

DISCUSSION TOPICS
Franchise Tax Board Interested Parties Meeting
Section 17942, Limited Liability Company Fees
November 19, 2010

In response to litigation challenging the constitutionality of the LLC fee based upon total income from all sources reportable to California, not just total income from all sources attributable to or derived from California, the Legislature amended Revenue and Taxation Code¹ section 17942 to add a new provision:

For purposes of this section, "total income from all sources derived from or attributable to this state" shall be determined using the rules for assigning sales under Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor.

Section 17942 (b)(1)(B).

Sections 25135 and 25136 are the statutes which assign sales to the California numerator of the sales factor. Section 25135 assigns sales of tangible personal property and contains as its primary rule the assignment of the sale to California if the property is delivered to a purchaser in this state. Section 25136 assigns all other sales and its primary rule assigns sales on the basis of where the income producing activity associated with that sale occurred. The regulations under section 25136 also provide specific rules for items such as real property, which is assigned to the state where the real property is located.

The regulations adopted pursuant to section 25137 provide specific apportionment rules for special industries, such as banks and financials, truckers, and franchisors. The regulations also provide specific sales factor rules for various types of income that are especially problematic. Regulation section 25137(c) sets forth these provisions.

While the new LLC fee methodology utilizes the sales factor numerator rules to determine the total income assignable to California for purposes of the LLC fee calculation, the method is not the UDITPA apportionment method. There is no calculation of a factor, only the determination of whether a given item of income is assignable to California using the sales factor numerator assignment mechanisms. Once the total income of the LLC is assigned to the various states using this methodology, the fee is calculated based on the total income assignable to California.

The purpose of the interested parties meeting will be to discuss what regulatory guidance (if any) should be provided regarding the use of this new assignment mechanism.

Possible areas to be address in a regulation include:

¹ All section references are to the California Revenue & Taxation Code, unless otherwise specifically noted.

1. Rules to address passive investments. The regulations under section 25137 would exclude from the sales factor all receipts that are not related to an identifiable income producing activity. (See Regulation section 25137(c)(1)(C).) This exclusion is disallowed under the new rules for the LLC fee, and therefore there may be a need for guidance regarding the assignment of the total income derived from these sources.
2. Similarly, Regulation section 25137(c)(1)(A) excludes occasional sales, such as a sale of a factory, from the sales factor. These sales also cannot be excluded in the calculation of the LLC fee. Perhaps a rule for these types of sales should be addressed in a regulation.
3. Is there a need to provide examples to demonstrate the method required by the new section? This could be done in a new regulation.
4. Should the regulation address the use of Schedule R as a means of determining total income for fee purposes? Generally, this schedule is already prepared by LLCs engaged in business within and without California. Clearly sales factor numerator rules are utilized in the preparation of Schedule R. Should a regulation address the use of this numerator amount and the adjustments that would be necessary to comply with section 17942? Among these adjustments would be the inclusion of nonbusiness activities and the statutorily-required elimination of amounts received from other LLCs that included that amount in calculating their own LLC fee.

As always, any other suggestions for this process are welcome. Instructions for the calculation of the LLC fee as well as the LLC worksheet may be accessed and printed by visiting http://www.ftb.ca.gov/forms/2009/09_568bk.pdf. These documents may be discussed during the interested parties meeting as a possible starting point for regulatory language.