible entity electing to be classified as an association taxable as a corporation.
- **e** ☐ A foreign eligible entity electing to be classified as a partnership.
- **f** ☐ A foreign eligible entity with a single owner electing to be disregarded as a separate entity.

7 If the eligible entity is created or organized in a foreign jurisdiction, provide the foreign country of organization ▶ _____

8 Election is to be effective beginning (month, day, year) (see instructions) . . . . . ▶ _____

9 Name and title of contact person whom the IRS may call for more information	**10** Contact person's telephone number

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this election and consent statement, and to the best of my (our) knowledge and belief, this election and consent statement are true, correct, and complete. If I am an officer, manager, or member signing for the entity, I further declare under penalties of perjury that I am authorized to make the election on its behalf.

Signature(s)	Date	Title

Part II Late Election Relief

11 Provide the explanation as to why the entity classification election was not filed on time (see instructions).

Under penalties of perjury, I (we) declare that I (we) have examined this election, including accompanying documents, and, to the best of my (our) knowledge and belief, the election contains all the relevant facts relating to the election, and such facts are true, correct, and complete. I (we) further declare that I (we) have personal knowledge of the facts and circumstances related to the election. I (we) further declare that the elements required for relief in Section 4.01 of Revenue Procedure 2009-41 have been satisfied.

Signature(s)	Date	Title