

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Skinner Analyst: Brian Werking Bill Number: AB 1143  
Related Bills: See Legislative History Telephone: 845-5103 Introduced Date: February 22, 2013  
Attorney: Patrick Kusiak Sponsor: Franchise Tax Board

**SUBJECT:** Equal Tax Treatment of Nonqualified Foreign Limited Liability Companies for Contract Voidability

### SUMMARY

This bill would amend the definition of taxpayer as it relates to suspension, forfeiture, revivor, and contract voidability, to specifically include all limited liability companies (LLCs).

### RECOMMENDATION

Support.

On December 5, 2012, the three-member Franchise Tax Board voted 2-0 to sponsor the language included in this bill, with the representative from the Department of Finance abstaining.

### REASON FOR THE BILL

The reason for the bill is to provide equitable tax treatment between foreign non-qualified LLCs and all other LLCs and corporations.

### EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment. Contract voidability for foreign nonqualified LLCs lacking an FTB-assigned account number would be specifically operative for contracts entered into during the period beginning on the later of January 1, 2014, or the first day of the taxable year for which the taxpayer has failed to file a return.

### ANALYSIS

#### FEDERAL/STATE LAW

Under existing federal law, business entities are not subject to contract voidability for failure to pay taxes, penalties, fees, or interest, or for failure to file required tax returns with the Internal Revenue Service (IRS). Nor does the IRS offer relief from contract voidability for any business entities.

Board Position:

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Under existing state law, domestic or foreign registered (qualified) LLCs or domestic or foreign qualified corporations may be subject to suspension or forfeiture for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice. One consequence of suspension or forfeiture is being subject to contract voidability for the period in which the entity is suspended or forfeited.

Foreign nonqualified corporations may be subject to contract voidability in two ways depending on whether or not the corporation has an FTB-assigned account number. The two ways are as follows:

- Foreign nonqualified corporations that do not have an FTB-assigned account number, because the FTB is unaware of the entities' business activities within the state, may be subject to contract voidability beginning on the first day of the taxable year for which the taxpayer has failed to file a required return
- Foreign nonqualified corporations that have an FTB-assigned account number may be subject to contract voidability for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice before contract voidability.

Unlike, foreign nonqualified corporations, foreign nonregistered (nonqualified) LLCs are not subject to contract voidability for failure to file tax returns or for failure to pay taxes, penalties, fees, or interest. Consequently, foreign nonqualified LLCs do not need to obtain relief from contract voidability.

All business entities that enter into a contract while subject to contract voidability may have the contract voided by another party to the contract. The third party may exercise the right to declare a contract void only in a lawsuit brought by either party with respect to the contract. A court shall not issue a final judgment rescinding the contract unless the taxpayer subject to contract voidability is provided a reasonable opportunity to cure the voidability. In no event shall a court order a contract rescinded without providing the taxpayer full restitution of the benefits provided by the taxpayer under the contract.

Entities that are subject to contract voidability may elect to obtain relief from contract voidability. If obtained during the revivor process, the entity may choose relief for a portion of the time in which the entity was subject to contract voidability by choosing the starting tax year for which the relief period will begin. If an entity elects to obtain relief from contract voidability outside of the revivor process, the entity must choose relief for the entire period for which the entity was subject to contract voidability. Relief from contract voidability is granted at a cost of \$100 a day for the period of relief granted. The amount cannot exceed the amount of tax due for the relief period. When a return is not due, the minimum franchise tax is considered the tax due for that period.

**THIS BILL**

This bill would include foreign nonqualified LLCs within the definition of taxpayer as it relates to contract voidability. As a result, contracts of foreign nonqualified LLCs would be subject to contract voidability in the following situations:

- Foreign nonqualified LLCs without an FTB-assigned account number that fail to file a required tax return would be subject to contract voidability during the period beginning on the later of the first day of the taxable year for which the LLC failed to file a required tax return, or January 1, 2014, and ending when the LLC qualifies with the Secretary of State or obtains an FTB account number.
- Foreign nonqualified LLCs with an FTB-assigned account number that fail to file a tax return or fail to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice would be subject to contract voidability during the period beginning with the end of the 60-day demand notice and ending on the earlier of (1)the date relief from contract voidability is granted or (2)the date the LLC qualifies with the Secretary of State.

**IMPLEMENTATION CONSIDERATIONS**

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

**LEGISLATIVE HISTORY**

AB 318 (Skinner, Chapter 313, Statutes of 2012), among other things, expanded the imposition of the non-qualified, suspended, or forfeited failure to file penalty to include LLCs.

**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. None of the states reviewed impose contract voidability, nor do they offer relief from contract voidability.

**FISCAL IMPACT**

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

**ECONOMIC IMPACT**

Revenue Estimate

Estimated Revenue Impact of AB 1143 Operative Upon Enactment Assumed Enactment After June 30, 2013		
2013-14	2014-15	2015-16
+\$50,000	+\$30,000	+\$50,000

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

## **SUPPORT/OPPOSITION**

Support: Franchise Tax Board.

Opposition: None provided.

## **ARGUMENTS**

Proponents: Supporters could argue that this bill would provide greater protection to California consumers when contracting with foreign nonqualified LLCs.

Opponents: Some could argue that this bill would place an additional burden on specified LLCs, thus discouraging economic activity within the state.

## **LEGISLATIVE STAFF CONTACT**

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