

REVISED FINAL STATEMENT OF REASONS
PROPOSED SECTION 17942,
RELATING TO INTERCOMPANY LIMITED LIABILITY COMPANY FEES

The proposed regulation does not impose any mandate on local agencies or school districts.

UPDATE OF INITIAL STATEMENT OF REASONS

In accordance with the requirement of Government Code section 11346.2, subdivision (b)(5), that the Franchise Tax Board consider alternatives to the proposed regulatory action, staff of the Franchise Tax Board conducted three interested parties meetings prior to commencing the formal regulatory process. A first interested parties meeting was held on June 17, 2008, to solicit input from the public. Staff did not provide language at that time, but rather provided discussion topics that sought to elicit input on the content of a potential regulation. The discussion centered on the methodology for calculating the limited liability company fee, a general background of the purpose behind the proposed regulation and potential issues that may arise with regard to it.

A second interested parties meeting was held on November 19, 2010. Staff provided proposed language pertaining to the calculation of the limited liability company fee. The meeting was successful and the proposed regulation language was generally found acceptable.

Much of the public response at the second interested parties meeting concerned the treatment of nonbusiness income in determining total income from all sources derived from or attributable to this state. Staff explained that the distinction between business and nonbusiness income was not an issue because as all income is allocated, rather than apportioned, through the language of subdivision (b) of proposed Regulation section 17942. Each item of income is assigned either to California or another location for purposes of Revenue and Taxation Code section 17942. Another public concern involved the application of fees in tiered ownership structures involving multiple limited liability companies. This concern was addressed at the second interested parties meeting and the public was satisfied with the staff's responses.

A third interested parties meeting was held on October 4, 2011 to further discuss the proposed language, to allow the public a final opportunity to raise issues to be addressed in the proposed regulation and to discuss two issues raised subsequent to the second interested parties meeting. One issue concerned whether cost of goods sold includes the tax basis of real property. The other issue concerned whether a limited liability company may make a single sales factor election while a member of a unitary group.

After the meeting, department staff considered the public comments and determined that, with regard to the tax basis of real property, the Limited Liability Company Income Worksheet (FTB Form 568) should be amended to specifically exclude the basis of real property from the cost of goods sold for purposes of calculating the limited liability company fee. This change would occur starting with the 2012 taxable year. With regard to the single sales factor election, staff determined that allowing the limited liability company to make an

independent election is beyond the authority of Revenue and Taxation Code section 25128.5.

The comments subsequent to this change indicated that the participants were in agreement with the proposed language.

The public notice required by Government Code section 11346.4 was mailed and published in the California Notice Register on February 7, 2014. The notice stated that there would not be a public hearing unless requested by an interested person at least 15 days before the close of the written comment period, which ended March 27, 2014. No request was made for a public hearing, but there was one written comment received. A summary of responses to the comments received was prepared as Tab 9 in the rulemaking file and is hereby incorporated by reference into this Final Statement of Reasons. Consequently, the department has not made any revisions to the proposed regulation.

Subsections (a) and (b) of the regulation substantially duplicate subdivisions (a) and (b)(1)(A) of Revenue and Taxation Code section 17942, but have been included within the regulation for clarity so that the reader can easily follow the steps necessary to calculate the LLC fee. Subsection (b) also contains an example clarifying when income passed through from another limited liability company is treated as “subject to the fee” when calculating total income from all sources under the second sentence of subdivision (b)(1)(A) of the Revenue and Taxation Code section 17942. Subsection (c) provides a rule to calculate items of income that are received from another pass-through entity that is not a limited liability company (such as a general or limited partnership), and also an example illustrating this calculation. Subsection (d) further explains subdivision (b)(1)(B) of Revenue and Taxation Code section 17942 as to the assignment of sales apportionment rules that are to be used in computing total income, and in particular references the subsequent statutory amendments made to the cross-referenced statutory rules under Revenue and Taxation Code section 25136, as well as providing examples where the statutory exception in the last clause of subdivision (b)(1)(B) of Revenue and Taxation Code section 17942, relating to provisions that exclude receipts not applying to this calculation, will be applicable in making the LLC fee calculation. Subsection (e) provides a rule of convenience where an LLC derives all of its income from California sources, it does not need to apply the assignment of sales rules described in subsection (d) since the result will be the same. Subsection (f) provides an alternative method for calculating the LLC fee whereby the LLC may be able to start with its California sales factor numerator and make adjustments thereto, as well as some examples illustrating how this calculation is to be made.

ALTERNATIVES DETERMINED

The Franchise Tax Board has determined with supporting information that no alternative to the proposed regulation it considered would be more effective in carrying out the purpose of the proposed regulation or would be as effective and less burdensome to affected private

persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of the law, in accordance with Government Code section 11346.9, subdivision (a)(4). The proposed regulation is the only text identified by or proposed to the Franchise Tax Board that accomplishes the intent of the regulation and no alternatives have been identified or proposed that would reduce costs to those regulated.