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California: Disregarded limited partnerships no longer subject to filing requirement or annual tax (possible refund opportunities)

The California Franchise Tax Board (FTB) issued a legal ruling that reverses a long-standing position that limited partnerships that are disregarded for federal income tax purposes must file California partnership returns and pay the \$800 annual tax.

Read [Legal Ruling 2019-02](#) [PDF 186 KB] (dated November 20, 2019)

KPMG observation

With reversal of the FTB's position, there may be a refund opportunity for disregarded limited partnerships to recover taxes paid for all tax years open under the statute of limitations (generally, four years for California). The refund opportunity could be especially beneficial for tiered REITs (real estate investment trusts) and asset management structures.

Summary

Limited partnerships generally must file an annual return and pay an annual tax if they are doing business in California. California Revenue and Taxation Code (CRTC) section 17935.

Limited partnerships also generally must file if they have income from a California source.

Historically, the FTB's position has been to include disregarded limited partnerships (DLPs) under the purview of CRTC section 17935, requiring them to file returns and pay tax. Some DLPs challenged the FTB's position because CRTC section 23038(b)(2)(B)(iii) does not expressly require DLPs to file in California. The DLPs argued that the FTB lacked authority to include them under the purview of CRTC section 17935.

The FTB finally conceded, and in Legal Ruling 2019-02 stated:

CRTC section 23038(b)(2)(B)(iii) states that if the separate existence of an eligible business entity is disregarded for federal tax purposes, its separate existence is generally disregarded for California franchise and income tax purposes other than for purposes of expressly specified limited exceptions. The exceptions from the general rule identified in CRTC section 23038(b)(2)(B)(iii) do not apply to a federal DLP.... Therefore, [a DLP] is not subject to the annual limited partnership tax and partnership return filing requirements under CRTC sections 17935 and 18633.

Refund procedures

In addition to Legal Ruling 2019-02, the FTB also issued [Notice 2019-06](#) [PDF 101 KB] to explain the procedures for:

- Filing refund claims
- Substantiating previously filed refund claims
- Addressing previously issued FTB filing enforcement notices

Pursuant to Notice 2019-06, the FTB is requiring DLPs to submit certain documents to establish that the DLP has no California filing or payment requirement. These documents include:

- (1) The certificate of limited partnership, partnership agreement, organizational chart of ownership, and federal returns of the partners for the particular taxable year or years in question; or*
- (2) A declaration signed under penalty of perjury by the general partner of the limited partnership under local law. If the limited partnership's general partner under local law is a limited liability company ("LLC"), then the manager or, if there is no manager, the authorized member of the general partner LLC must sign the declaration. The declaration must clearly identify the general partner and must state that the entity was disregarded for federal income tax purposes during the respective tax years.*

In the notice, the FTB stated that it will review the documentation and determine whether the entity established that it is a federal DLP, and whether a refund or exception from a filing requirement is warranted.

KPMG observation

It is unclear why the FTB believes that a partner's filing status has any connection with a DLP's duty to file—see item (1) above—and this question has been posed by KPMG tax professionals to the FTB.

KPMG tax professionals are currently working with the FTB to make the refund process more efficient and to streamline the filing of multiple claims at one time. DLPs need to consider the implications of the ruling and notice to determine whether to file refund claims.

The FTB has already drafted a legislative proposal that, if enacted in its current form, would once again require DLPs to file an annual return and pay the annual tax in California, but prospectively only.

For more information, contact a tax professional with KPMG's State and Local Tax practice:

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