



Frequently Asked Questions **Limited Liability Company Income Tax Compliance and SB429**

What is the nature and purpose of the “tax clearance certificate” under Montana law?

The purpose of the tax clearance certificate is to help ensure compliance with Montana tax laws by businesses that had previously registered under Montana law that had allowed that registration to lapse and are now seeking to reinstate their registration as a Montana business. It guards against a business seeking to benefit from Montana law if it has a record of being out of compliance with Montana tax laws.

What is a “limited liability company that has only one member and has not elected to be taxed as a corporation?”

This type of business is a limited liability company (LLC) that has a single owner, and that single owner is responsible for paying the taxes that are due and owing as a consequence of any taxable activity or income earned through the operation of the LLC. For example, the owner of an LLC engaged in business in Montana and that has not elected to be taxed as a corporation is ultimately liable for payment of taxes such as the LLC’s withholding taxes and lodging and facilities taxes and, of course, the owner’s income taxes on the profit earned by the LLC in Montana. That is true whether the owner is a Montana resident or a non-resident.

Do limited liability companies pose any special challenges for tax compliance?

Yes. Because of the flexible nature of the LLC structure and their ease of creation, it is not always possible for the Department of Revenue to readily find the identity of the true owner who actually owes Montana tax—especially in the case of a non-resident. The task of finding the true owner is especially challenging if another layer or layers of LLC’s own the LLC before one reaches the true owner. Finally, LLC’s are rapidly expanding in the number registered in Montana. The large and growing number of these business entities makes tax compliance more challenging for the Department to administer.

Can limited liability companies be used to improperly avoid or evade Montana income taxes?

Yes. For example, a recent trend is for a non-resident who owns and plans to sell real property in Montana to first transfer that real property to a solely owned LLC. Next the non-resident will sell its full interest in the LLC instead of selling the real property itself.

The sale of the interest in the LLC will not be reported on a realty transfer certificate, making it more difficult for the Montana Department of Revenue to detect the sale. If the Department actually discovered this particular type of transaction as a tax avoidance transaction, it would in these circumstances assess income taxes on the non-resident. However, the challenge is to find the true seller of the LLC.

Why is the Department now requiring that LLC's that are seeking reinstatement as a Montana business and, therefore, requesting a tax clearance certificate, to disclose the true owners, their tax identification numbers and their assets?

There are three reasons:

1. To fulfill the basic purpose of Montana law, Section 35-9-812, to ensure that businesses registering in Montana and benefitting from Montana law are in compliance with Montana law.
2. To comply with a series of legislative audit recommendations—to which the Department of Revenue agreed—that require the Department to upgrade and make more effective its tax clearance certifications to the Secretary of State. In short, the Legislative Auditor found the Department's efforts in the past to be inadequate and has asked that the Department do a more effective job in this area to protect Montana's tax base.
3. To catch up to and keep pace with both the rapid increase in the number of LLCs and their use as a tax avoidance mechanism by non-residents.

Are Montana LLC's created for the purpose of registering vehicles by non-residents in Montana—regardless of whether the vehicles are actually purchased in Montana or in other states—instead of in states with sales taxes and/or higher registration fees subject to MCA Section 35-9-812, the reinstatement/tax clearance process?

Yes.

Does SB 429 propose to exempt only single LLC's created for vehicle registration purposes from the reinstatement/tax clearance process or does it exempt all single member, non-corporate LLC's, including those that earn income in Montana?

SB 429 proposes to exempt all single members, non-corporate LLCs, including those that earn income in Montana, from the reinstatement/tax clearance process. It is not restricted to simply those created for vehicle registration purposes.

Can LLC's initially created for vehicle registration purposes also be used by their non-resident owners to earn income in Montana?

Yes. An owner can use an LLC for a variety of purposes, including earning income in Montana, even if originally created for vehicle registration purposes.

Is there anything on the surface of the records of an LLC that identifies whether it is being used by the owner to only register vehicles or to also earn income in Montana?

No. The Department needs to know identity of the owner, the tax identification number and the assets of the LLC to determine the nature, purpose and potentially tax liability of the owner of the LLC.

Can the owner of an LLC created for registering vehicles in Montana also be separately earning income in Montana?

Yes.

What is the net impact of SB 429 on ensuring that non-resident owners of single member, non-corporate LLCs are complying with Montana tax laws?

SB 429 will make it significantly more difficult for the Department to identify cases where non-resident owners of these LLC's are earning income in Montana and to secure the payment of the correct taxes to the state.

Are there other effects of SB 429 on Department operations?

Yes. SB 429 would make the Department of Revenue significantly *less efficient* in identifying and setting aside those LLCs that are not earning income in Montana, such as those that are being solely used for Montana vehicle registration purposes. If SB 429 were to be enacted, the Department would have to use manual processes using staff time instead of its modern computer systems to efficiently classify LLCs between those requiring attention for Montana tax compliance purposes and those that do not.

Why are the businesses that create vehicle registration LLCs concerned about the Department of Revenues tax clearance procedures?

The businesses that create vehicle registration LLCs have expressed concerns that the reinstatement/tax clearance information might be shared with the tax authorities of the state of residency of the non-residents for whom they are registering vehicles in Montana. They are concerned that those non-residents will be subject to increased audits of those purchases by the tax authorities of states of residency.

Does the Montana Department of Revenue volunteer this tax clearance information to other states?

No. The other states must request it under exchange of information agreements and procedures.

Does the Department receive regular or frequent requests from other states for this information?

No. We have not received requests in nearly three years. The states of residency have developed their own internal procedures for identifying Montana LLC registration and are not relying on information secured through exchange of information agreements with other states.

Does the Montana Department of Revenue have any statutory responsibility to aid, assist or facilitate non-residents in avoiding the payment of registration fees or sales taxes in their respective home states of residency.

No. Montana law does not assign that responsibility to the Montana Department of Revenue. The Montana Department of Revenue is only responsible for ensuring proper compliance by residents, non-residents and businesses with Montana tax laws.