

05.22.2009

FTB NOTICE 2009-04

Subject: Processing Limited Liability Company Fee Claims for Refund as a Result of *Ventas Finance I, LLC v. Franchise Tax Board* (2008) 165 Cal.App.4th 1207

PURPOSE

To inform limited liability companies (LLCs) that have filed claims for refund that the Franchise Tax Board (FTB) will process claims for refund for LLCs with substantially the same factual situation as *Ventas Finance I, LLC v. Franchise Tax Board*¹ (*Ventas*), an LLC that earned income within and outside of California. The FTB will process the claims for refund using the **Default Method**, unless an LLC informs FTB that it wishes to use the **Alternative Method**, as described below.

1. **Default Method:** FTB will use the LLC's Schedule R filed with the LLC's Return of Income (Form 568) to calculate the revised LLC fee and the refund amount, if any. LLCs that did not attach a Schedule R to the originally filed Form 568 must submit a Schedule R.
2. **Alternative Method:** The LLC must complete and submit the LLC Income Worksheet from the 2008 LLC Tax Booklet (Form 568 Booklet) with the respective information for each tax year that a claim for refund is filed. Based on the information provided by the LLC, the FTB will then calculate the revised LLC fee and the refund amount, if any.

In addition, this notice instructs LLCs with substantially the same factual situation as *Ventas* that now wish to file a claim for refund, of the information to submit with the claim in order for it to be promptly processed, assuming the statute of limitations remains open.

BACKGROUND

In *Ventas*, the Court of Appeal held that the LLC fee imposed pursuant to former California Revenue and Taxation Code (CR&TC) section 17942 was unconstitutional as applied to *Ventas* because the statute did not use a method of fair apportionment to calculate the total income upon which the LLC fee was based. The LLC fee was based on *Ventas*' total income from all sources, and was not limited to income derived from, or attributable to, California.

¹ (2008) 165 Cal.App.4th 1207, review den. Nov. 12, 2008, cert. den. (2009) 556 U.S. ____ [2009 U.S. LEXIS 2647].

The First Appellate District Court of Appeal's decision in *Ventas* is final as to the constitutional issue. The Court of Appeal's decision did not hold that the LLC fee statute was unconstitutional "on its face." The refund of the LLC fee paid will be limited to the amount of the LLC fee that "exceeds the amount it would have been assessed, without violating the Commerce Clause, using a method of fair apportionment."

The *Ventas* decision addresses the situation where a taxpayer earns income from activities within and outside of California. The *Ventas* decision does not address the circumstance where an LLC did not earn any income from activities in California or where an LLC earned all of its income from activities in California. Those circumstances are being addressed in separate cases.

The LLC Fee Prior to January 1, 2007

Prior to the enactment of Assembly Bill 198 (Stats. 2007, ch. 381, effective on October 10, 2007, and operative for taxable years beginning on or after January 1, 2007), LLCs paid an annual fee based on the LLC's total income from all sources reportable to the state. The LLC fee was in addition to the annual tax set forth in CR&TC section 17941. Former CR&TC section 17942, subdivision (b)(1), defined total income as "gross income, as defined in Section 24271, plus the cost of goods sold that are paid or incurred in connection with the trade or business of the taxpayer." Therefore, an LLC doing business within and outside of California was required to pay the LLC fee based on its worldwide total income, regardless of the fact that a portion of its income was attributable to non-California sources.

The LLC Fee Beginning On or After January 1, 2007

After the enactment of Assembly Bill 198, CR&TC section 17942 was revised. The LLC fee is now determined by reference to the total income derived from or attributable to California. The total income attributable to California is determined by utilizing the sales factor rules contained in CR&TC sections 25135 and 25136, and the regulations under these sections (as modified by the regulations under CR&TC section 25137, if applicable). The regulations under CR&TC section 25137 that exclude receipts from the sales factor entirely will not be applied.

The LLC Fee Litigation

Three separate cases have been filed challenging the constitutionality of the LLC fee as calculated pursuant to former CR&TC section 17942. Each case presents separate factual circumstances. Two of the cases, *Ventas Finance I, LLC* and *Northwest Energetic Services, LLC (Northwest)*, are now final with respect to the constitutional issue regarding the LLC fee as calculated pursuant to former CR&TC section 17942. The third case, *Bakersfield Mall, LLC*, is ongoing.

Ventas Finance I, LLC v. Franchise Tax Board – The LLC in this case had income attributable to activities within and outside California. The Court of Appeal held former CR&TC section 17942 was unconstitutional as applied to *Ventas* because the

statute did not provide a method of fair apportionment for calculating the total income used to determine the LLC fee. The Court of Appeal concluded Ventas' refund was limited to the amount of the LLC fee that "exceeds the amount it would have been assessed, without violating the Commerce Clause, using a method of fair apportionment." This case is now final with respect to the constitutional issue.²

Northwest Energetic Services, LLC v. Franchise Tax Board³ – The LLC in this case registered with the Secretary of State but did no business in California. The Court of Appeal held that assessing an LLC fee on an entity that had no income attributable to activities in California was unconstitutional and the fee should be refunded. This case is now final with respect to the constitutional issue.⁴

Bakersfield Mall, LLC v. Franchise Tax Board – San Francisco Superior Court CGC-07-462728 – The LLC in this case alleges it conducted all of its activities in California. The case is ongoing.

Claims for Refund Previously Filed

The FTB received a number of claims for refund from LLCs based upon the above cases. Action on these claims was deferred pending the outcome of the LLC fee litigation described above. Once the decision in *Northwest* was final with respect to the constitutional issue, the FTB began processing claims for refund from LLCs with the same factual situation as *Northwest*. (See FTB Notice 2008-2.) Because the decision in *Ventas* is now final with respect to the constitutional issue, action can be taken on claims for refunds from LLCs that have substantially the same factual situation as Ventas, an LLC that earned income attributable to activities within and outside of California.

If you filed a claim for refund with the same factual circumstance as Ventas, the refund will be computed using one of two methods:

- **Default Method:** If the LLC attached a Schedule R to its LLC Return of Income (Form 568) filed for each year that a claim for refund has been submitted, the FTB will use the amount reported on Schedule R, Schedule R-1, Total Sales, Column (b), *Total within California*, to calculate the revised LLC fee and compute the available refund, if any.
 - ***No additional information is needed if the LLC attached a Schedule R to its Form 568. The LLC does not need to resubmit a Schedule R.***

² *Ventas* was remanded to the superior court with respect to an attorneys' fees issue and the calculation of the LLC fee refund due to Ventas in accordance with the Court of Appeal's decision.

³ (2008) 159 Cal.App.4th 841, opn. mod. Mar. 3, 2008, review den. June 11, 2008.

⁴ *Northwest Energetic Services, LLC v. Franchise Tax Board* was remanded to the superior court with respect to the award of attorneys' fees.

- *However, if the LLC did not attach a Schedule R with its Form 568, the LLC needs to complete a Schedule R for each year that a claim for refund has been filed and submit the Schedule(s) R to FTB, as described below in items 1-4(a).*
- **Alternative Method:** An LLC may choose to have its refund calculated by completing the LLC Income Worksheet from the 2008 LLC Tax Booklet (Form 568 Booklet) with the respective information for each tax year that a claim for refund is filed.⁵
 - The LLC must provide the completed LLC Income Worksheet to FTB with a revised calculation of the LLC's Total California Income no later than August 20, 2009.
 - If the LLC does not provide this information by August 20, 2009, FTB will compute the revised LLC fee and the refund amount, if any, using the Default Method described above.

If you are using the **Default Method** to calculate your refund, **but did not attach a Schedule R to the Form 568**, or you choose to have the refund calculated using the **Alternative Method**, you must provide the following information:

1. The LLC's name and address, together with the name and phone number of the managing member or designated contact person.
2. The LLC's Secretary of State file number or Franchise Tax Board temporary LLC number (for unregistered entities), and Federal Employer Identification Number.
3. Tax years involved.
4. The LLC must choose either "(a)" or "(b)":
 - (a) For the Default Method: a completed Schedule R if the LLC did not attach a Schedule R to the original Form 568 filed for each tax year that a claim for refund is filed, or
 - (b) For the Alternative Method: a completed 2008 LLC Income Worksheet with the respective information for each tax year that a claim for refund is filed.

If the LLC is using the **Default Method** and has provided the completed Schedule R, you are not required to submit any further information at this time.

This information may be faxed to the FTB at:

(916) 845-9796

Or this information may be mailed to:

**ABS 389 MS: F340
Franchise Tax Board
C/O FTB Notice 2009-04
P.O. Box 942867
Sacramento, CA 94267-8888**

⁵ The Form 568 Booklet is available at www.ftb.ca.gov, search for "2008 568 Booklet."

For Courier Service Delivery or Private Courier Mail:

ABS 389 MS: F340
Franchise Tax Board
C/O FTB Notice 2009-04
Sacramento, CA 95827

Faxed information will expedite the receipt of your information.

New Claims for Refund Based on the *Ventas* Decision

If an LLC wants to file a claim for refund based on the *Ventas* decision, the LLC or its representative should fax a letter to the FTB stating, "This letter constitutes a claim for refund for (taxpayer's name) – Income Earned Within and Outside of California." The letter must include:

- For LLCs using the **Default Method**: the information listed above in items 1-4(a) under "Claims for Refund Previously Filed."
- For LLCs that choose the **Alternative Method**: the information listed above in items 1-3 and 4(b) under "Claims for Refund Previously Filed."

Fax this letter and additional information to (916) 845-9796 or mail to one of the addresses shown above. The LLC's managing member or representative with a power of attorney must sign this letter, under penalty of perjury. Note that claims may only be filed for those tax years for which the statute of limitations remains open.

Protective Claims for Refund based on *Bakersfield Mall, LLC v. Franchise Tax Board*

For more information about filing a protective claim for refund based on the pending case of *Bakersfield Mall, LLC v. Franchise Tax Board*, please see the instructions contained in the FTB Public Service Bulletin (PSB) issued July 13, 2007.⁶

Claims for Refund Based on the *Northwest* Decision

For information about filing a claim for refund based on the *Northwest* decision, for an LLC that did no business and earned no income in California, please see FTB Notice 2008-2.

The principal author of this notice is Jeanne M. Sibert of the Franchise Tax Board, Legal Division. For further information regarding this notice, contact Ms. Sibert at P.O. Box 1720, MS A260, Rancho Cordova, CA 95741-1720.

⁶ This PSB is available at www.ftb.ca.gov, search for "PSB 2007-07-13."