OFFICE OF
CHIEF COUNSEL

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR BROOKLYN DISTRICT COUNSEL

FROM: Assistant Chief Counsel (Field Service)
CC:DOM:FS

SUBJECT: At-Risk Limitation

This Field Service Advice responds to your memorandum dated December 20, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

| | |
|---|---|
| T1 | = |
| C | = |
| T2 | = |
| G | = |
| $a | = $ |
| $b | = $ |
| x | = |
| Year 1 | = |
| Year 2 | = |

ISSUES:

1. Whether, when a member in his individual capacity enters into an agreement to pay a liability of the limited liability company, the member is at-risk with respect to such amount.

2. Whether each member who has guaranteed a liability of the limited liability company is at-risk for such amount.

CONCLUSIONS:

1. To the extent the member who enters into an agreement to pay a liability of the limited liability company has ultimate responsibility for the debt, he is at-risk with respect to such amount.

2. Each member who has guaranteed a liability of the limited liability company is at-risk, except to the extent the member has a right of reimbursement against the remaining members.

FACTS:

Situation 1

T1 is a limited liability company with two members. It engages in a retail restaurant and catering business. C, a corporation, is a supplier of T1 and had extended goods to T1 on credit. When T1 failed to make payment to C, C commenced collection against T1 to obtain payment of an unpaid account balance in the amount of $a. C agreed to withhold legal action provided T1 paid the outstanding balance under the terms of a stipulation of settlement, which provided for x monthly payments with interest. One member of T1 executed the stipulation on behalf of T1 and in his individual capacity.

Situation 2

T2 is a limited liability company with three members. It operates an indoor roller skating rink. T2 entered into a lease agreement with G. Pursuant to the terms of the lease, each member of T2 was jointly and severally liable for the rental obligation up to $b. In Year 1, each member of T2 executed a personal guarantee for the payment of rent due under the lease agreement to the extent of $b. In Year 2, T2 defaulted on the lease, and G commenced legal action to enforce the personal guarantees.

LAW AND ANALYSIS

A limited liability company can be classified for Federal income tax purposes as either a partnership or a corporation. For purposes of this advice, it is assumed that T1 and T2 are each classified, for Federal income tax purposes, as a partnership. Pursuant to state law in which T1 and T2 were formed, members of a limited liability company have limited liability. The members of T1 and T2 are, therefore, analogous to limited partners. Also, for purposes of this analysis, it is assumed that, to the extent a member has incurred a liability, he has incurred genuine risk of loss and there is no understanding or implied agreement that the member would be held harmless.

In the case of an individual engaged in a trade or business for the production of income, any loss from the activity for the taxable year is allowed only to the extent of the aggregate amount with respect to which the taxpayer is at-risk for such activity at the close of the taxable year. I.R.C. § 465(a)(1), (c)(3)(A). A taxpayer is considered at-risk for an activity with respect to amounts including the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity and amounts borrowed with respect to such activity. I.R.C. § 465(b)(1)(A). A taxpayer's amount at-risk in an activity is increased by the amount of any liability incurred in the conduct of an activity to the extent the taxpayer is personally liable for repayment of the liability. Prop. Treas. Reg. § 1.465-24(a)(1). Also, when a partnership incurs a liability and under state law, members of the partnership may be held personally liable for repayment of the liability, each partner's amount at-risk is increased to the extent the partner is not protected against loss. Prop. Treas. Reg. § 1.465-24(a)(2)(i).

Situation 1

T1 entered into a stipulation of settlement, which provided for x monthly payments with interest. One member of T1 executed the stipulation on behalf of T1 and in his individual capacity. A partner who, through a contractual obligation, has ultimate responsibility for the debt is at-risk with respect to such amount. Pritchett v. Commissioner, 827 F.2d 644 (9th Cir. 1987), rev'g and remanding 85 T.C. 580 (1985); Gefen v. Commissioner, 87 T.C. 1471 (1986); Abramson v. Commissioner, 86 T.C. 360 (1986). Thus, the member who executed the stipulation in his individual capacity is at-risk with respect to the liability. Peters v. Commissioner, 89 T.C. 423 (1987); Brand v. Commissioner, 81 T.C. 821 (1983).

Situation 2

Each member of T2 executed a personal guarantee for the payment of rent due under the lease agreement and, therefore, was jointly and severally liable for the rental obligation up to $b. A guarantor of a partnership liability is not at-risk for purposes of section 465 to the extent there is a right of reimbursement against any partner. Brand v. Commissioner, 81 T.C. 821 (1983). Each member of T2 is at-risk for purposes of section 465, except to the extent the member has a right of reimbursement against the remaining two members.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

The in-coming memorandum sets forth a position that a guarantor may only increase at-risk basis if the guarantor pays the creditor and exhausts all legal remedies against the primary obligor. This position has been criticized by the courts. We note that the issue of the amount which a partner is at-risk and his basis in the partnership has been the subject to Litigation Guideline Memorandum (LGM) TL-37 and its revision. Relying on Pritchett v. Commissioner, 827 F.2d 644 (9th Cir. 1987), rev'g and remanding 85 T.C. 580 (1985), Melvin v. Commissioner, 88 T.C. 63 (1987), aff'd, 894 F.2d 1072 (9th Cir. 1990), and Bennion v. Commissioner, 88 T.C. 684 (1987), the LGM states that at-risk "status should be accorded taxpayers who have ultimate liability under arrangements described above, regardless of whether such liability runs directly to the creditor, unless such liability may be viewed as contingent." As set forth in the LGM, [redacted] is inconsistent with our field guidance which has been made available to the public (see 1988 IRS LGM LEXIS 108).

Please call if you have any further questions.

By: _____

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