

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: Kristina E. North Bill Number: SB 1022

Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: February 22, 2005

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Domestic Limited Liability Companies May Be Organized To Render Professional Services

SUMMARY

This bill would attempt to clarify the professional services that a domestic limited liability company (LLC) may render.

PURPOSE OF THE BILL

According to the author's office, the intent of this bill is to clarify what professional services may be legitimately rendered by a business organized as an LLC.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on or after January 1, 2006.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

The Beverly-Killea Limited Liability Company Act (LLC Act) first authorized the organization of LLCs in 1994 in California and also recognized LLCs organized under the laws of other states. An LLC is a hybrid form of an unincorporated business entity affording its members certain benefits:

- ◆ Limited liability to the extent of a member's equity investment;
- ◆ Flexible management alternatives; and
- ◆ Liberal membership qualification requirements.

Members of an LLC are afforded the same advantage of limited liability as shareholders of a corporation. If an LLC is classified as a partnership for income tax purposes, the income of the LLC is generally subject to only one level of income tax, as are the partners of a partnership. LLCs lack the membership restrictions or the two levels of income tax imposed on S corporations.

Current federal law allows LLCs to be treated as partnerships, corporations, or entities that are disregarded for federal tax purposes.

Board Position:

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Department Director

Date

Gerald H. Goldberg

5/5/05

Current state law allows domestic or foreign LLCs to engage in any lawful business except banking, insurance, or trust company business. Domestic and foreign LLCs also are not permitted to render any professional services unless expressly authorized by law.

"Professional services" is defined in the Moscone-Knox Professional Corporation Act (Corporation Act) as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act. "Professional services" also means any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Yacht and Ship Brokers Act.

Until 2004, the Office of the Secretary of State (SOS) did not accept LLC applications from all businesses licensed under the Business and Professions Code. In 2004, SOS requested an Attorney General (AG) opinion asking if "a business that provides services requiring a license, certification, or registration pursuant to the Business and Professions Code [could] conduct its activities as [an LLC]." AG Opinion 04-103 concluded that a business could "conduct its activities as an LLC if the services rendered require only a nonprofessional, occupational license." In its opinion, the AG declined to determine if each licensed activity specified in the Business and Professions Code was a professional or a nonprofessional occupational activity. As a result of the AG's opinion, the SOS does not deny any application on the basis that the business is licensed under the Business and Professions Code.

THIS BILL

This bill would specify in the LLC Act that domestic LLCs could be organized to render any professional services other than those that require a license issued solely to a natural person under the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act.

The provisions would not be construed to authorize an LLC to engage in the banking business, the business of issuing policies of insurance and assuming insurance risks, or the trust company business.

This bill would eliminate any reference to foreign LLCs and restrictions on the types of professional services that may be rendered by a foreign LLC. As a result, this bill would allow foreign LLCs to render any professional services without restriction.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

It does not appear that this bill would provide the clarity intended by the author with respect to the professional services that may be performed by an LLC. The author's staff indicates intent to amend the bill.

LEGISLATIVE HISTORY

AB 229 (Baldwin - 1999/2000) and AB 2245 (Baldwin - 1997/1998) would have specified that an LLC could not render certain professional services and that an LLC may engage in other lawful activity, even if that activity requires licensing, registration, or certification pursuant to the Business and Professions Code. Both bills failed passage out of Assembly Judiciary Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida, Michigan, and New York – define “professional services” as any type of service to the public that requires obtaining a license or other legal authorization as a condition to rendering the service. LLCs are allowed to render *any* professional services if they are licensed or otherwise legally authorized to render such professional services.

Illinois – defines “professional services” as any personal service that requires obtaining a license from a state agency, the United States Patent Office, or the Internal Revenue Service. LLCs are allowed to form for any business with some exceptions: 1) banking, except for fiduciaries organized for the purpose of accepting and executing trusts, 2) insurance, except if the Director of Insurance finds the LLC meets certain requirements, 3) dentistry, unless all the members and managers are licensed by the state to practice dentistry, and 4) medicine, unless all the managers are licensed to practice medicine and each member meets certain criteria.

Massachusetts – defines “professional services” as a service performed by registered or licensed physicians and surgeons, chiropractors, podiatrists, engineers, electrologists, physical therapists, psychologists, certified public accountants, public accountants, dentists, veterinarians, optometrists, acupuncturists and registered nurses; attorneys-at-law admitted to practice in the courts of the commonwealth; and other types of licensed service that is allowed to organize by the regulating board. An LLC may render professional services in any lawful business, trade, profession, purpose, or activity as allowed by the appropriate licensing board.

Minnesota – defines “professional services” as a service performed by registered, licensed, or certificated physicians and surgeons, physicians' assistants, chiropractors, nurses, optometrists, psychologists, dentists, dental hygienists, pharmacists, podiatrists, veterinarians, architects, engineers, surveyors, landscape architects, geoscientists, interior designers, accountants, or lawyers. An LLC may render professional services if the members are registered, licensed, or certificated to render such services, and no other state law specifically prohibits them.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The decision to become an LLC may include business factors other than tax savings and could result in net revenue gains, losses, or neutrality for those particular business entities added by this bill. Based on historical data from existing LLCs and the fact that the fee structure for LLCs was designed to be revenue neutral to the state, as compared to other business structures that could be utilized, it is anticipated that any revenue impact for these additional entities would be insignificant.

LEGISLATIVE STAFF CONTACT

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