

Small Business Assistance Office

The Single Member Limited Liability Company (SMLLC)

As An Alternative to the Sole Proprietorship

Some Frequently Asked Questions

There is increasing interest in the Single Member Limited Liability Company (SMLLC) as an alternative to the sole proprietorship for the organization and operation of a small business in Minnesota. A SMLLC is an LLC in which a single individual or other entity (called a “member”) owns all of the LLC ownership interest. A SMLLC is a legal entity separate from its owner and so offers the owner a degree of protection from liability for the acts, debts, and obligations of the SMLLC. The SMLLC also offers the choice of taxation as a corporation or taxation as a “disregarded entity” where the SMLLC is disregarded for income tax purposes and all income flows directly to the owner who reports the income and pays the tax using the owner’s personal income tax return. Anecdotal evidence would indicate that the majority of individuals considering the SMLLC as an alternative to a sole proprietorship choose to be taxed as a disregarded entity.¹

In the course of assisting individuals interested in the formation of a SMLLC to be taxed as a disregarded entity, the Minnesota Small Business Assistance Office has encountered a number of frequently asked questions which we answer briefly here. These questions do not address all issues associated with the choice of a SMLLC nor do they address the procedures for SMLLC formation. Further information may be obtained in the Minnesota Small Business Assistance Office publication, *A Guide To STARTING A BUSINESS IN MINNESOTA*. The Guide is available for viewing, downloading or for ordering in print copy or on CD on the Minnesota Department of Employment and Economic Development website at http://mn.gov/deed/assets/guide-starting-business-minnesota-35th-ed-2017_tcm1045-155254.pdf

¹ The reasons for choosing taxation as a corporation (for example, tax treatment of business losses) are beyond the scope of this publication which is directed toward the SMLLC choosing to be taxed as a disregarded entity.

How extensive is the liability protection given the owner of a SMLLC?

Unlike a sole proprietorship where the business owner and the business are one and the same, a SMLLC is an entity separate from its owner.² Minnesota law provides that a member, governor, manager, or agent of a limited liability company is not personally liable for the acts, debts, liabilities, or obligations of the limited liability company.³

It is important to note that the owner will be liable for any personal guarantees or pledges the owner may make to any financial institutions or other lenders to guarantee a loan or other credit facility or financing made to the SMLLC.

The owner will be liable for any and all deliberate or negligent personal torts.

The owner can also be personally liable for actions (like signing a contract) where it is not clear that the owner is acting on behalf of the SMLLC. All documents of the SMLLC, to include checks, contracts, purchase orders, bids, and the like should bear the name of the business entity with LLC following the name. Likewise, those documents should be clear on their signature lines that the owner is an authorized signer and is signing on behalf of the SMLLC and not in his personal capacity.

Minnesota law also provides that the same conditions and circumstances under which creditors can “pierce the corporate veil” of a corporation to reach the assets of an owner also apply to piercing the veil of an LLC.⁴

Is the owner of a SMLLC an “employee” for purposes of federal employment and Social Security (FICA) taxes?

The owner of a SMLLC is self employed for purposes of employment and FICA taxes. Payments to the owner are not classed as “wages” but as “distributions.” The owner is subject to the self-employment tax equal to the sum of both the employer and employee FICA and Medicare tax. For the year 2016 that total is 15.3 percent of the first \$118,500 income (for 2017 the base is \$127,200). All combined wages, tips, and net earnings in 2016 are subject to any combination of the 2.9% Medicare part of SE tax, Medicare tax, or Medicare part of railroad retirement tax.⁵

² See *Lattanzio v. COMTA*, 482 F.3d 137 (2nd Cir. 2007)
U.S. v. Hagerman, 545 F.3d 579 (7th Cir. 2007).

³ Minn. Stat. § 322B.303, subd. 1.

⁴ Minn. Stat. § 322B.303, subd. 2. The issue of creditors’ remedies is beyond the scope of this publication.

⁵ Internal Revenue Service (IRS) Publication 334, Tax Guide for Small Business and Treas. Reg. § 301.7701-2(C)(iii).

Can the owner of a SMLLC deduct “trade or business expenses” of the SMLLC on the owner’s personal income tax return?

Treasury Regulations provide that the owner of a SMLLC is treated as a sole proprietor in this situation and may deduct trade or business expenses—including the LLC’s share of employment taxes—for activities carried on or through the SMLLC. These are reported on the owner’s Form 1040, Schedule C, E, or F (depending on the nature of the business).⁶ As a self-employed taxpayer the owner may also deduct the cost of health insurance for the owner, the owner’s spouse, and the owner’s dependents.⁷

Does a SMLLC have to file an IRS election if it wants to be taxed as a disregarded entity?

Only a SMLLC wishing to be taxed as a corporation must file Form 8832 making the election. Treasury Regulations provide that an eligible entity (here the SMLLC) not filing an election will be “disregarded as an entity separate from its owner if it has a single owner.”⁸

Does a SMLLC require a federal Tax Identification Number (TIN)?

If the SMLLC has employees it will obtain its own TIN for making employment and FICA payments and filing quarterly and annual employment tax returns.⁹

If the SMLLC has no employees the owner may continue to use the owner’s Social Security number or to obtain a separate TIN. If the SMLLC does not have a TIN and the owner uses the owner’s Social Security number, Treasury Regulations require that the SSN be used for all federal tax purposes.¹⁰

⁶ Treas. Reg. § 301.7701-2(C)(iii).

⁷ IRC § 162(l).

⁸ Treas. Reg. § 301.7701-3(b).

⁹ Treas. Reg. § 301.7701-2(C)(ii).

¹⁰ Treas. Reg. § 301-6109-1(b)(2)(1).

Is the owner of a SMLLC personally liable for employment tax payments for SMLLC employees?

Not since 2009. Current regulations provide that the SMLLC itself and not the owner is the party liable for payment of employment taxes.¹¹

How will a SMLLC be treated for State of Minnesota tax purposes?

Minnesota has adopted the federal tax treatment for LLC—including SMLLCs—formed in Minnesota.¹²

Can an LLC whose only owner-members are a husband and wife be a SMLLC?

Treasury Regulations provide that an LLC whose only members are a husband and wife can be a SMLLC which the owners can elect to have taxed as a disregarded entity *if—among other factors—the LLC is held as community property under state law.*¹³ Minnesota is not a community property state.

A section of the Internal Revenue Code resulting from the Small Business and Work Opportunity Act of 2007 provides that a husband and wife owned unincorporated “qualified joint venture” can elect to not be taxed as a partnership and instead have the respective income of each spouse taxed as if it were sole proprietor income.¹⁴ The guidance for such an election on the IRS’ web site, however, states that “A business owned and operated by the spouses through a limited liability company does not qualify for the election.”

¹¹ Treas. Reg. § 301-7701-2(C)(II).

¹² Minn. Rev. Notice 98-08.

¹³ Rev. Proc. 2002-69.

¹⁴ IRC § 761(f)(1)(A).

This publication is published to offer timely, accurate, and useful information on topics of concern to small businesses in Minnesota. It is for general information purposes only. It is not legal advice and should not be relied on for resolution or evaluation of legal issues or questions. Readers are advised to consult with their private legal advisors for specific legal advice on any legal issues they may have.

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