

BASIC CALIFORNIA ENTITY-LEVEL TAXES

(For complete and up-to-date information regarding tax liability, please consult with your CPA or financial advisor)

In determining the form of a business entity investors should always consider the effect of state taxes. In this regard, it is important to note that certain pass-through entities (i.e. entities where the income is taxed at the investors' level) that are not subject to income taxation must nevertheless pay certain minimum state-level taxes.

A. LLCs

For California state tax purposes, CA LLCs pay a minimum "***franchise tax***" of \$800 (for the privilege of doing business in CA) **as well as** a "***franchise fee***" on income in excess of \$250,000. The franchise ***tax*** is the same amount that corporations and limited partnerships must pay (i.e. \$800), Rev. & Tax Code §17941. The franchise fee is computed based on the LLC's "***total income***" (i.e. gross income) and is imposed ***in addition to*** the franchise tax, Cal. Rev. & Tax Code § 17942. The franchise fee is computed as follows:

Total Income:	Fee:
\$250,000-\$499,999	\$900
\$500,000-\$999,999	\$2,250
\$1million-\$4,999,999	\$6,000
\$5million or more	\$11,790

NOTE: LLCs that are classified as associations for California tax purposes are subject to the same franchise tax that is imposed on general corporations (see below).

B. "C" CORPORATIONS

Unless specifically exempt, every corporation (inc. professional corporation, associations and business trusts) doing business in California must pay an annual franchise tax, unless specifically exempted. Even if the corporation has little or no net income, the Revenue and Taxation Code sets a minimum annual franchise tax of \$800, Rev. & Tax Code § 23151. The franchise tax is based on the net income of the year in which the tax is imposed.

Corporations that qualify to do business (i.e. engaging in any transaction for the purpose of financial gain) in California on or after January 1, 2000, are not subject to the minimum franchise tax for their ***first*** taxable years, Rev. & Tax Code § 23151 (unless the corporation reorganizes solely for the purpose of avoiding payment of its minimum franchise tax). Generally, the tax is determined by applying the rate of 8.84% to the corporation's "net income" (note: the tax rate for banks and financial corporations the franchise tax rate imposed on general corporations, plus 2 percent).The corporation then

pays the greater of the minimum franchise (i.e. \$800) or the amount obtained by multiplying 8.84% with the corporation's net income.

C. "S" CORPORATIONS

A California corporation which makes a subchapter "S" election for federal income tax purposes is treated as an S corporation for California income tax purposes as well, unless a special affirmative election is made to treat the corporation as a C corporation for state income tax purposes. Generally, all items of income, gain, loss, deduction, and credit attributable to the operation of the S corporation's business are reportable by and taxable to its shareholders, subject to certain at risk limitations. However, in California, the S corporation must also pay a tax at the corporate level in an amount equal to the greater of the minimum franchise tax (i.e. \$800) *or* 1 and ½% of its net income, Rev. & Tax Code § 23802.

D. LIMITED PARTNERSHIPS

Limited partnerships that (a) are doing business in California and are required to file a California partnership return, or (b) have executed, acknowledged, and filed a certificate of limited partnership with the Secretary of State are subject to a tax equal to the \$ 800 minimum franchise tax. The tax is not an income tax, but a tax for the privilege of doing business in California. The tax is due at the same time as the partnership return, which is three months and 15 days after the close of the partnership's taxable year.

E. FOREIGN LLCs OR CORPORATIONS ENGAGED IN CALIFORNIA BUSINESS ACTIVITIES

Whenever a foreign LLC *does business* in CA, it is subject to the minimum (i.e. \$800) franchise tax, Rev. & Tax Code § 17941. In addition, LLCs that are subject to the minimum franchise tax *are also subject to the additional franchise fee*, Rev. & Tax Code § 17942. Pursuant to A.B. 198, the LLC fee is computed with respect to income from sources derived from or attributable to California.

Generally, every foreign corporation *doing business* in California must pay an annual *franchise tax*, Rev. & Tax Code §§ 23151, 23802. Even if the corporation has little or no net income, the Revenue and Taxation Code sets a minimum annual franchise tax of \$800, Rev. & Tax Code § 23153. A foreign corporation is subject to the minimum franchise tax from the taxable year in which it is qualified or commences doing business in California.

On the other hand, if a corporation merely derives income from California but does not do business in California, the corporation is liable for a *corporate income tax* on net income so derived, Rev. & Tax Code §§ 23501, 23802. Nevertheless, the corporate income tax rate is the same as the franchise tax rate.