



November 20, 2019

LEGAL RULING - 2019-02

SUBJECT: Annual Tax and Return Filing Requirements of a Limited Partnership that is Disregarded for Federal Income Tax Purposes

ISSUE

Whether a limited partnership that is disregarded for federal income tax purposes pursuant to federal eligible entity classification regulations (a "federal DLP") is subject to the California annual limited partnership tax and the requirement to file a California partnership return?

SITUATION

Taxpayer-Partner is an entity recognized for federal income tax purposes and is a partner under local law in a domestic (U.S.) limited partnership (LP 1). The other partners (Disregarded Partners) under local law are wholly-owned by Taxpayer-Partner and are disregarded entities pursuant to federal Treasury Regulations promulgated under Internal Revenue Code section 7701 (federal entity classification regulations)¹. As a result, pursuant to the same federal entity classification regulations, Taxpayer-Partner is treated as the sole owner of LP 1. Under the federal entity classification regulations (commonly referred to as the "check-the-box" regulations), unless LP 1 makes an election to be classified as an association taxable as a corporation, LP 1 is classified as a disregarded entity and is treated for federal income tax purposes as a division of its owner or as a sole proprietorship.

LAW AND ANALYSIS

A federal DLP can exist in various factual situations. These include when Taxpayer-Partner is the sole owner in the limited partnership for federal income tax purposes and all other partners are Disregarded Partners wholly-owned by Taxpayer-Partner. The

¹ United States Treasury Regulation section 301.7701-2(c)(2),

ownership structure in the situation described above results in the limited partnership having a single owner for federal income tax purposes and results in the limited partnership being disregarded for federal income tax purposes unless it elects to be classified as an association taxable as a corporation. (See IRS Rev. Rul. 2004-77.)

California Revenue and Taxation Code ("CRTC") section 23038(b)(2)(B)(iii) generally conforms to the federal check-the-box entity classification rules for eligible business entities, with the result that eligible entities that are disregarded for federal income tax purposes are also generally disregarded for California income and franchise tax purposes. CRTC section 23038(b)(2)(B)(iii) provides that: "If the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of that business entity shall be disregarded for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401)..." The language also provides limited exceptions to this general rule relating to the annual tax, fee, and return filing requirements, as well as the use of tax credits, for limited liability companies. However, CRTC section 23038(b)(2)(B)(iii) does not contain any exceptions for the annual limited partnership tax or partnership return filing requirement for limited partnerships under CRTC sections 17935 and 18633. Thus, the language of CRTC section 23038(b)(2)(B)(iii) indicates that there is no annual limited partnership tax or partnership return filing requirement for limited partnerships that are disregarded for federal income tax purposes. Therefore, DLPs are not required to pay the annual limited partnership tax under CRTC section 17935 or file a partnership return pursuant to CRTC section 18633.

HOLDING

CRTC section 23038(b)(2)(B)(iii) states that if the separate existence of an eligible business entity is disregarded for federal tax purposes, its separate existence is generally disregarded for California franchise and income tax purposes other than for purposes of expressly specified limited exceptions. The exceptions from the general rule identified in CRTC section 23038(b)(2)(B)(iii) do not apply to a federal DLP such as LP 1. Therefore, LP 1 is not subject to the annual limited partnership tax and partnership return filing requirements under CRTC sections 17935 and 18633.

DRAFTING INFORMATION

The principal author of this legal ruling is Michael R. Laisné of the Franchise Tax Board, Legal Division. For further information regarding this ruling, contact Mr. Laisné at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, California 95741-1720.