

# Tax News

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## LLC and LLP Losses Held Deductible Against Salary

The U.S. Tax Court has recently ruled in a case that could have a significant impact on the federal income-tax treatment of business interests that are held in a limited liability company (LLC) or limited liability partnership (LLP).

### Attractive LLP and LLC Features

LLCs and LLPs have enjoyed popularity as the business-entity choice (for new businesses and conversions alike) over the past decade or two. The combination of the limited liability protection of a corporation with pass-through taxation of income for owners, as is the case with a partnership, represents the “best of both worlds” for many entrepreneurs. An added wrinkle from a tax perspective now makes LLCs and LLPs only look more attractive.

Generally, there has been a long-standing federal tax law principle (and IRS position) that investment losses generated by businesses held within an LLC or LLP cannot be used to directly offset an owner’s salary from a job and/or regular investment income. However, if not overturned, this case stands to mark a significant departure from that rule.

### Losses Were Not Passive Losses

Prior to the Tax Court’s decision, investor-owners in small businesses could generally deduct business losses only against future profits from that business, potentially postponing for years (or eliminating) the ability to realize LLP and LLC loss deductions.

The facts of the case involve entrepreneurs – in this case a husband and wife – who actively work in several LLCs and/or LLPs that they have established. Historically, the IRS considered losses relating to a taxpayer who plays an active role in an LLC or LLP to be passive in nature. The tax code also presumes that losses from an “interest in a limited partnership as a limited partner” are passive losses. And, in general, net passive losses cannot be used to offset other income, such as salaries, capital gains, or dividends. Rather, a taxpayer would have to wait until the particular business entity that generated the passive losses

actually realized a profit (if at all) or was ultimately sold in order for the losses to be deductible.

The ruling in this case is significant in that the Tax Court held that since the LLP and LLC interests were not held by the taxpayers as limited partners, the tax code’s presumptive passive loss treatment was inapplicable. Rather, the Tax Court essentially allowed the married taxpayers to offset the losses of the businesses against the current salaries or outside investment income earned by the spouses when computing the couple’s income taxes.

### Future of Holding Uncertain

The IRS may appeal the Tax Court’s decision to a federal appeals court. Alternatively, the IRS may seek a legislative solution and try to get Congress to enact a new law to restore the tax treatment of LLC and LLP losses as it was before the decision in this case.

### Doeren Mayhew Can Help

In the meantime, if you have an ownership interest in an LLC or LLP business that has sustained losses and actually work in that business, please call Doeren Mayhew today at (248) 244-3000. Our professionals can analyze your situation to help you determine whether any losses that your business has incurred may be used to offset your other income, such as salary, capital gains, or dividends.