
ALERT – NEW CALIFORNIA LAW REGARDING VOIDABILITY PENALTIES FOR FOREIGN OR OUT-OF-STATE LLCs

On September 15, 2014, California Assembly Bill 1143 went into effect. The Bill effectively closes a loophole exempting nonqualified foreign or out-of-state Limited Liability Companies (LLCs) from the penalty of contract voidability for failure to file tax returns or pay taxes in California.

The Loophole That Was

The FTB requires that all LLCs classified as partnerships or disregarded entities that organize in California, register in California or do business in California, must file California Form 568 Limited Liability Company Return of Income. A LLC that files a form 568 must pay an annual tax, calculated on the total income from all sources derived from or attributable to the state of California. The minimum tax assessed is \$800 per year.

When a LLC fails to file a California tax return or pay its California taxes, the LLC may be suspended or forfeited. A contract entered into with that LLC may be voided by another party because of the status of the LLC. However, there was a loophole in that a foreign or out-of-state, nonqualified LLC who did business in California was exempted from such voidability actions. In essence, an out-of-state LLC that did not register or qualify with the California Secretary of State could operate in California without fear of having contracts voided by other contract parties for reasons relating to the status of the LLC in California.

Closing the Loophole

AB 1143 was introduced and passed as a remedy to the disparity of the penalty of contract voidability with respect to suspended or forfeited LLCs.

Therefore, as of September 15, 2014, all LLCs who operate or do business in California are subject to the voidability penalty if the LLC fails to file California tax returns and/or pay its California taxes.

The law also requires that the Franchise Tax Board (the “FTB”) regulations regarding business entity classifications be consistent with federal regulations in effect as of May 1, 2014. This allows the definition of corporations subject to the California Corporation Tax law to reflect changes to the federal “check the box” regulations.

If you have any questions regarding the new law, please contact our office for assistance.

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