

TAX LETTER

HAPPY HOLIDAY and A PROSPEROUS 2008

LLC Fee Problem

LLC, Limited Liability Company, was an entity created by an act of legislation several years ago. To day nearly every State of the Union has a LLC statute. A LLC is, in much respect, similar to a Limited Partnership (LP). A LP is required by law to have at least one general partner, who will be responsible for the financial liabilities of the LP in excess of the capital invested and/or committed. On the other hand, a LLC can be structured in a way such that not one single member of the LLC will be required to have personal liability for the debt or financial obligation of the LLC in excess of the invested and committed capital.

From the income tax point of view, again a LLC is similar to a Partnership. It is a pass thru entity such that it passes thru its annual income or loss to the members of the LLC. Afterward, the members of the LLC will recognize and/or deduct the passed thru items accordingly. Therefore a LLC, in general, is not a tax paying entity for Federal purposes. For the States that's a different story. A great number of States impose a minimum tax for the franchise from the State or a special LLC fee or both.

California is one of those States that impose both a minimum franchise tax of \$800 per year and a special LLC fee based on annual gross receipt. Gross receipt is not profit. Every LLC in California must pay the fee, profitable or not. Because of this unreasonable assessment of taxes, the California Franchise Tax Board (FTB) was sued twice on constitutional ground. Both cases the trial court found for the LLC and considered that the California LLC Fee as it is being administered is unconstitutional.

In April 2006, the first case filed by Northwest Energetic Services, LLC, an out-of-state LLC, registered in California, but doing no business in California. The Superior Court in San Francisco decided that the annual gross receipts fee, based on total gross income, violated the Due Process and Commerce Clauses of the US Constitution. In November 2006, another Superior Court decided in favor of Ventas Finance, LLC, a California LLC doing business both inside and outside California. The Court in Ventas Finance case ruled the LLC fee was a tax and not a fee. As it was applied, it was unconstitutional because it was not fairly apportioned. The FTB appealed the rulings to the California Court of Appeal. Currently, both cases are pending for decisions from the Appeals.

Facing a huge revenue loss, California can not afford to take the risk that the LLC fee being found unconstitutional by the high Court; therefore the California Senate passed AB1614 to counter the possible adverse effect. However, AB1614 was vetoed by Governor Schwarzenegger citing that since there was current pending litigation regarding the same matter, it is premature for any legislative action.

In April 2007, the FTB loss for the third time for the same matter. This time the case was bought by Bakersfield Mall, LLC, a California LLC doing all its business inside California. The Court ruled that the LLC fee assessed against a California LLC doing business solely in California is unconstitutional. Now, it is clear that any LLC, whether out-of-state or in California, whether doing business partially or totally in California, the assessment of LLC fee based on gross receipt is unconstitutional. The Court of Appeal must decide the constitutionality for the LLC fee for all LLCs.

One more time, out of fear and deception, in October 2007 the California Senate passed AB 198 in an attempt to pre-empt the decision from the Court of Appeal. This time, Governor Schwarzenegger signed the bill. As it currently stands, the FTB will enforce AB198. All LLC doing business in California will have to pay a LLC fee as follows:

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| (1) California gross receipt less than \$250,000 | No fee |
| (2) California gross receipt from \$250,000 to \$500,000 | \$ 900 |
| (3) California gross receipt from \$500,000 to \$1,000,000 | \$ 2,500 |
| (4) California gross receipt from \$1,000,000 to \$5,000,000 | \$ 6,000 |
| (5) California gross receipt \$5,000,000 and above | \$11,790 |

We will try to keep you informed for any future development in this matter. Cho Chan CPA and staff will be vacationing in China for the new year, our January 2008 Tax Letter will be late. Happy New Year.