



NEBRASKA WILL FOLLOW FEDERAL TAX TREATMENT OF LIMITED LIABILITY COMPANIES

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In Revenue Ruling 25-21-1, the Nebraska Department of Revenue addressed the issue of how limited liability companies are treated for Nebraska income tax purposes. In this ruling, the Nebraska Department of Revenue confirmed that limited liability companies will be treated for Nebraska income tax purposes in the same manner as they are for federal income tax purposes.

Federal Income Tax Treatment of Limited LLCs

For federal income tax purposes, a limited liability company can be treated as a partnership, part of its owner (a “disregarded entity”), or an “association” that is taxable as a corporation.

Under the IRS’ default rules, a domestic limited liability company with at least two members is classified as a partnership for federal income tax purposes unless it files IRS Form 8832 (or IRS Form 2553 to be a subchapter S corporation) and affirmatively elects to be treated as a corporation. In addition, under the IRS’ default rules, a limited liability company with only one member is treated as an entity disregarded as separate from its owner, unless it files IRS Form 8832 (or IRS Form 2553 to be a subchapter S corporation) and affirmatively elects to be treated as a corporation.

Revenue Ruling 25-21-1’s Analysis and Holding

Revenue Ruling 25-21-1 notes that under Neb. Rev. Stat. § 77-2714 any terms used in §§ 77-2714 to 77-27,123 have the same meaning as those used in a comparable context in the laws of the United States relating to federal income tax, unless a different meaning is clearly required. A federal classification of an entity for federal income tax purposes is the conclusive determination of the entity’s classification for Nebraska purposes.

The Nebraska Uniform Limited Liability Company Act, Neb. Rev. Stat. § 21-104(d), provides that a limited liability company is classified for Nebraska income tax purposes in the same manner as it is classified for federal income tax purposes.

Based on this, Revenue Ruling 25-21-1 concludes that (1) a limited liability company treated as a partnership for federal income tax purposes will be treated as a partnership for Nebraska income tax purposes and will file a Nebraska Return of Partnership Income, Form 1065N; (2) a limited liability company treated as a corporation for federal income tax purposes will be treated as a corporation for Nebraska income tax purposes and will file a Nebraska Corporation Income Tax Return, Form 1120N; and (3) a single member limited liability company treated as a disregarded entity for federal income tax purposes will be treated as a disregarded entity for Nebraska income tax purposes with the income of the disregarded entity being reported on the income tax return of its sole member.

Significance of Revenue Ruling 25-21-1

In a past audit that Koley Jessen was involved in, the Nebraska Department of Revenue took the position that limited liability company interests of a limited liability company that was taxed as a subchapter S corporation for federal income tax purposes were not “capital stock” for purposes of Nebraska’s special capital gains exclusion and attempted to deny the exclusion. Although we were able to secure the exclusion for our client on this audit, there



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was still uncertainty regarding whether limited liability company interests of a limited liability company that is taxed as a corporation for federal income tax purposes would be treated as capital stock for purposes of the exclusion.

Nebraska’s special capital gains exclusion was adopted in 1987 as part of the Employment and Investment Growth Act, which is commonly known as LB775. The special gains exclusion allows a Nebraska taxpayer to make a one-time election during his or her lifetime to exclude from Nebraska income capital gains from the sale of capital stock of a corporation acquired by the individual (1) on account of employment by such corporation or (2) while employed by such corporation and avoid paying 6.84% Nebraska income tax on the excluded gain.

As Revenue Ruling 25-21-1 confirms that a limited liability company treated as a corporation for federal income tax purposes will be treated as a corporation for Nebraska income tax purposes, the Nebraska Department of Revenue should be unable to assert that limited liability company interests of a limited liability company that is treated as a corporation for federal income tax purposes are not “capital stock” for purposes of Nebraska’s special capital gains exclusion. This is a taxpayer favorable development that brings welcome certainty regarding the availability of Nebraska’s special capital gains exclusion for Nebraska residents who own limited liability companies that are taxed as corporations for federal income tax purposes. ◀



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