

# CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

## LLC FEE REGULATIONS

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California enacted the LLC fee in 1994 when the state first adopted LLC statutes.

The LLC fee addressed concerns advocated by the Franchise Tax Board that increases in passed-through California income would deplete California tax revenues generated by corporations. The legislature passed legislation designed to replace, but not add to, the state's tax revenues.

Until 1999, the LLC fee ranged from \$0 for LLC total income under \$250,000 to \$4,500 for annual total income in excess of \$5 million. In 1999, as provided in the initial legislation, California began adjusting the LLC fee annually based upon a study conducted by the FTB to calculate the revenue losses to the state due to LLCs. The studies, which had many shortcomings, caused the LLC fee to rise by 108% in two years, making it \$9,377 in 2000 for LLCs with total income in excess of \$5 million.

In 2001, California enacted AB 898, which did away with the FTB studies and fixed the LLC fee at roughly

the 1999 levels, except for the top fee which rose to \$11,790. AB 898 also changed the law to prevent LLC income from being counted twice in tiered-entity structures, such as where a single member LLC owns a membership interest in another California LLC.

In 2006 and 2007, the Superior Court for the County of San Francisco declared the LLC fee unconstitutional in *NW Energetic* and *Ventas Finance* because the LLC fee did not allocate or apportion LLC income among California and other jurisdictions. I made the same arguments on behalf of *NW Energetic* in its proceedings before the Board of Equalization.

In September 2007, the California Legislature enacted AB 198 to amend the LLC fee to apportion LLC total income to California and other jurisdictions and provide for a limited refund of prior years' fees. The FTB created "Sacramento magic" and avoided a 2/3 vote in each house of the Legislature by scoring AB 198 as not increasing taxes since the California Court of Appeal had yet to declare the LLC fee

unconstitutional, which it did in January 2008.

The 2007 changes to the LLC fee have led to draft proposed regulations, which have been discussed at various interested parties meetings over the last four years. I have provided written and oral comments.

The LLC fee regulations, when finalized, likely will provide examples demonstrating how to determine LLC "total income from all sources derived from or attributable to" California, including when the LLC owns an interest in another pass-through entity. The regulations also likely will address the assignment to California of non-business income, such as dividends, interest and capital gains from stocks and bonds, which is not part of the business activity of the LLC.

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