

## Explanation of Revisions to Proposed Regulation Section 17942

During the time period within which both the interested parties process and the subsequent staff effort in drafting the text of proposed Regulation section 17942 occurred, Revenue and Taxation Code section 25128.5 granted certain taxpayers an election to use single sales factor apportionment for taxable years beginning on or after January 1, 2012. Proposed Regulation section 17942 took this election into account.

After the interested parties process and the drafting of the text was complete for proposed Regulation section 17942, Revenue and Taxation Code section 25128.5 was repealed by the adoption of Proposition 39 for taxable years beginning on or after January 1, 2013 (approved by the voters on November 6, 2012), which had the effect of mandating that most taxpayers utilize single sales factor apportionment for taxable years beginning on or after January 1, 2013. Accordingly, the text of proposed Regulation section 17942 has been further modified to address the repeal of Revenue and Taxation Code section 25128.5, as follows:

Subsection (d) was amended to include language clarifying that for taxable years beginning on or after January 1, 2013, all LLCs must calculate the limited liability company fee utilizing the sales factor assignment rules contained in Revenue and Taxation Code section 25136, as applicable for years beginning on or after January 1, 2013. In addition, other changes were made to reflect the operative date of the regulation as well as to clarify the existing language that was previously approved by the Board.

Subsection (d)(2) was similarly amended to include language clarifying that for taxable years beginning on or after January 1, 2013, all LLCs must calculate the limited liability company fee utilizing the sales factor assignment rules contained in Revenue and Taxation Code section 25136, as applicable for years beginning on or after January 1, 2013. In addition, other changes were made to reflect the operative date of the regulation as well as to clarify the existing language that was previously approved by the Board.

Subsection (g) was added to provide that this proposed Regulation is effective for taxable years beginning on or after January 1, 2012.

**NOTE: Changes made are shown in underscore for additions and strikeout for deletions.**

Section 17942 is adopted to read:

§ 17942. LLC Fees.

(a) In addition to the tax imposed under Revenue and Taxation Code section 17941, every limited liability company subject to tax under Revenue and Taxation Code section 17941 shall pay annually to the state a fee determined by the amount of total income from all sources derived from or attributable to this state for the taxable year.

(b) "Total income from all sources derived from or attributable to this state" means gross income, as defined in Revenue and Taxation Code section 24271, plus the cost of goods sold that is paid in or incurred in connection with the trade or business of the taxpayer. This amount does not include, however, any allocation or attribution of income or gain or distributions made to the limited liability company in its capacity as a member or holder of an economic interest in another limited liability company, so long as the income of the limited liability company that earned the income was itself subject to the fee described in Revenue and Taxation Code section 17942.

Example: Assume A, a limited liability company organized in Georgia that is taxed as a partnership, has total income from all sources derived from or attributable to this state from its own business activities in the amount of \$400,000. A also owns an interest in B, a limited liability company organized in Ohio that is also taxed as a partnership. B has total income from all sources derived from or attributable to this state from its business activities in the amount of \$200,000. A's distributive share of B's total income from all sources attributable to this state is \$150,000. In calculating its total income from all sources derived from or attributable to this state, A will not include its \$150,000 distributive share of income from B, even though B did not actually pay any limited liability company fee itself (under these facts, B's total income is below the \$250,000 minimum threshold for the imposition of the fee), because the \$200,000 earned by B was "subject to" the fee. As a result, A will pay a fee based on its total income from all sources derived from or attributable to this state of \$400,000.

(c) Items of total income from all sources derived from or attributable to this state that a limited liability company receives from pass-through entities, other than other limited liability companies that are themselves subject to the fee, must be computed and assigned for purposes of the limited liability company fee calculation. This means that a limited liability company's distributive share of items allocated to it by another pass-through entity that is not itself a limited liability company must be adjusted to include cost of goods sold, if applicable, in order to compute the correct amount of total income for fee purposes.

Example: Assume C, a limited liability company organized in Oregon that is taxed as a partnership, has a 50%percent interest in Partnership X. During the year, Partnership X sells widgets for \$10,000 with a related cost of goods sold of \$5,000. C is allocated a 50%percent distributive share of X's gross income from Partnership X in the amount of \$2,500 at the end of the year. For limited liability company fee purposes, in addition to any

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total income from its own activities, C has an item of total income of \$5,000, comprised of C's \$2,500 distributive share of gross income from X, plus the associated \$2,500 of cost of goods sold from X representing C's distributive share of X's cost of goods sold.

(d) To determine total income from all sources derived from or attributable to this state, the assignment rules of Revenue and Taxation Code sections 25135 and 25136, and the regulations thereunder, as modified by regulations under Revenue and Taxation Code section 25137, other than those provisions that exclude receipts from the sales factor, are to be utilized. These rules are the sales factor numerator assignment rules of the apportionment formula for entities paying the corporate franchise or income tax. For taxable years beginning on or after January 1, 2012, for purposes of computing the limited liability company fee, sales of other than tangible personal property Sales shall be assigned under Revenue and Taxation Code section 25136 ~~for fee purposes~~ using the same method as that elected under Revenue and Taxation Code section 25128.5 to assign sales for apportionment purposes. For taxable years beginning on or after January 1, 2013, sales of other than tangible personal property shall be assigned using the standard assignment rules contained in Revenue and Taxation Code section 25136, applicable for taxable years beginning on or after January 1, 2013.

(1) Items of total income from all sources derived from or attributable to this state that are derived from the passive holding of intangible personal property, an activity that may not have been assigned to a location due to Regulation section 25137, subsection (c)(1)(C), must be assigned to a location for purposes of computing the limited liability company fee. Income derived from such property shall be assigned for limited liability company fee purposes to the location from which the intangible personal property is managed by the limited liability company.

Example: Assume D, a limited liability company organized in Indiana that is taxed as a partnership, holds a portfolio of bonds that generates interest income. Assume an individual bond portfolio manager located in Nevada monitors these bond investments and makes decisions regarding the portfolio. In assigning the interest income from the bonds for limited liability company fee purposes under this regulation, the income will be assigned to Nevada, the state where the individual bond portfolio manager is located.

(2) Occasional sales of assets ~~are may also be~~ disregarded for sales factor purposes under the rules of Regulation section 25137, subsection (c)(1)(A), under certain circumstances however. However, for purposes of computing the limited liability company fee, total income from all sources derived from or attributable to this state from occasional sales of assets such transactions must be assigned to a location ~~for purposes of computing the limited liability company fee~~. Therefore, for taxable years beginning on or after January 1, 2012, the apportionment methodology election made by the taxpayer pursuant to Revenue and Taxation Code section 25128.5 shall apply and total income from all sources derived from or attributable to this state shall be assigned under Revenue and Taxation Code section 25136 in accordance with such election. For taxable years beginning on or after January 1, 2013, total income from all

sources derived from or attributable to this state shall be assigned under Revenue and Taxation Code section 25136.

Example: Assume E, a limited liability company organized in California that is taxed as a partnership, elects single-factor sales pursuant to Revenue and Taxation Code section 25128.5. Therefore, for purposes of calculating the LLC fee, total income from all sources derived from or attributable to this state will be assigned based on the market-rules for sales contained in Revenue and Taxation Code section 25136, subdivision (b).

(3) All items of total income from all sources received by the limited liability company from other pass-through entities, other than as specifically provided by subsection (b) of this regulation, shall be assigned to the state where the partnership assigned the income on the Schedule K-1 provided to the limited liability company.

(e) If a limited liability company conducts all of its business activities in California, then the limited liability company may simply calculate its total income and may disregard the assignment rules set forth above, since the application of the rules would result in the same amount of income being assigned to this state.

(f) Alternative method for assigning total income from all sources derived from or attributable to this state. Under Regulation section 17951-4, a limited liability company that is classified as a partnership under Revenue and Taxation Code section 23038 and conducts its business within and without this state shall apportion its income at the partnership level in accordance with Revenue and Taxation Code sections 25120 through 25139. The limited liability company shall determine its California sales factor numerator pursuant to Revenue and Taxation Code sections 25135, 25136, and, if applicable, 25137. As an alternative, multistate limited liability companies may utilize this apportionment information to calculate the limited liability company fee in the following manner:

(1) If the sales factor numerator amount is over five million dollars (\$5,000,000) for the taxable year, the limited liability company may report the sales factor numerator amount as the correct amount for purposes of calculating the fee since the sales factor amount exceeds the top bracket for calculating the fee amount.

(2) If the sales factor numerator is less than five million dollars (\$5,000,000) for the taxable year, then the limited liability company may use the sales factor numerator amount as the starting point for the calculation of the fee and then make the following adjustments:

(A) Assign all items of total income from all sources that were previously assigned as nonbusiness income for apportionment purposes, using the assignment rules of this regulation.

(B) Assign, pursuant to this regulation, all items of total income from all sources that were not included in the sales factor numerator by operation of the

provisions of regulations under Revenue and Taxation Code section 25137 that exclude sales from the sales factor.

(C) Remove all items of total income that were derived from or attributable to other limited liability companies that were subject to the limited liability company fee, consistent with the methodology described in subsection (b) of this regulation.

(3) If the sales factor numerator amount is over five million dollars (\$5,000,000) for the taxable year, but the limited liability company has included an amount received from another limited liability company in the numerator amount such that the removal of that amount will result in the remaining sales factor numerator falling below five million dollars (\$5,000,000), the limited liability company may remove the amount and then make the other adjustments pursuant to subsections (2)(A) and (2)(B).

(g) This regulation shall apply to taxable years beginning on or after January 1, 2012.

Note: Authority cited: Section 19503, Revenue and Taxation Code.  
Reference: Section 17942, Revenue and Taxation Code.