

# CALIFORNIA LIMITED LIABILITY COMPANY REVIEW

## LLC FEE REGULATIONS

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The California LLC Fee, enacted as Cal. R&T Code Section 17942, has created

much consternation in California since its inception in 1994. California enacted the LLC Fee when the state first adopted LLC statutes to address concerns advocated by the Franchise Tax Board that increases in passed-through California income would deplete California 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, 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 study caused the LLC Fee to rise by 108% in two years, making it \$9,377 in 2000 for LLC total income in excess of \$5 million.

In 2001, California enacted AB 898, which did away with the FTB study 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 Court of Appeal for California 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 are to be discussed at an interested parties meeting in Sacramento on **November 19, 2010**. I am providing written comments.

The proposed regulations likely will provide examples showing how to determine the sales factor numerator used 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 proposed regulations also likely will address the allocation 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.

Those wishing to keep up on the latest developments regarding the LLC Fee regulations should email me or visit my website at: [www.pacetaxlaw.com](http://www.pacetaxlaw.com).

*The preceding discussion should not be construed as legal or tax advice or representation on specific legal matters, but rather as a general commentary on the subjects discussed. Your questions and comments are always welcome.*