



## BUSINESS LAW SECTION

NONPROFIT & UNINCORPORATED ORGANIZATIONS COMMITTEE  
THE STATE BAR OF CALIFORNIA  
180 Howard Street  
San Francisco, CA 94105-1639  
<http://www.calbar.org/buslaw/nonprofits/>

### ***TAX EXEMPTION AND EXEMPTION PROCESS FOR SINGLE MEMBER LLC***

#### **LEGISLATIVE PROPOSAL (BLS-2011-04)**

**TO:** Office of Governmental Affairs  
**FROM:** Lani Meanley Collins, Chair  
Business Law Section (the “Section”) Nonprofit & Unincorporated Organizations Committee  
(the “Committee”)  
**DATE:** June 1, 2010  
**RE:** Proposal to amend Revenue & Taxation Code Sections 17941, 17942, 18633.5, and 23701d

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#### **SECTION ACTION AND CONTACTS**

Date of Approval by Section Executive Committee (the “Executive Committee”): July 16, 2010

Approval Vote: For: 15      Against: 0

<b>Executive Committee Contact:<sup>1</sup></b>	<b>Committee Contact:</b>
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#### **HISTORY, DIGEST AND PURPOSE**

This Proposal seeks to conform California tax law to federal tax law regarding the treatment of a single member limited liability company (“LLC”) whose sole member is a tax-exempt entity and to further streamline the process for obtaining an acknowledgement of tax-exempt status under Revenue and Taxation Code Section 23701d(c).

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<sup>1</sup> Contact information is as of the date submitted. After completion of the State Bar Annual Meeting following submission, the Committee will submit a Supplemental Contacts Information sheet to the Office of Governmental Affairs providing corresponding contact information for the following Bar year.

## **History**

Revenue and Taxation Code Section 17941 was chaptered in 1996. It was subsequently amended in 1997, 2002, 2003, and 2004. Section 17942 was also chaptered in 1996. It was subsequently amended in 2001, 2002, 2007, and 2008. Revenue and Taxation Code Section 18633.5 was chaptered in 1994, and subsequently amended in 1996, 1997, 1998, 2000, 2001, and 2005. Revenue and Taxation Code Section 23701d was chaptered in 1949, and subsection (c) was added in 2008 and amended in 2010.

## **Proposal and Reasons for the Proposal**

### Single Member LLCs

Under federal tax law, a single member LLC can be a disregarded entity for federal income tax purposes. Such a single member LLC whose sole member is an exempt organization is not required to file Form 1023/1024 for federal income tax exemption and is reported on the member's return. On the other hand, under current California law, a single member LLC formed by an exempt organization, other than a title holding company, is not disregarded for purposes of the LLC franchise tax, fee, and filing requirement. In order to be exempt, a single member LLC is required to file Form 3500 with the Franchise Tax Board and elect to be treated as a corporation under federal tax law. This, in turn, necessitates filing IRS Form 1023/1024 for the organization, since it is no longer disregarded for federal purposes if it is treated as a corporation. The alternative is for the single member LLC to pay the annual franchise fee. By removing the necessity to file for exemption to avoid having to pay fees and taxes, this makes the use of the single member LLC much more cost effective and brings the law in line with other states as well as federal tax law.

This Proposal amends Revenue and Taxation Code Sections 17941, 17942, and 18633.5 in order to exempt single member LLCs from the LLC franchise tax and fee and the requirements of filing a return as long as the member is and remains an exempt entity.

### Acknowledgement of Tax-Exempt Status

This Proposal will help the Franchise Tax Board and tax-exempt corporations utilize the streamlined process for acknowledgement of tax exemption under Revenue and Taxation Code Section 23701d in an efficient manner. An organization that has received a determination from the IRS that it is tax exempt under Internal Revenue Code Section 501(c)(3) can apply for an acknowledgement of tax-exempt status using the simplified Form 3500A (Submission of Exemption Request). Under the current law, the Franchise Tax Board has no authority to require that a corporation be in good standing with the Secretary of State and Franchise Tax Board when it reviews the corporation's Form 3500A and attached documents. Thus, the Franchise Tax Board may issue its acknowledgement letter to a corporation that is not in good standing with both the Secretary of State and the Franchise Tax Board. The Franchise Tax Board's only recourse once it has issued the acknowledgement letter is to revoke the corporation's tax exemption and require that the corporation file a full Form 3500 if the corporation wishes to re-apply for tax-exempt status. This Proposal will enable the Franchise Tax Board to require that a

corporation applying for tax exemption is in good standing before the Franchise Tax Board issues its acknowledgement letter, thus promoting the efficient use of the government's and the taxpayer's time.

#### **APPLICATION**

If enacted in 2011, the proposed legislation would become effective in 2012.

#### **PENDING LITIGATION**

We are not aware of any specific pending litigation that would be affected by this Proposal.

#### **LIKELY SUPPORT AND OPPOSITION**

We anticipate support from organizations tax exempt in California but have not taken any steps to assess the potential for such support, much less solicit it. We believe that these changes address concerns voiced by the Franchise Tax Board. We are unaware of any specific segments that might oppose this Proposal.

#### **FISCAL IMPACT**

None known.

#### **GERMANENESS**

The matters addressed in this Proposal require the special knowledge, training, experience or technical expertise of the Section and of members of the Committee. The position advanced would promote clarity, consistency, and comprehensiveness in the law.

**TEXT OF PROPOSAL**

**§ 17941.** (a) For each taxable year beginning on or after January 1, 1997, a limited liability company doing business in this state (as defined in Section 23101) shall pay annually to this state a tax for the privilege of doing business in this state in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 for the taxable year.

(b) (1) In addition, ~~to~~ any limited liability company that is doing business in this state and is therefore subject to the tax imposed by subdivision (a), for each taxable year beginning on or after January 1, 1997, a limited liability company shall pay annually the tax prescribed in subdivision (a) if articles of organization have been accepted, or a certificate of registration has been issued, by the office of the Secretary of State. The tax shall be paid for each taxable year, or part thereof, until a certificate of cancellation of registration or of articles of organization is filed on behalf of the limited liability company with the office of the Secretary of State.

(2) If a taxpayer files a return with the Franchise Tax Board that is designated as its final return, the Franchise Tax Board shall notify the taxpayer that the annual tax shall continue to be due annually until a certificate of cancellation is filed with the Secretary of State pursuant to Section 17356 or 17455 of the Corporations Code.

*(c) Notwithstanding subdivisions (a) and (b) of this section and clause (iii) of subparagraph (B) of paragraph (2) of subdivision (b) of Section 23038, a limited liability company whose separate existence is disregarded pursuant to Section 23038 and whose sole member is either an entity exempt under Chapter 7 (Commencing with Section 17631) of Part 10, or an entity exempt under Chapter 4 (commencing with Section 23701) of Part 11, or a federal, state, or local governmental entity shall not be subject to the tax imposed under this section, except for an insurance company described in Section 28 of Article XIII of the California Constitution.*

~~(d)-(e)~~ The tax assessed under this section shall be due and payable on or before the 15th day of the fourth month of the taxable year.

~~(e) (d)~~ For purposes of this section, "limited liability company" means an organization, other than a limited liability company that is exempt from the tax and fees imposed under this chapter pursuant to Section 23701h or Section 23701x, that is formed by one or more persons under the law of this state, any other country, or any other state, as a "limited liability company" and that is not taxable as a corporation for California tax purposes.

~~(f) (e)~~ Notwithstanding anything in this section to the contrary, if the office of the Secretary of State files a certificate of cancellation pursuant to Section 17350.5 of the Corporations Code for any limited liability company, then paragraph (1) of subdivision (f) of Section 23153 shall apply to that limited liability company as if the limited liability company were properly treated as a corporation for that limited purpose only, and paragraph (2) of subdivision (f) of Section 23153 shall not apply. Nothing in this subdivision entitles a limited liability company to receive a reimbursement for any annual taxes or fees already paid.

**§ 17942.** (a) In addition to the tax imposed under Section 17941, every limited liability company subject to tax under Section 17941 shall pay annually to this state a fee equal to:

(1) Nine hundred dollars (\$900), if the total income from all sources derived from or attributable to this state for the taxable year is two hundred fifty thousand dollars (\$250,000) or more, but less than five hundred thousand dollars (\$500,000).

(2) Two thousand five hundred dollars (\$2,500), if the total income from all sources derived from or attributable to this state for the taxable year is five hundred thousand dollars (\$500,000) or more, but less than one million dollars (\$1,000,000).

(3) Six thousand dollars (\$6,000), if the total income from all sources derived from or attributable to this state for the taxable year is one million dollars (\$1,000,000) or more, but less than five million dollars (\$5,000,000).

(4) Eleven thousand seven hundred ninety dollars (\$11,790), if the total income from all sources derived from or attributable to this state for the taxable year is five million dollars (\$5,000,000) or more.

(b) (1) (A) For purposes of this section, "total income from all sources derived from or attributable to this state" means 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. However, "total income from all sources derived from or attributable to this state" shall not include allocation or attribution of income or gain or distributions made to a limited liability company in its capacity as a member of, or holder of an economic interest in, another limited liability company if the allocation or attribution of income or gain or distributions are directly or indirectly attributable to income that is subject to the payment of the fee described in this section.

(B) For purposes of this section, "total income from all sources derived from or attributable to this state" shall be determined using the rules for assigning sales under Sections 25135 and 25136 and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor.

*(C) Notwithstanding clause (iii) of subparagraph (B) of paragraph (2) of subdivision (b) of Section 23038, a limited liability company whose separate existence is disregarded pursuant to Section 23038 and whose sole member is either an entity exempt under Chapter 7 (Commencing with Section 17631) of Part 10, or an entity exempt under Chapter 4 (commencing with Section 23701) of Part 11, or a federal, state, or local governmental entity shall not be subject to the fee imposed under this section, except for an insurance company described in Section 28 of Article XIII of the California Constitution.*

(2) In the event a taxpayer is a commonly controlled limited liability company, the total income from all sources derived from or attributable to this state, taking into account any election under Section 25110, may be determined by the Franchise Tax Board to be the total income of all the commonly controlled limited liability company members if it determines that multiple limited liability companies were formed for the primary purpose of reducing fees payable under this section. A determination by the Franchise Tax Board under this subdivision may only be made with respect to one limited liability company in a commonly controlled group. However, each commonly controlled limited liability company shall be jointly and severally liable for the fee. For purposes of this section, commonly controlled limited liability companies shall include the taxpayer and any other partnership or limited liability company doing business (as defined in Section 23101) in this state and required to file a return under Section 18633 or 18633.5, in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

(c) The fee assessed under this section shall be due and payable on the date the return of the limited liability company is required to be filed under Section 18633.5, shall be collected and refunded in the same manner as the taxes imposed by this part, and shall be subject to interest and applicable penalties.

(d) (1) The fee imposed by this section shall be estimated and paid on or before the 15th day of the sixth month of the current taxable year.

(2) A penalty of 10 percent of the amount of any underpayment shall be added to the fee. The underpayment amount shall be equal to the difference between the total amount of the fee imposed by this section for the taxable year less the amount paid under paragraph (1) by the date specified in that paragraph. A penalty shall not be imposed with respect to any fee estimated and paid under this section if the amount paid by the date prescribed in this subdivision is equal to or greater than the total amount of the fee of the limited liability company for the preceding taxable year.

**§ 18633.5.** (a) Every limited liability company which is classified as a partnership for California tax purposes that is doing business in this state, organized in this state, or registered with the Secretary of State shall file its return on or before the fifteenth day of the fourth month following the close of its taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). The return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under penalty of perjury, signed by one of the limited liability company members. In the case of a limited liability company not doing business in this state, and subject to the tax imposed by subdivision (b) of Section 17941, the Franchise Tax Board shall, for returns required to be filed on or after January 1, 1998, prescribe the manner and extent to which the information identified in this subdivision shall be included with the return required by this subdivision.

(b) Each limited liability company required to file a return under subdivision (a) for any limited liability company taxable year shall, on or before the day on which the return for that taxable year was required to be filed, furnish to each person who holds an interest in that limited liability company at any time during that taxable year a copy of that information required to be shown on that return as may be required by forms and instructions prescribed by the Franchise Tax Board.

(c) Any person who holds an interest in a limited liability company as a nominee for another person shall do both of the following:

(1) Furnish to the limited liability company, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that person, and any other information for that taxable year as the Franchise Tax Board may prescribe by forms and instructions.

(2) Furnish to that other person, in the manner prescribed by the Franchise Tax Board, the information provided by that limited liability company under subdivision (b).

(d) The provisions of Section 6031(d) of the Internal Revenue Code, relating to the separate statement of items of unrelated business taxable income, shall apply.

(e) (1) A limited liability company shall file with its return required under subdivision (a), in the form required by the Franchise Tax Board, the agreement of each nonresident member to file a return pursuant to Section 18501, to make timely payment of all taxes imposed on the member by this state with respect to the income of the limited liability company, and to be subject to personal jurisdiction in this state for purposes of the collection of income taxes, together with related interest and penalties, imposed on the member by this state with respect to the income of the limited liability company. If the limited liability company fails to timely file the agreements

on behalf of each of its nonresident members, then the limited liability company shall, at the time set forth in subdivision (f), pay to this state on behalf of each nonresident member of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under Section 17041, in the case of members which are individuals, estates, or trusts, and Section 23151, in the case of members that are corporations, multiplied by the amount of the member's distributive share of the income source to the state reflected on the limited liability company's return for the taxable period, reduced by the amount of tax previously withheld and paid by the limited liability company pursuant to Section 18662 and the regulations thereunder with respect to each nonresident member. A limited liability company shall be entitled to recover the payment made from the member on whose behalf the payment was made.

(2) If a limited liability company fails to attach the agreement or to timely pay the payment required by paragraph (1), the payment shall be considered the tax of the limited liability company for purposes of the penalty prescribed by Section 19132 and interest prescribed by Section 19101 for failure to timely pay the tax. Payment of the penalty and interest imposed on the limited liability company for failure to timely pay the amount required by this subdivision shall extinguish the liability of a nonresident member for the penalty and interest for failure to make timely payment of all taxes imposed on that member by this state with respect to the income of the limited liability company.

(3) No penalty or interest shall be imposed on the limited liability company under paragraph (2) if the nonresident member timely files and pays all taxes imposed on the member by this state with respect to the income of the limited liability company.

(f) Any agreement of a nonresident member required to be filed pursuant to subdivision (e) shall be filed at either of the following times:

(1) The time the annual return is required to be filed pursuant to this section for the first taxable period for which the limited liability company became subject to tax pursuant to Chapter 10.6 (commencing with Section 17941).

(2) The time the annual return is required to be filed pursuant to this section for any taxable period in which the limited liability company had a nonresident member on whose behalf an agreement described in subdivision (e) has not been previously filed.

(g) Any amount paid by the limited liability company to this state pursuant to paragraph (1) of subdivision (e) shall be considered to be a payment by the member on account of the income tax imposed by this state on the member for the taxable period.

(h) Every limited liability company that is classified as a corporation for California tax purposes shall be subject to the requirement to file a tax return under the provisions of Part 10.2 (commencing with Section 18401) and the applicable taxes imposed by Part 11 (commencing with Section 23001).

(i) (1) Every limited liability company doing business in this state, organized in this state, or registered with the Secretary of State, that is disregarded pursuant to Section 23038 shall file a return that includes information necessary to verify its liability under Sections 17941 and 17942, provides its sole owner's name and taxpayer identification number, includes the consent of the owner to California tax jurisdiction, and includes other information necessary for the administration of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(2) If the owner's consent required under paragraph (1) is not included, the limited liability company shall pay on behalf of its owner an amount consistent with, and treated the same as, the amount to be paid under subdivision (e) by a limited liability company on behalf of a nonresident

member for whom an agreement required by subdivision (e) is not attached to the return of the limited liability company.

(3) The return required under paragraph (1) shall be filed on or before the fifteenth day of the fourth month after the close of the taxable year of the owner subject to tax under Part 10 (commencing with Section 17001) of Division 2 or on or before the fifteenth day of the third month after the close of the taxable year of the owner subject to tax under Chapter 2 (commencing with Section 23101) of Part 11 of Division 2, whichever is applicable.

(4) For limited liability companies disregarded pursuant to Section 23038, "taxable year of the owner" shall be substituted for "taxable year" in Sections 17941 and 17942.

*(5) Notwithstanding paragraph (1) of this subdivision and clause (iii) of subparagraph (B) of paragraph (2) of subdivision (b) of Section 23038, a limited liability company whose separate existence is disregarded pursuant to Section 23038 and whose sole member is either an entity exempt under Chapter 7 (Commencing with Section 17631) of Part 10, or an entity exempt under Chapter 4 (commencing with Section 23701) of Part 11, or a federal, state, or local governmental entity shall not file a return under this section, except for an insurance company described in Section 28 of Article XIII of the California Constitution.*

(j) The amendments made by the act adding this subdivision apply to taxable years beginning on or after January 1, 2005.

**§ 23701d.** (a) A corporation, community chest or trust, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involved the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation, (except as otherwise provided in Section 23704.5), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. An organization is not organized exclusively for exempt purposes listed above unless its assets are irrevocably dedicated to one or more purposes listed in this section. Dedication of assets requires that in the event of dissolution of an organization or the impossibility of performing the specific organizational purposes the assets would continue to be devoted to exempt purposes. Assets shall be deemed irrevocably dedicated to exempt purposes if the articles of organization provide that upon dissolution the assets will be distributed to an organization which is exempt under this section or Section 501(c)(3) of the Internal Revenue Code or to the federal government, or to a state or local government for public purposes; or by a provision in the articles of organization, satisfactory to the Franchise Tax Board; that the property will be distributed in trust for exempt purposes; or by establishing that the assets are irrevocably dedicated to exempt purposes by operation of law. The irrevocable dedication requirement shall not be a sole basis for revocation of an exempt determination made by the Franchise Tax Board prior to the effective date of this amendment.

(b) (1) In the case of a qualified amateur sports organization--

(A) The requirement of subdivision (a) that no part of its activities involves the provision of athletic facilities or equipment shall not apply.

(B) That organization shall not fail to meet the requirements of subdivision (a) merely because its membership is local or regional in nature.

(2) For purposes of this subdivision, "qualified amateur sports organization" means any organization organized and operated exclusively to foster national or international amateur sports competition if that organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

(c) (1) Notwithstanding subdivisions (a), (b), and (c) of Section 23701, an organization organized and operated for nonprofit purposes in accordance with this section shall be exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731), upon its submission to the Franchise Tax Board of one of the following:

(A) A copy of the determination letter or ruling issued by the Internal Revenue Service recognizing the organization's exemption from federal income tax under Section 501(a) of the Internal Revenue Code, as an organization described in Section 501(c)(3) of the Internal Revenue Code.

(B) A copy of the group exemption letter issued by the Internal Revenue Service that states that both the central organization and all of its subordinates are tax-exempt under Section 501(c)(3) of the Internal Revenue Code and substantiation that the organization is included in the federal group exemption letter as a subordinate organization.

(2) Upon receipt of the documents required in subparagraph (A) or (B) of paragraph (1), the Franchise Tax Board shall issue an acknowledgment that the organization is exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731). The acknowledgment may refer to the organization's recognition by the Internal Revenue Service of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code and, if applicable, the organization's subordinate organization status under a federal group exemption letter. The effective date of an organization's exemption from state income tax pursuant to this subdivision shall be no later than the effective date of the organization's recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code, or its status as a subordinate organization under a federal group exemption letter, as applicable. *Notwithstanding any other provisions of this subdivision, an organization formed as a California corporation or qualified to do business in California that, as of the date of receipt by the Franchise Tax Board of the documents required under paragraph (1), is listed by the Secretary of State or Franchise Tax Board as "suspended" or "forfeited" may not establish its exemption under paragraph (1) and shall not receive an acknowledgement referred to under this paragraph until such time as such corporation is listed by the Secretary of State and Franchise Tax Board as an "active" corporation.*

(3) If, for federal income tax purposes, an organization's exemption from tax as an organization described in Section 501(c)(3) of the Internal Revenue Code is suspended or revoked, the organization shall notify the Franchise Tax Board of the suspension or revocation, in the form and manner prescribed by the Franchise Tax Board. Upon notification, the board shall suspend or revoke, whichever is applicable, for state income tax purposes, the organization's exemption under paragraph (1) of this subdivision.

(4) This subdivision shall not be construed to prevent the Franchise Tax Board from revoking the exemption of an organization that is not organized or operated in accordance with this chapter or Section 501(c)(3) of the Internal Revenue Code.

(5) If the Franchise Tax Board suspends or revokes the exemption of an organization pursuant to paragraph (3) or (4), the exemption shall be reinstated only upon compliance with

Section 23701, regardless of whether the organization can establish exemption under paragraph (1).

(d) The Franchise Tax Board may prescribe rules and regulations to implement this section.