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FEDERAL ELECTION COMMISSION
Washington, DC 20463

August 26, 1998

MEMORANDUM

AGENDA ITEM
For Meeting of: 9-2-98

TO: The Commission

THROUGH: James A. Pehrkon
Acting Staff Director

FROM: Lawrence M. Noble
General Counsel

N. Bradley Litchfield
Associate General Counsel

Michael Marinelli
Staff Attorney

SUBJECT: Alternative Draft Advisory Opinion 1998-11, with
IRS "check-the-box" form

Attached is an alternative draft of the subject advisory opinion, as requested by the Commission at the meeting of August 20, 1998. The new text in this alternative draft, as compared to text in Agenda Document No. 98-54, is presented in **bold font**. Also attached is IRS Form 8832 (four pages) which illustrates and explains how a limited liability company would "check-the-box" to elect tax treatment as a corporation or as a partnership. The form instructions also explain the "default rules" which permit some LLC's to take partnership tax treatment without filing the form.

We request that both this alternative draft and Agenda Document No. 98-54 be placed on the agenda for September 2, 1998.

Attachments

1 **ACT AND COMMISSION REGULATIONS**

2 Under the Act, the term "person" includes an individual, partnership, committee,
3 association, corporation, labor organization, or any other organization or group of
4 persons. 2 U.S.C. §431(11); 11 CFR 100.10. The Act prohibits corporations from
5 making any contribution or expenditure in connection with a Federal election. 2 U.S.C.
6 §441b(a); 11 CFR 114.2(b). Contributions by persons whose contributions are not
7 prohibited by the Act are subject to limits set out in 2 U.S.C. §441a.² Contributions by
8 partnerships are permitted, but are limited under 2 U.S.C. §441a(a). In addition,
9 lawful contributions from a partnership are attributed proportionately against each
10 contributing partner's limit for the same candidate and election. 11 CFR 110.1(e);
11 see 11 CFR 110.1(b), 110.1(c) and 110.1(d) .

12 Under 2 U.S.C. §441c, it is unlawful for a Federal contractor "directly or indirectly
13 to make any contribution of money or other things of value, or to promise expressly or
14 impliedly to make any such contribution to any political party, committee, or candidate for
15 public office...". Commission regulations indicate that the prohibition bans contributions
16 to Federal candidates and any political party or committee, but does not prohibit
17 contributions (or expenditures) in connection with State or local elections. 11 CFR
18 115.2(a). This prohibition extends from the commencement of the contract negotiations
19 until the completion of the contract performance or the termination of negotiations. 11
20 CFR 115.2(b) and 115.1(b).

² The Act prohibits contributions by several entities: corporations, labor organizations, Federal contractors, and foreign nationals. 2 U.S.C. §§441b, 441c, and 441e; 11 CFR 114.2(b), 115.2, and 110.4(a).

1 **The Commission's past analysis required a review of State law regarding**
2 **classification of LLC's and their attributes, as compared with the similar attributes**
3 **of both partnerships and corporations in the relevant State. These aspects of LLC's**
4 **have also concerned the Internal Revenue Service ("IRS") for Federal income tax**
5 **purposes. Starting in 1988, the IRS used an approach similar to that followed by**
6 **the Commission (since 1995) by focusing on those attributes of an LLC that made it**
7 **both different from and similar to corporations and partnerships. IRS scrutiny of**
8 **the characteristics of individual LLCs was necessary to determine whether they**
9 **should be taxed as corporations or as partnerships.³ However, in view of changes**
10 **by the States allowing greater flexibility in their LLC statutes that, in effect,**
11 **considerably blurred or narrowed the traditional differences between corporations**
12 **and partnerships, the IRS concluded in 1996 that it should adopt regulations**
13 **reflecting those altered circumstances. The IRS regulations abandoned the past**
14 **State by State LLC approach in the interest of achieving greater simplification and**
15 **conserving both IRS and taxpayer resources. Known as the "check-the-box" rules,**
16 **they permit entities that are not corporations under State law, such as LLCs, to**
17 **designate themselves on an IRS form as either corporations or partnerships for**
18 **Federal tax purposes. 26 CFR 302.7701-3. An LLC with two or more members is**
19 **automatically treated as a partnership for tax purposes and need not file the tax**
20 **form, unless it wishes to "check-the-box" and elect to take corporate tax treatment.⁴**

³ These characteristics were the corporate characteristics of limited liability for all members, perpetual duration, free transferability of interests, and centralization of management.

⁴ Some LLC's are not eligible for partnership treatment and are required to file as corporations. One example is an LLC with publicly traded shares or ownership interests. The IRS regulations and IRS Form

1 **Commission regulations at 11 CFR 110.1(e). When it contributes to Federal**
2 **political committees or candidates, PH should state its Federal tax status in writing.**
3 **PH should also include a written notice of the contributing partners and the**
4 **amounts attributed to each partner.⁷**

5 **Because corporations are prohibited from making political contributions in**
6 **Federal campaigns and foreign nationals are prohibited from making political**
7 **contributions, no portion of any contribution may be attributed to a partner who is**
8 **a corporation or a foreign national. The information you have provided indicates**
9 **that all the members of PH are natural persons and that PH does not have foreign**
10 **national members. Also given, PH's status and relationships with two other LLC's**
11 **that hold Federal contracts, PH is subject to certain restrictions on its Federal**
12 **election activity. See discussion below.**

13 **The Commission recognizes that the foregoing conclusion regarding the**
14 **treatment of contributions by LLCs differs substantially from the analysis and**
15 **conclusions reached in Advisory Opinions 1997-17, 1997-4, 1996-13, and 1995-11.**
16 **These prior opinions on limited liability companies are therefore overruled and**
17 **superseded.⁸ The Commission further recognizes that the conclusions in this**
18 **opinion requiring the attribution of contributions among the members of a limited**
19 **liability company, which is treated as a partnership under both IRS rules and**

determined under State law. If under State law such an association is a corporation, it would be prohibited from making a political contribution as a corporation.⁷⁾

⁷ **For the obligations and requirements of a committee receiving the contribution from an LLC see Advisory Opinion 1998-15.**

⁸ **The Commission notes that, in view of the fact that contributions by LLCs are not specifically addressed in the Act or Commission regulations and have been periodically addressed in the advisory opinion process, the Commission may address these issues in a future rulemaking project.**

1 several opinions dealing with bank holding companies and national banks are relevant to
2 your situation. As you know, 2 U.S.C. §441b(a) prohibits the making of a contribution by
3 national banks or Federally chartered corporations in any election to any political office in
4 the United States. In past opinions, the Commission permitted a holding company of a
5 national bank, a holding company of a Federally chartered savings and loan, and a wholly
6 owned subsidiary of a Federally chartered savings and loan association, to make
7 contributions in connection with State and local elections and to make donations to
8 committees associated with national political party conventions. See Advisory Opinions
9 1995-32, 1995-31, 1981-61, 1981-49, and 1980-7. The Commission reasoned in these
10 opinions that a holding company is considered a distinct legal entity in its own right, apart
11 from its subsidiaries, and that there is no language in section 441b indicating that the
12 prohibition (as to contributions in any election, including State or local elections) extends
13 to parent holding companies which are not themselves national banks, or Federally
14 chartered corporations or banks. See *id.*

15 The Commission premised this position on the separate identity of a holding
16 company from a subsidiary and the absence of facts which indicated the subsidiary was
17 merely an agent, instrumentality, or alter ego of the holding company. See Advisory
18 Opinions 1995-32, 1995-31 and 1980-7. The Commission has further required that the
19 permitted political contributions of the holding company be funded only from revenue not
20 derived from subsidiaries that are prohibited from the same activity by section 441b. See
21 Advisory Opinions 1995-32, 1995-31, 1981-61 and 1981-49.

within the time frames cited above and comply with the terms of the advisory opinions superseded herein.

1 *Establishment of nonconnected committees*

2 Your second question concerns the establishment of nonconnected committees by
3 individuals associated with PH, ASM and PCS. The Commission notes that 11 CFR
4 115.6 permits the employees, officers, or individual members of an unincorporated
5 association, or other group or organization which is a Federal contractor, to make
6 otherwise lawful contributions from their own personal assets, or to form a nonconnected
7 political committee. See Advisory Opinions 1993-12, 1991-1 and 1990-20. However,
8 while individuals employed by enterprises that are Federal contractors may establish these
9 committees, such a committee would have to be independent of the Federal contractor and
10 receive no support, direct or indirect, from the Federal contractor. See Advisory Opinion
11 1993-12 and 11 CFR 100.6. The Act does not extend to other forms of business
12 organizations the ability granted to corporations to set up a separate segregated fund and
13 conduct itself as a connected organization. Thus, payments for such costs would be
14 contributions, rather than exempt costs. See Advisory Opinions 1991-1 and 1990-20; See
15 also *California Medical Association v. Federal Election Commission*, 453 U.S. 182
16 (1981).

17 Therefore, individuals from PH, ASM and PCS could establish a nonconnected
18 committee. However, any type of administrative support given to the committee would be
19 a contribution subject to the prohibitions and limitations of the Act. See Advisory Opinion
20 1997-15. Consequently, ASM and PCS, as Federal contractors, would be prohibited from
21 making any such contribution by section 441c, while PH could make the contributions if
22 within the limitations of 2 U.S.C. §441a and if its contributions are made only from
23 revenues generated by PH's separate business ventures, not those of ASM or PCS.

Entity Classification Election

| | | |
|-----------------------------------------|------------------------------------------------------------------------------------------------------------------|--------------------------------------|
| Please Type or Print | Name of entity | Employer identification number (EIN) |
| | 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. | |

1 Type of election (see instructions):

- a Initial classification by a newly-formed entity (or change in current classification of an existing entity to take effect on January 1, 1997)
- b Change in current classification (to take effect later than January 1, 1997)

2 Form 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.

3 Election is to be effective beginning (month, day, year) (see instructions) ▶ / /

| | |
|------------------------------------------------------------------------------|-----------------------------------------|
| 4 Name and title of person whom the IRS may call for more information | 5 That 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 consent statement, and to the best of my (our) knowledge and belief, it is true, correct, and complete. If I am an officer, manager, or member signing for all members of the entity, I further declare that I am authorized to execute this consent statement on their behalf.

| Signature(s) | Date | Title |
|--------------|------|-------|
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| | | |

b. The entity's classification was relevant (as defined below) on May 8, 1996.

c. No person (including the entity) for whom the entity's classification was relevant on May 8, 1996, treats the entity as a corporation for purposes of filing that person's Federal income tax returns, information returns, and withholding documents for the tax year including May 8, 1996.

d. Any change in the entity's claimed classification within the 60 months prior to May 8, 1996, was a result of a change in the organizational documents of the entity, and the entity and all members of the entity recognized the Federal tax consequences of any change in the entity's classification within the 60 months prior to May 8, 1996.

e. The entity had a reasonable basis (within the meaning of section 6662) for treating the entity as other than a corporation on May 8, 1996.

f. Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).

Binding contract rule.—If a foreign business entity described in Regulations section 301.7701-2(b)(8)(i) is formed after May 8, 1996, under a written binding contract (including an accepted bid to develop a project) in effect on May 8, 1996, and all times thereafter, in which the parties agreed to engage (directly or indirectly) in an active and substantial business operation in the jurisdiction in which the entity is formed, 8 on page 2 is applied by substituting the date of the entity's formation for May 8, 1996.

Eligible entity.—An eligible entity is a business entity that is not included in items 1 or 3 through 8 under the definition of corporation on page 2.

Limited liability.—A member of a foreign eligible entity has limited liability if the member has no personal liability for any debts of or claims against the entity by reason of being a member. This determination is based solely on the statute or law under which the entity is organized (and, if relevant, the entity's organizational documents). A member has personal liability if the creditors of the entity may seek satisfaction of all or any part of the debts or claims against the entity from the member as such. A member has personal liability even if the member makes an agreement under which another person (whether or not a member of the entity) assumes that liability or agrees to indemnify that member for that liability.

Partnership.—A partnership is a business entity that has at least two members and is not a corporation as defined on page 2.

Relevant.—A foreign eligible entity's classification is relevant when its classification affects the liability of any person for Federal tax or information purposes. The date the classification of a foreign eligible entity is relevant is the date an event occurs that creates an obligation to file a Federal tax return, information return, or statement for which the classification of the entity must be determined.

Effect of Election

The resulting tax consequences of a change in classification remain the same no matter how a change in entity classification is achieved. For example, if an organization classified as an association elects to be classified as a partnership, the organization and its owners must recognize gain, if any, under the rules applicable to liquidations of corporations.

Who Must File

File this form for an eligible entity that is one of the following:

- A domestic entity electing to be classified as an association taxable as a corporation.

- A domestic entity electing to change its current classification (even if it is currently classified under the default rule).

- A foreign entity that has more than one owner, all owners have limited liability, and it elects to be classified as a partnership.

- A foreign entity that has at least one owner without limited liability, and it elects to be classified as an association taxable as a corporation.

- A foreign entity with a single owner having limited liability, and it elects to have the entity disregarded as an entity separate from its owner.

- A foreign entity electing to change its current classification (even if it is currently classified under the default rule).

Do not file this form for an eligible entity that is:

- Tax-exempt under section 501(a), or
- A real estate investment trust (REIT), as defined in section 856.

When To File

See the instructions for line 3.

Where To File

File Form 8832 with the Internal Revenue Service Center, Philadelphia, PA 19255. Also attach a copy of Form 8832 to the entity's Federal income tax or information return for the tax year of the election. If the entity is not required to file a return for that year, a copy of its Form 8832 must be attached to the Federal income tax or information returns of all direct or indirect owners of the entity for the tax year of the owner that includes the date on which the election took effect. Although failure to attach a copy will not invalidate an otherwise valid election, each member of the entity is required to file returns that are consistent with the entity's election. In addition, penalties may be assessed against persons who are required to, but who do not, attach Form 8832 to their returns. Other penalties may apply for filing Federal income tax or information returns inconsistent with the entity's election.