



FREQUENTLY ASKED QUESTIONS

What is a Limited Liability Company?

Limited Liability Companies (“LLC’s”) are organizations created under state law that are recognized as legal entities separate from their owners. Although they are neither corporations, partnerships, nor proprietorships, state business law provides that an LLC offers its members protection from personal liability for the debts of the LLC’s business, similar to the liability protection that a corporation offers to its shareholders. Generally, this means that an LLC member’s financial risk is limited to the amount of his or her investment in the LLC.

How does an LLC operate?

Once an LLC is formed in accordance with state law, its members draft a contract amongst themselves (referred to as an “Operating Agreement”), which is similar to a business or partnership agreement. The Operating Agreement will outline the LLC’s management, governance (including the voting rights of members), and certain financial requirements. The LLC continues in operation until such time as it is formally dissolved, (typically based upon a resolution of the members).

As a member of Little Hogback Community Forest LLC, how will I be taxed on its activities?

An LLC can elect to be taxed on its annual business activity as either a corporation or as a partnership. Since it’s anticipated that Little Hogback will be taxed as a partnership, its annual activity will “flow-through” to its members who will report it on their personal income tax returns for the year. This activity will include any taxable income (including possible gains or losses from the sale of property) and related operating expenses. To the extent annual operating expenses exceed operating income, the resulting loss which will flow through to the members will most likely represent a “passive loss” which may not be currently tax-deductible but will instead be suspended until such time as the LLC generates operating income (or until the member liquidates his/her interest in the LLC). *It is important to note that taxable income may be reported to a member for the year even if that income is not distributed to the member.* Each member’s share of Little Hogback’s taxable income or loss will be determined on a pro-rata basis based on that member’s proportionate share of the LLC’s total capital.

What’s meant by the term “capital”?

A member’s “capital” or “capital account” generally represents his or her ownership in the LLC, similar to shares of stock in a corporation. The balance of a member’s capital account is determined by the amount which a member contributes to the LLC, *plus*: the member’s cumulative share of net income from LLC activities, *less*: the member’s cumulative share of net losses from LLC activities, and *less*: any withdrawals or distributions made to the member. The aggregate capital of all members makes up the total capital of the LLC.

How are members notified of their tax reportable amounts?

The LLC will operate on the basis of a calendar year and file its own federal and state tax returns, after which it will provide each member with a copy of Schedule K-1 (Form 1065) “Partner’s Share of Income, Deductions, Credits, etc.” (a draft copy of which is attached). The member will use the information from Schedule K-1 to complete his/her personal income tax returns.

How much taxable income or loss will flow through to me each year as a member of the LLC?

That depends upon the level and nature of annual operations. Since there are no timber cuttings anticipated for most years, there will probably not be much income (other than possibly interest income) to “flow-through” to the members on a regular basis. In addition, although some of the LLC’s annual operating expenses may pass through to the members as a current year loss (potentially subject to the “passive loss” rules discussed above), many of the expenses associated with the maintenance and working of the forest will probably be “capitalized” (i.e., added to the cost of the property) and will therefore not flow through to the members currently. In the event income is passed through to a member for tax reporting purposes however, the LLC may elect to make a cash distribution to its members essentially reimbursing them for the income tax liability which the members will incur as a result.

Are there special rules governing forestry and timber activities that differ from most other types of investment activity?

Yes - because timber is a unique “wasting” asset, timbering operations are accorded special treatment under the Tax Code. First, timber is potentially subject to a “depletion allowance” when it is cut, which spreads the cost of the timber ratably over the total estimated units available for cutting. In addition, under certain circumstances, income from the cutting of timber that is held for more than one year, can qualify for so-called Section 1231 treatment, which allows it to be taxed at the more favorable tax rates provided for long-term capital gain property. Whether the cuttings anticipated by Little Hogback would qualify for this treatment would need to be determined by the circumstances at that time.

What happens if I sell off my interest in Little Hogback Community Forest LLC?

The amount you will receive for your interest will be determined under the terms of the Operating Agreement. The difference between this amount and your “tax basis” in your interest will represent a capital gain or loss to you. A member’s tax basis in this regard is usually arrived at in a similar manner as his or her capital account balance is determined – i.e., the amount of any capital contribution(s), plus the member’s cumulative share of pass-through income, less his/her share of cumulative pass-through losses, less the amount of any cumulative withdrawals or distributions to the member.

I understand that LLC members are not required to work on the land, however, if I am hired by the Forest Manager to perform approved land management activities for Little Hogback, how will I be taxed in that case?

Your earnings will be reported to you separately and you will be subject to regular federal and state income taxes and social security taxes, just as you would be if you were compensated for your services elsewhere.

NOTE: The above is provided for general informational purposes only and an interested party should direct any specific questions to his or her legal and/or tax advisors. This information also should not be considered an offering to sell or an inducement to invest in Little Hogback LLC.