



BDO Seidman, LLP
Accountants and Consultants

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State and Local Tax Alert

Subject:

California LLC Fee: Calculation Revised

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Summary

The Governor of California recently signed into law a bill (A.B. 198) that changes the calculation for computing the California limited liability company (LLC) fee and eliminates the possibility of a full refund for many of the LLCs that have paid the fee.

Background: Pending Legislation

The California LLC fee has been in existence since 1994 and was imposed on all LLCs that registered to do business in the state. The rate of the fee was imposed at graduated levels, based on the LLC's total income from all sources reportable to the state. "Total income" was defined as gross income from whatever source derived and the Franchise Tax Board interpreted that to mean worldwide total income without apportionment.

In *Northwest Energetic Services, LLC v. Franchise Tax Board*, California Superior Court for San Francisco County, No. CGC-05-437721, April 13, 2006, and *Ventas Finance I, LLC v. Franchise Tax Board*, California Superior Court for San Francisco County, No. CGC-05-440001, November 7, 2006, the California superior courts held that the California LLC fee was an "illegal tax" that violated the Commerce Clause and the Due Process Clause due to the way the fee was calculated. The Courts held the fee was unconstitutional because the fee was not based on income from California sources. Those LLCs that paid the fee were able to file protective refund claims even though the FTB has appealed both cases.

A.B. 198

Effective for tax years ending on or after January 1, 2007, the annual LLC fee imposed on those LLCs doing business in California will be calculated on the basis of apportioned revenue earned within California. This will be determined by applying the existing apportionment rules for assigning the sales of an entity doing business within and without the state.

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Refunds

If the LLC fee is determined to be unconstitutional by the Appellate Courts, the Legislation eliminates the possibility of a full refund for those LLCs that have paid the fee in prior tax years. For those disfavored taxpayers that filed a timely protective refund claim, the fee will be recomputed, but only to the extent necessary to remedy the discrimination or unfair apportionment. The refund of the fees will thus be limited to the amount of which the fee paid, plus any interest assessed, exceeds the amount of the fee that would have been assessed if the fee had been determined under the new provisions.

To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

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