



February 2017

California Court of Appeal Holds Passive LLC Interest Does Not Create Nexus

A non-California corporation's only connection with California was its passive minority interest in a limited liability company (LLC) that was doing business in California. The California Court of Appeal held that this limited connection was not sufficient to subject the out of state corporation to California's Corporation Franchise Tax. All taxpayers that have filed and paid California corporation franchise tax based solely on the ownership of a passive membership interest in an LLC that is doing business in California should consider whether they may be able to submit a refund claim.

Background

On January 12, 2017, in *Swart Enterprises, Inc. v. Franchise Tax Board*, Case No. F070922 (Cal. App. Ct. 2017), the California Court of Appeal, Fifth Appellate District, ruled on the California corporation franchise tax filing requirement for Swart Enterprises, Inc. (Swart), an out of state corporation that operated a farm. Swart's only connection with California was a 0.2% passive ownership interest in a California LLC that was engaged in the acquisition, holding, leasing, and disposition of capital equipment. Under the LLC agreement, the LLC manager had exclusive and complete authority for the management and control of the LLC, and other members, including Swart, were prohibited from participating in the control or operation of the LLC. Swart was not liable for LLC's debts and obligations under the terms of the LLC agreement.

The California Franchise Tax Board (FTB) took the position that Swart was required to file a California corporation franchise tax return on the basis that it was "doing business" in California as a result of its ownership of the membership interest in the LLC.

California Court of Appeal's Analysis of the California Nexus Standard

Section 23101 of the California Revenue and Taxation Code, in pertinent part, provides that a corporation is "doing business" in California if it is actively engaging in any transaction for the purposes of financial or pecuniary gain or profit. The court determined that Swart's passive ownership interest in the LLC was comparable to a limited

partnership interest, and as such, the activities of the LLC within California could not be attributed to Swart in order to require Swart to file a California return.

The FTB had until February 22 to request review by the California Supreme Court, but did not file an appeal. As such, the Court of Appeal's decision is final.

Potential Refund Opportunity

While the California Court of Appeal's decision was based on the specific facts regarding the taxpayer's ownership interest, participation in the LLC's activities, and the terms of the LLC agreement, an out of state taxpayer with a passive ownership interest in an LLC that is doing business in California should consider whether it should be required to file a California tax return or pay taxes in California based on the court's decision in *Swart*. In addition, taxpayers that have filed and paid California corporation franchise tax based solely on the FTB's position that ownership of a passive membership interest in an LLC that is doing business in California creates a filing requirement should consider whether they may be entitled to a refund.

This *GT Alert* was prepared by **William H. Gorrod and Bradley R. Marsh**. Questions about this information can be directed to:

- > [William H. Gorrod](mailto:gorrodw@gtlaw.com) | +1 415.655.1313 | gorrodw@gtlaw.com
- > [Bradley R. Marsh](mailto:marshb@gtlaw.com) | +1 415.655.1252 | marshb@gtlaw.com
- > Any other member of Greenberg Traurig's State and Local Tax Team:
- > [Andrew W. Bodeau](mailto:bodeaua@contract.gtlaw.com) | +1 310.586.7757 | bodeaua@contract.gtlaw.com
- > [Lawrence H. Brenman](mailto:brenmanl@gtlaw.com) | +1 312.456.8437 | brenmanl@gtlaw.com
- > [Burt Bruton](mailto:brutonb@gtlaw.com) | +1 305.579.0593 | brutonb@gtlaw.com
- > [C. Stephen Davis](mailto:daviscs@gtlaw.com) | +1 949.732.6527 | daviscs@gtlaw.com
- > [Alan T. Dimond](mailto:dimonda@gtlaw.com) | +1 305.579.0770 | dimonda@gtlaw.com
- > [G. Michelle Ferreira](mailto:ferreiram@gtlaw.com) | +1 415.655.1305 | ferreiram@gtlaw.com
- > [Scott E. Fink](mailto:finks@gtlaw.com) | +1 212.801.6955 | finks@gtlaw.com
- > [Colin W. Fraser](mailto:frasercw@gtlaw.com) | +1 949.732.6663 | frasercw@gtlaw.com
- > [Courtney A. Hopley](mailto:hopleyc@gtlaw.com) | +1 415.655.1314 | hopleyc@gtlaw.com
- > [Barbara T. Kaplan](mailto:kaplanb@gtlaw.com) | +1 212.801.9250 | kaplanb@gtlaw.com
- > [Marvin A. Kirsner](mailto:kirsnerm@gtlaw.com) | +1 561.955.7630 | kirsnerm@gtlaw.com
- > [Norman H. Lane](mailto:lanen@gtlaw.com) | +1 310.586.6539 | lanen@gtlaw.com
- > [Ivy J. Lapedes](mailto:lapedesi@gtlaw.com) | +1 212.801.9208 | lapedesi@gtlaw.com
- > [Jonathan P. Leleu](mailto:leleuj@gtlaw.com) | +1 702.599.8070 | leleuj@gtlaw.com
- > [Jonathan I. Lessner](mailto:lessnerj@gtlaw.com) | +1 302.661.7363 | lessnerj@gtlaw.com
- > [Joel D. Maser](mailto:maserj@gtlaw.com) | +1 954.765.0500 | maserj@gtlaw.com
- > [Nick McGrath](mailto:mcgrathn@gtlaw.com) | +1 303.685.7412 | mcgrathn@gtlaw.com
- > [Richard J. Melnick](mailto:melnickr@gtlaw.com) | +1 703.903.7505 | melnickr@gtlaw.com
- > [Marc J. Musyl](mailto:musylm@gtlaw.com) | +1 303.572.6585 | musylm@gtlaw.com
- > [Glenn Newman](mailto:newmang@gtlaw.com) | +1 212.801.3190 | newmang@gtlaw.com
- > [Neil Oberfeld](mailto:oberfeldn@gtlaw.com) | +1 303.685.7414 | oberfeldn@gtlaw.com
- > [Cris K. O'Neill](mailto:oneallc@gtlaw.com) | +1 949.732.6610 | oneallc@gtlaw.com
- > [James P. Redding](mailto:reddingj@gtlaw.com) | +1 617.310.6061 | reddingj@gtlaw.com
- > [Benjamin L. Reiss](mailto:reissb@gtlaw.com) | +1 305.579.0547 | reissb@gtlaw.com
- > [Sarah Niemiec Seedig](mailto:seedigs@gtlaw.com) | +1 303.685.7402 | seedigs@gtlaw.com
- > [Thomas L. Sheehy](mailto:sheehyt@gtlaw.com) | +1 916.442.1111 | sheehyt@gtlaw.com
- > [Charles A. Simmons](mailto:simmonsc@gtlaw.com) | +1 813.318.5747 | simmonsc@gtlaw.com
- > [Labry Welyt](mailto:welytl@gtlaw.com) | +1 214.665.3638 | welytl@gtlaw.com
- > Or your [Greenberg Traurig](#) attorney

~ *Not admitted to the practice of law*

Amsterdam
+ 31 20 301 7300

Atlanta
+1 678.553.2100

Austin
+1 512.320.7200

Berlin-
+49 (0) 30 700 171 100

Berlin-GT Restructuring⁻
+49 (0) 30 700 171 100

Boca Raton
+1 561.955.7600

Boston
+1 617.310.6000

Chicago
+1 312.456.8400

Dallas
+1 214.665.3600

Denver
+1 303.572.6500

Fort Lauderdale
+1 954.765.0500

Houston
+1 713.374.3500

Las Vegas
+1 702.792.3773

London*
+44 (0)203 349 8700

Los Angeles
+1 310.586.7700

Mexico City+
+52 55 5029.0000

Miami
+1 305.579.0500

New Jersey
+1 973.360.7900

Northern Virginia
+1 703.749.1300

Orange County
+1 949.732.6500

Orlando
+1 407.420.1000

Philadelphia
+1 215.988.7800

Phoenix
+1 602.445.8000

Sacramento
+1 916.442.1111

San Francisco
+1 415.655.1300

Seoul[∞]
+82 (0) 2.369.1000

Shanghai
+86 (0) 21.6391.6633

Tallahassee
+1 850.222.6891

Tampa
+1 813.318.5700

Tel Aviv[^]
+03.636.6000

Tokyo^α
+81 (0)3 4510 2200

Warsaw[~]
+48 22 690 6100

Washington, D.C.
+1 202.331.3100

Westchester County
+1 914.286.2900

West Palm Beach
+1 561.650.7900

*This Greenberg Traurig Alert is issued for informational purposes only and is not intended to be construed or used as general legal advice nor as a solicitation of any type. Please contact the author(s) or your Greenberg Traurig contact if you have questions regarding the currency of this information. The hiring of a lawyer is an important decision. Before you decide, ask for written information about the lawyer's legal qualifications and experience. Greenberg Traurig is a service mark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. -Greenberg Traurig's Berlin office is operated by Greenberg Traurig Germany, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. - Berlin - GT Restructuring is operated by Köhler-Ma Geiser Partnerschaft Rechtsanwälte, Insolvenzverwalter. *Operates as a separate UK registered legal entity. **Greenberg Traurig is not responsible for any legal or other services rendered by attorneys employed by the strategic alliance firms. +Greenberg Traurig's Mexico City office is operated by Greenberg Traurig, S.C., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ∞Operates as Greenberg Traurig LLP Foreign Legal Consultant Office. ^Greenberg Traurig's Tel Aviv office is a branch of Greenberg Traurig, P.A., Florida, USA. αGreenberg Traurig Tokyo Law Offices are operated by GT Tokyo Horitsu Jimusho, an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. ~Greenberg Traurig's Warsaw office is operated by Greenberg Traurig Grzesiak sp.k., an affiliate of Greenberg Traurig, P.A. and Greenberg Traurig, LLP. Certain partners in Greenberg Traurig Grzesiak sp.k. are also shareholders in Greenberg Traurig, P.A. Images in this advertisement do not depict Greenberg Traurig attorneys, clients, staff or facilities. No aspect of this advertisement has been approved by the Supreme Court of New Jersey. ©2017 Greenberg Traurig, LLP. All rights reserved.*