



ABA Subchapter S News



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LLC OR SUB S?

Community banks play a significant role in America's communities and neighborhoods. The ABA strongly supports efforts that would grant community banks the same range of corporate tax structures that are available to other small businesses. There is no doubt that flexibility in structure would allow banks to be able to compete on both a local and national level, and to remain independent.

While Congress has made it possible for banks to elect Sub S status (although many issues relating to the election to be taxed as a Sub S entity continue to arise as more banks make the election), they have done very little to address the issue of allowing banks to be structured as limited liability companies (LLC). Nevertheless, many states have enacted legislation that allows banks to be structured as LLCs. On the basis of such legislation, in 1995, a Texas bank requested a private letter ruling (PLR) from the IRS relating to partnership (flow through) tax treatment for the bank. In the PLR, the IRS denied partnership tax treatment, ruling that the bank was a corporation under state law notwithstanding its treatment as an LLC for state tax purposes. Based on this ruling, LLC banks continue to be subject to corporate federal income tax. In general, LLCs and S corporations have some similarities. However, because of some restrictions that currently exist in the Sub S structure for banks, the LLC structure may present a viable alternative for banks. The chart below summarizes some of the features (similarities and differences) inherent in both structures.

In 2003, in response to letters from the ABA and state banking associations, the FDIC issued a rule establishing the circumstances under which it will grant deposit insurance to a state bank chartered as an LLC. Under the rule, a bank chartered as an LLC would be granted deposit insurance if it is determined to be incorporated, i.e., possesses the following four attributes of "incorporation:" perpetual succession; centralized management; limited liability; and free transferability of ownership interests.

Based on this new FDIC rule, in 2004, the ABA sent a letter to Treasury asking that it reconsider its 1995 ruling/position, and issue new regulations allowing a bank that charters as an LLC to elect to be taxed as a partnership. The ABA has followed up with several meetings with the Treasury on this issue. The Treasury's official response is that they are researching the issue, while the "unofficial" response is that any change in this area would most likely have to be through Congress, rather than regulatory changes to the "check-the-box" rules.

The ABA continues to advocate flexibility in structure for banks so that they can remain competitive with other tax-advantaged financial institutions such as credit unions and the farm credit system. The fact that banks are now eligible to elect Sub S status has not diminished ABA's efforts promoting the LLC structure for banks.

Sub S	LLC
<ol style="list-style-type: none"> 1. A legal entity (separate from its owners) created by a state filing. 2. Offers limited liability protection - the owners are typically not personally responsible for the debts and liabilities of the business. 3. Pass-through tax entity: the entity is generally not subject to income tax – all income or loss generated by the business flows through to the shareholders. 4. Statutory restrictions on number of shareholders: cannot have more than 100 shareholders. 5. Statutory restrictions on eligible shareholders: for instance, cannot have C corporations, certain trusts, LLCs, or partnerships as shareholders. 6. As a corporation, its existence is perpetual. 7. Restrictions on capital structure: can have only one class of stock. 8. Subject to built-in-gains (BIG) rule: applies where a C corp converts to S corp – all built in gains will be realized and subject to tax, unless held for 10 years. 9. All shareholders must consent to S election: creates issues where there are non-consenting shareholders. 10. S status election must be made at the statutorily provided date. 11. Entity must always be conscious of acts that may result in inadvertent termination of S status (for instance, shareholder transfer of stock to an ineligible shareholder). Unless waived by the IRS, such termination would result in corporate level tax. 	<ol style="list-style-type: none"> 1. A legal entity (separate from its owners) created by a state filing. 2. Offers limited liability protection - the owners are typically not personally responsible for the debts and liabilities of the business. 3. Pass-through tax entity: the entity is generally not subject to income tax – all income or loss generated by the business flows through to the shareholders. 4. No restriction on the number of owners: can have an unlimited number of owners. 5. Allowed to have subsidiaries without restrictions 6. Typically has a limited life span. Most states require that an LLC list a dissolution date in its articles of organization and certain events such as the death or withdrawal of a member can cause the LLC to dissolve. 7. No restriction on capital structure. 8. Unlike a corporation, LLCs are not required to hold annual meeting of shareholders and directors. (However, it is a good idea to document major decisions of the company.) 9. No fear of inadvertent termination of status resulting in corporate level tax.

Sub-S Banks by U.S. States

As of June 2009

State	# of Sub-S Banks	Total # of Banks	% of Sub-S Banks
AK	1	7	14.3%
AL	47	156	30.1%
AR	36	136	26.5%
AS	0	1	0.0%
AZ	4	57	7.0%
CA	23	308	7.5%
CO	40	148	27.0%
CT	1	56	1.8%
DC	0	6	0.0%
DE	1	31	3.2%
FL	70	301	23.3%
FM	0	1	0.0%
GA	80	324	24.7%
GU	0	3	0.0%
HI	0	9	0.0%
IA	223	376	59.3%
ID	1	18	5.6%
IL	235	650	36.2%
IN	20	155	12.9%
KS	174	343	50.7%
KY	62	199	31.2%
LA	59	158	37.3%
MA	4	172	2.3%
MD	5	93	5.4%
ME	0	29	0.0%
MI	18	149	12.1%
MN	297	426	69.7%
MO	126	349	36.1%
MS	27	95	28.4%
MT	29	76	38.2%
NC	3	107	2.8%
ND	63	94	67.0%
NE	96	240	40.0%
NH	1	24	4.2%
NJ	7	124	5.6%
NM	29	54	53.7%
NV	5	39	12.8%
NY	5	203	2.5%

OH	26	251	10.4%
OK	171	252	67.9%
OR	3	38	7.9%
PA	3	226	1.3%
PR	0	10	0.0%
RI	1	13	7.7%
SC	5	90	5.6%
SD	40	86	46.5%
TN	43	197	21.8%
TX	295	640	46.1%
UT	9	65	13.8%
VA	0	120	0.0%
VI	1	2	50.0%
VT	0	14	0.0%
WA	14	96	14.6%
WI	83	282	29.4%
WV	6	66	9.1%
WY	23	39	59.0%
TOTAL	2515	8204	30.7%

Source: FDIC



Subchapter S News and Special Reports are published by the American Bankers Association as a member service. For questions, please contact Fran Mordi, Tax Counsel (202-663-5317, fmordi@aba.com) or call 1-800-BANKERS. ABA Members: To unsubscribe and to manage your subscriptions, please visit ABA E-Mail Bulletins (<http://www.aba.com/Members+Only/bulletin.htm>) and check or uncheck the appropriate boxes.

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