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12.08.15

Chief Counsel Ruling 2015-02

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### Re: Request for Chief Counsel Ruling

Dear Mr. \*\*\*\*\*

You requested a Chief Counsel Ruling regarding the California filing requirements of a California single member limited liability company that is disregarded for federal tax purposes, as well as its sole owner, which is a tax-exempt entity.

### FACTS

\*\*\*\*\* , LLC ("\*\*\*\*\*" organized in California on \*\*\*\*\*  
\*\*\*\*\* is a single member limited liability company ("SMLLC") that is classified as a disregarded entity for federal tax purposes. \*\*\*\*\* states that it owns raw land (home sites) and vineyards in California, where it grows and sells grapes. \*\*\*\*\* states that it is "doing business" in California within the meaning of California Revenue & Taxation Code ("RTC") section 23101. \*\*\*\*\* is wholly owned by the \*\*\*\*\*  
\*\*\*\*\* ("\*\*\*\*\*" is a single-employer pension and retirement fund for police officers and firefighters employed by the \*\*\*\*\* , \*\*\*\*\* The Internal Revenue Service ("IRS") issued a determination letter stating that \*\*\*\*\* is a trust qualified, and exempt from federal income taxes, under Internal Revenue Code ("IRC") Section 501(a) as a governmental benefit plan under Section 401(a). \*\*\*\*\* states that it is "doing business" in California within the meaning of RTC section 23101 because of its disregarded SMLLC's (\*\*\*\*\* activities. \*\*\*\*\* states that it does not have unrelated business taxable income ("UBTI").

### ISSUES

1. Whether \*\*\*\*\* has a requirement to file a tax return in California.
2. Whether \*\*\*\*\* has a requirement to file a tax return in California.

### HOLDING

1. \*\*\*\*\* has a filing requirement in California and is subject to LLC annual tax and fee.
2. \*\*\*\*\* does not have a filing requirement in California because of its Federal tax-exempt status under IRC section 501(a) as a governmental benefit plan under Section 401(a).

## DISCUSSION

### ISSUE 1

RTC section 23038(b)(2)(B)(iii) states that an eligible business entity (like a SMLLC) that is disregarded for federal tax purposes will also be generally disregarded for California tax purposes; however, this general rule does not apply for purposes of the \$800 LLC tax,<sup>1</sup> the LLC fee,<sup>2</sup> and the LLC return filing requirement.<sup>3</sup> The relevant provisions of California law that result in a disregarded SMLLC having a California filing requirement and being subject to the LLC tax and fee are the following: (1) Registration to do business in California with California Secretary of State;<sup>4</sup> (2) Being organized in California with the California Secretary of State;<sup>5</sup> or (3) "Doing business" in California within the meaning of RTC section 23101.<sup>6</sup> If any of these three provisions apply in a given taxable year, then a disregarded SMLLC will have a California filing requirement and will be subject to the LLC tax and fee.<sup>7</sup>

Subdivision (a) of RTC section 23101 states that "doing business" means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. Subdivision (b) of RTC section 23101 provides that for taxable years beginning on or after January 1, 2011, a taxpayer is doing business in this state if the taxpayer is: (1) organized or commercially domiciled in this state; (2) has sales in this state that exceed the lesser of five hundred thousand dollars (\$500,000), or 25 percent of the taxpayer's total sales; (3) the real property and tangible personal property of the taxpayer in this state exceed the lesser of fifty thousand dollars (\$50,000) or 25 percent of the taxpayer's total real property and tangible personal property; or (4) compensation paid in this state exceeds the lesser of fifty thousand dollars (\$50,000) or 25% of total compensation paid by the taxpayer. The dollar amounts contained in the statute are indexed annually for inflation.

\*\*\*\*\* has represented that it is "doing business" in California pursuant to RTC section 23101. Additionally, \*\*\*\*\* is organized in California. Therefore, \*\*\*\*\* a SMLLC classified as a

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<sup>1</sup> Cal. Rev. & Tax Code, § 17941.

<sup>2</sup> Cal. Rev. & Tax. Code, § 17942.

<sup>3</sup> Cal. Rev. & Tax. Code, § 18633.5.

<sup>4</sup> See Cal. Rev. & Tax. Code, § 17941(a) and (b)(1).

<sup>5</sup> See Cal. Rev. & Tax. Code, § 17941(a) and (b)(1).

<sup>6</sup> See Cal. Rev. & Tax. Code, § 17941(a).

<sup>7</sup> Every LLC that is subject to the tax under Section 17941 is also subject to the fee under Section 17942. (See Cal. Rev. & Tax Code, § 17942(a).)

disregarded entity and wholly owned by a tax exempt pension trust, has a California filing requirement and is subject to the LLC tax and fee.

## ISSUE 2

California tax law conforms to federal law regarding the tax classification of eligible business entities, and specifically mandates that an eligible business entity's federal and California tax classification be the same.<sup>8</sup>

In the case of an eligible business entity like an SMLLC, federal and California law allow the SMLLC to elect how it will be classified for tax purposes.<sup>9</sup> Specifically, the SMLLC may choose the default treatment of being disregarded as an entity separate and distinct from its sole owner.<sup>10</sup> In the alternative, the SMLLC can elect to "check-the-box" on the Entity Classification Election (Federal Form 8832) to be classified as a corporation for tax purposes. If the separate entity status of the SMLLC is disregarded, the activities of the SMLLC are treated in the same manner as a sole proprietorship or division of the SMLLC's sole owner.<sup>11</sup> Thus, if a disregarded SMLLC is owned by another business entity, the activities of the disregarded SMLLC are treated as the activities of a division of the owner. If the activities of a division are sufficient to be considered "doing business" (within the meaning of RTC section 23101) in California, those activities are sufficient to treat the owner as "doing business" in California.<sup>12</sup>

Based on \*\*\*\*\* representation that it is "doing business" in California within the meaning of RTC section 23101 because of its disregarded SMLLC's (\*\*\*\*\* activities, this ruling will move forward with the analysis based on that representation.

Pursuant to RTC section 17631, California generally conforms to the Federal tax exemption provided under IRC section 401(a). IRC section 401 provides automatic tax exemption to pension plans, without a requirement to file for exemption or request a federal determination letter. As California conforms to IRC section 401, the Franchise Tax Board ("FTB") does not require pension plans described in IRC section 401(a) to file an Exemption

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<sup>8</sup> See e.g., Cal. Rev. & Tax. Code, §§ 23038, subd. (b)(2)(B)(iii), 23800, and 23800.5; Int.Rev. Code, § 1361; Treas. Reg., §§ 301.7701-2(a) and 3.

<sup>9</sup> See FTB Legal Ruling 2011-01: Activities of a Disregarded Entity. The Legal Ruling deals with a SMLLC that is disregarded for tax purposes.

<sup>10</sup> See Treas. Regs., § 301.7701-3(a); Cal. Code Regs., tit. 18, § 23038(b)-2(a). See also *Britton v. Shulman* (1st Cir. 2010) 106 A.F.T.R.2d 6048, affg. *Medical Practice Solutions LLC, Carolyn Britton, Sole Member v. Commissioner* (March 31, 2009) 132 T.C. 125; *McNamee v. Dept. of the Treas.* (2nd Cir. 2007) 488 F.3d 100; and *Littriello v. U.S.* (6th Cir. 2007) 484 F.3d 372.

<sup>11</sup> *Ibid.*

<sup>12</sup> See, e.g., *Appeal of Atlantic, Gulf and Pacific Company of Manila, Inc.*, 82-SBE-255, Nov. 17, 1982 [Activities of Taxpayer's machinery sales division in California sufficient to create nexus to impose California franchise tax].

Application (Form 3500).<sup>13</sup> Additionally, RTC section 18506 and California Code Regulations, title 18, section 23772(a)(1)(E) states that a pension trust exempt under RTC section 17631 (conforming to IRC section 401(a)) is not required to file an Exempt Organization Annual Information Return (Form 199).<sup>14</sup>

Pursuant to RTC section 17632, \*\*\*\*\* would be subject to taxation on any UBTI under RTC section 17651. \*\*\*\*\* states it does not have UBTI because it has not been actively conducting the business of growing and selling grapes for some time. However, \*\*\*\*\* states that it does anticipate getting back into the business of growing and selling grapes in the future. Whether or not \*\*\*\*\* has UBTI is not the focus of this Ruling; therefore, FTB is not taking any position on this issue.

While \*\*\*\*\* is "doing business" in California within the meaning of RTC section 23101, it does not have a filing requirement in California because of its exempt status as a governmental benefit plan under IRC section 401(a), to which California conforms pursuant to RTC section 17631. However, \*\*\*\*\* would have a filing requirement if it were to have UBTI, pursuant to RTC section 17632.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of RTC section 21012. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Sara A. Hosey  
Tax Counsel

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<sup>13</sup> FTB 3500 Booklet 2014 provides that pension plans described in IRC section 401(a) are not required to file an California Exemption Application (Form 3500) with the FTB. See FTB 3500 Booklet 2014, page 4.

<sup>14</sup> FTB Form 199 Instructions provides that pension trusts exempt under RTC section 17631 (IRC section 401(a)) are not required to file the California Exempt Organization Annual Information Return (Form 199); See FTB Form 199 Instructions, page 1.