



October 19, 2018

## LEGAL RULING 2018 - 01

### SUBJECT: MODIFICATION OF LEGAL RULING 2014-01: BUSINESS ENTITIES THAT ARE MEMBERS OF MULTIPLE-MEMBER LIMITED LIABILITY COMPANIES CLASSIFIED AS PARTNERSHIPS FOR TAX PURPOSES

#### PURPOSE

Legal Ruling 2014-01 sets forth the department's analysis on a number of "doing business" scenarios involving members of multiple-member limited liability companies (LLCs) that are classified as partnerships for tax purposes. After a review of subsequent judicial authority, the Franchise Tax Board has determined that some of the language in that ruling, specifically relating to the relevance of the distinction between "manager-managed" LLCs and "member-managed" LLCs, should be revised to provide additional clarity and guidance.

#### DESCRIPTION OF SPECIFIC MODIFICATIONS

The first paragraph on page four of Legal Ruling 2014-01 is modified to read:

If an LLC is treated as a partnership for tax purposes, both the LLC and its members, are subject to the same legal principles applicable to any partnership. Thus, if an LLC classified as a partnership for tax purposes is "doing business" in California under Section 23101, the members of the LLC are themselves generally considered to be "doing business" in California. A narrow exception may apply in limited circumstances. (See *Swart Enterprises, Inc. v. Franchise Tax Board* (Cal. App. 5th Dist. 2017) 7 Cal. App. 5th 497; see also FTB Notice 2017-01, Subject: Court of Appeal Decision in *Swart Enterprises, Inc. v. Franchise Tax Board*, February 28, 2017.)

The third paragraph on page 10 of Legal Ruling 2014-01 is modified to read:

Yes. Because LLC I is classified as a partnership for tax purposes and is "doing business" in California within the meaning of Section 23101, all of LLC I's members are generally considered to be "doing business" in California, and thus have California return filing requirements and are subject to all applicable taxes and fees, because LLC I's attribute of "doing business" is attributed to its members under general principles of partnership law. A narrow exception may apply in limited circumstances. (See *Swart Enterprises, Inc. v. Franchise Tax Board* (Cal. App. 5th Dist. 2017) 7 Cal. App. 5th 497 ("Swart"); see also FTB Notice 2017-01, Subject: Court of Appeal Decision in *Swart Enterprises, Inc. v. Franchise Tax Board*, February 28, 2017.) Please note that Member J's 15 percent membership interest in

LLC I greatly exceeds the taxpayer's 0.2 percent membership interest in the *Swart* Court of Appeal decision.

#### **EFFECT ON OTHER RULINGS**

Legal Ruling 2014-01 is modified as described herein.

#### **DRAFTING INFORMATION**

The principal author of this Legal Ruling is Adam J. Susz of the Franchise Tax Board, Legal Division. For further information regarding this ruling, contact Mr. Susz at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, California 95741-1720.