



California LLC Fee Unconstitutional; Filing Protective Claim for Refund

CALIFORNIA LLC FEE UNCONSTITUTIONAL. The limited liability company fee imposed under California law recently was held to be unconstitutional according to the court in *Northwest Energetic Services, LLC v. California Franchise Tax Board* (Super. Ct. San Francisco County, 2006, No. CGC-05-437721). The decision states that the graduated fee imposed on the “total income” of an LLC (meaning gross income plus the cost of goods sold) under Section 17942 of the California Revenue and Taxation Code is illegal for violating the Commerce Clause and the Due Process Clause of the U.S. Constitution. Such fee currently starts at \$900 if total income is \$250,000 or more but less than \$500,000, and ranges upward, topping out at \$11,790 if total income is \$5,000,000 or more.

The decision does not affect the flat \$800 minimum tax on LLCs under Section 17941 of the R&TC, which continues to be valid.

The decision likely will be appealed, and corrective legislation is possible. The appeals process may take several years.

FILING PROTECTIVE CLAIM FOR REFUND. Even though the *Northwest Energetic Services* case dealt with the California LLC fee being imposed on a Washington State LLC, we recommend that all of our clients (both in-state LLCs and out-of-state LLCs) file a “protective claim for refund” with the California Franchise Tax Board (FTB).

A protective claim will preserve the client’s right to obtain a refund if the Superior Court ruling is upheld upon appeal, and the tax is indeed confirmed to be unconstitutional. Such a claim will also help meet the four-year statute of limitations for filing refunds. In this respect, a protective claim for refund for calendar year taxpayers must be filed with the FTB by April 17, 2006 for tax

year 2001. Fiscal year taxpayers may have different limitation periods. A calendar year taxpayer can make a protective claim for refund with respect to tax years 2001, 2002, 2003, 2004 and, upon filing and paying the tax for 2005, also for 2005.

What to Include. The following information must be included in a letter to the FTB asserting a protective claim for refund:

- Statement that it is a protective claim for refund
- Name of the LLC
- ID number issued by the Secretary of State (unregistered LLCs should use the ID number issued by the FTB)
- The tax years involved
- The amount of the claim (which should match the amount of the fee paid)
- Description of the issue, which can simply be a statement that the LLC fee is unconstitutional

- Name of contact person, phone number and fax number

Who Signs. The letter must be signed by either (i) a representative with a power of attorney or (ii) the LLC's managing member.

How to Send. The letter may be either faxed or mailed to the FTB, although fax is preferred by the FTB.

- The FTB fax number is: (916) 845-9796.
- The FTB address is: Franchise Tax Board, PO Box 942867, Sacramento, CA 94267-8888

If you have any questions about the information contained in this bulletin, or would like more information or assistance with filing a protective claim for refund, please contact one of the members of the Firm's Tax Practice Group listed below.

If you have questions, please contact one of the following attorneys:

John Bonn

Washington D.C.
978.594.0170
jbonn@sheppardmullin.com

James Carreon

Los Angeles
213.617.5475
jcarreon@sheppardmullin.com

Matthew Richardson

Los Angeles
213.617.4222
mrichardson@sheppardmullin.com

Amy Tranckino

San Diego
619.338.6597
atranckino@sheppardmullin.com

David Ulich

Los Angeles
213.830.2020
dulich@sheppardmullin.com

