

BILL ANALYSIS

Analyst: Angela Raygoza
Work Phone: 845-7814

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| Department, Board, Or Commission | Author | Bill Number |
| Franchise Tax Board | Florez | SB 392 |

SUBJECT

Limited Liability Companies/Contractors

SUMMARY

This bill would allow contractors to organize and operate as limited liability companies (LLCs).

PURPOSE OF BILL

According to the author's office, the purpose of this bill is to provide contractors with the benefit of flexibility in estate planning, profit sharing, and liability protection for their personal assets.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2011, and would specifically require the Contractors' State License Board (CSLB) to begin processing applications for licensure for LLCs no later than January 1, 2012.

ANALYSIS

FEDERAL/STATE LAW

The Beverly-Killea Limited Liability Company Act (LLC Act) first authorized the organization of LLCs in California in 1994 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, such as the following:

- ◆ 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 treated as partnerships for income tax purposes are not subject to the membership restrictions or the two levels of income tax imposed on S corporations.

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| Brian Putler, FTB Contact Person (916) 845-6333 (Office) | Executive Officer Selvi Stanislaus | Date 09/01/10 |
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Current federal and state law allows eligible business entities including LLCs to be treated as partnerships, corporations, or entities that are disregarded for federal tax purposes. Generally, the classification of a business entity for California purposes is required to be the same as the entity's federal classification. LLCs not classified as a corporation that are organized, registered, or doing business in California are required to pay an annual tax of \$800 and a fee measured by total income attributable to California.

Current state law allows domestic or foreign LLCs to engage in any lawful business except banking, insurance, trust company business, or the offering of professional services for which a license, certification or registration is required, unless expressly authorized under provisions of the Business and Professions Code or the Chiropractic Act.

"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 pursuant to a license, certification, or registration authorized by the Yacht and Ship Brokers Act.

PROGRAM BACKGROUND

Until 2004, the Office of the Secretary of State (SOS) prohibited businesses licensed under the Business and Professions Code from forming LLCs. 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." The AG declined to determine if each licensed activity specified in the Business and Professions Code was a professional or a nonprofessional occupational activity. SOS no longer denies any application, professional or non-professional, on the basis that the business is licensed under the Business and Professions Code.

THIS BILL

This bill would allow an individual or a business providing services as a contractor to form and operate as an LLC. In addition, this bill would authorize the CSLB to issue a contractor's license to an LLC under the Business and Professions Code. Any LLC would be treated in the same manner as a corporation relative to the issuance, renewal, suspension, re-issuance, or termination of a contractor's license.

As a result, contractor's that form and operate as an LLC would be required to pay an \$800 annual tax to the Franchise Tax Board and a fee measured by total income attributable to California.

LEGISLATIVE HISTORY

SB 1008 (Padilla, 2009/2010) would authorize licensed engineers and land surveyors to organize and operate as limited liability partnerships (LLPs) and require engineers and land surveyors organizing as LLPs to maintain insurance liability coverage. This bill is currently enrolled to the Governor.

SB 1337 (Correa, 2007/2008) would have allowed a contractor to form an LLC and authorize the issuance of a contractor's license to an LLC under the Business and Professions Code. This bill failed passage out of the Senate Judiciary Committee.

AB 2235 (Parra, 2005/2006) would have expanded the definition of "person" under the Real Estate Law to include an LLC. This bill failed passage in the Senate Judiciary Committee without being heard.

SB 1022 (Campbell, 2005/2006) sought to authorize the formation of professional LLCs to provide professional services, as defined. This bill failed passage in the Senate Judiciary Committee.

AB 2724 (Runner, 2001/2002) would have authorized a contractor's license to be issued to an LLC that met certain requirements. That bill failed passage out of the Assembly Business and Professions 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, Illinois, Massachusetts, Michigan, Minnesota, and New York allow contractors to form an LLC if the members are registered, licensed, or certified by that state or local licensing entity.

FISCAL IMPACT

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

ECONOMIC IMPACT

This bill would result in the following revenue gains:

| Estimated Revenue Impact of SB 392 Effective For Tax Years Beginning On or After January 1, 2011 Enactment Assumed After September 30, 2010 (\$ in Millions) | | |
|---|---------|---------|
| 2010-11 | 2011-12 | 2012-13 |
| \$0 | +\$8.4 | +\$11.0 |

Support/Opposition

Support: Associated General Contractors of California (co-sponsor), Associated General Contractors of San Diego (co-sponsor), Associated Builders and Contractors, California Fence Contractors Association, California Landscape Contractors Association, Engineering and Utility Contractors Association, Engineering Contractors Association Flasher/Barricade Association, Golden State Builders Exchanges, Marin Builders Association, State Building & Construction Trades Council

Opposition: None.

VOTES

Assembly Floor – Ayes: 75, Noes: 0
Senate Floor – Ayes: 36, Noes: 0
Concurrence – Ayes: 37, Noes: 0

LEGISLATIVE STAFF CONTACT

Angela Raygoza
Franchise Tax Board
(916) 845-7814
angela.raygoza@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov