

LIMITED LIABILITY ENTITIES

The purpose of this information sheet is to explain California's payroll tax* treatment of the following types of limited liability entities:

- Limited Liability Company (LLC)
- Limited Partnership (LP)
- Limited Liability Partnership (LLP)
- Limited Liability Limited Partnership (LLLLP)

Each of the above business entity types is created when it formally organizes and registers as required by the laws of the jurisdiction where the organization occurs. They are classified as either domestic or foreign entities. *Domestic* entities are those organized in California under the California Corporations Code. *Foreign* entities are organized under the laws of jurisdictions other than California. Before transacting business in California, the foreign entities must first register with the California Secretary of State.

LLC ENTITIES

An LLC is a hybrid entity that combines the liability protection of a corporation with the benefit of pass-through taxation of a partnership or sole proprietorship. The owner(s)/investor(s) of an LLC are called members. In accordance with the Corporations Code, the member(s) must enter into an operating agreement governing the management and conduct of the LLC's business. The LLC is also required to maintain a current list of the full name and last known business or residence address of each member together with the contribution and the share in profits and losses.

Under the Corporations Code, the LLC may be managed by its member(s) or by one or more managers (who are not required to be members). If the LLC is to be operated by one or more managers rather than its members, the articles of organization must include this provision and the LLC is required to maintain a current list of the full name and business or residence address of each manager.

LLC as an Employing Unit

- For Unemployment Insurance (UI), Employment Training Tax (ETT), and State Disability Insurance** (SDI) purposes, Section 135(a)(2) of the California

Unemployment Insurance Code (CUIC) specifically includes an LLC as an *employing unit*. Under Section 675 of the CUIC, the *employing unit* becomes an employer when it employs one or more employees within California and pays wages in excess of \$100 during any calendar quarter. Refer to Information Sheet: *Employment* (DE 231).

- For California Personal Income Tax (PIT) purposes, Section 13005(a) of the CUIC specifically includes an LLC as an *employer* subject to withholding PIT and reporting PIT wages for its California employees. (For residents performing services within or without California, or nonresidents performing services within California, refer to Information Sheet: *Multistate Employment* [DE 231D].)

California Payroll Taxes for LLC Members

Generally, the Internal Revenue Service (IRS) and the Franchise Tax Board (FTB) treat an LLC as a sole proprietorship, partnership, or corporation, depending on the circumstances. However, the CUIC requires the Employment Development Department (EDD) to treat the LLC as a unique entity type, instead of classifying it as a sole proprietorship, partnership, or corporation.

For example, the IRS and FTB treat an LLC member as self-employed if the LLC is taxed as a sole proprietorship or partnership, and as an employee if the LLC has elected to be treated as a corporation. The CUIC, however, does not authorize the EDD to treat an LLC as a sole proprietorship, partnership, or corporation.

Effective January 1, 2011, Section 621(f) was added to the CUIC to *include* as a statutory employee *any member* of an LLC that is treated as a corporation for federal income tax purposes. Section 928.7 of the CUIC was also added and Section 13009 of the CUIC was amended to include as wages any compensation, that is deductible under Section 162 of the Internal Revenue Code (IRC), paid to a member of an LLC filing a federal corporate income tax return. Therefore, any member of an LLC treated as a corporation for federal income tax purposes is a statutory employee and any compensation paid to these members, deductible under Section 162 of the IRC, is considered wages subject to California payroll taxes.

*California payroll taxes consist of UI, ETT, SDI, and PIT unless otherwise stated.

**Includes Paid Family Leave (PFL)

In addition, effective January 1, 2011, Section 623 was added to the CUIIC providing that an employee *does not* include *any member* of an LLC that is treated as a partnership for federal income tax reporting purposes. However, this definition only applies for UI, ETT, and SDI purposes. Since no changes were made to Division 6, Withholding Tax on Wages, of the CUIIC, Section 13004 and 13009 of the CUIIC requires the EDD to apply common law to determine whether a member of an LLC treated as a partnership for federal income tax purposes is self-employed or an employee for PIT withholding and reporting purposes.

Under most circumstances, application of the common law factors to an LLC member who provides services to the LLC would generally result in one of the following determinations:

- If the LLC member is a manager under the articles of organization, the member would normally be considered self-employed, and compensation paid for services would not be considered wages subject to PIT withholding and reporting.
- If the LLC member is not a manager under the articles of organization and, therefore, is subject to direction and control by one or more managers, the member would normally be considered a common law employee (unless exempt by statute for some other reason), and compensation paid for services would be wages subject to PIT withholding and reporting.

Section 631 of the CUIIC, which excludes family members from subject employment for UI, ETT, and SDI, does not apply to LLCs.

Section 637.1 of the CUIIC, which provides for sole shareholder exemption from SDI, does not apply to an LLC member, even if the LLC has elected to be taxed as a corporation with the IRS and FTB.

Liability for LLC California Payroll Taxes

The California Corporations Code provides that a member of a domestic LLC is generally not responsible for the debts of the LLC solely by virtue of being a member of the LLC. However, Section 1735 of the CUIIC specifically provides that any person having charge of the affairs of an LLC employing unit who willfully fails to pay contributions or withholdings for the California payroll taxes shall be personally liable for the amount due (including penalties and interest).

The general liability of members of foreign LLCs is determined under laws of the jurisdiction where the LLC was organized. In addition, Section 1735 of the CUIIC (described above) also applies.

LP ENTITIES

An LP is a type of partnership that has at least one general partner and at least one limited partner. The general partner is responsible for managing the business affairs, while the limited partner typically provides capital to the partnership.

LP as an Employing Unit

Since an LP is a *partnership*, it is included in the definition of an employing unit under Sections 135(a)(2) and 13005(a) of the CUIIC. An LP becomes an employing unit for California payroll tax purposes under the same conditions as shown for LLCs above.

California Payroll Taxes for LP Partners

- For the *general* partners, Section 926-2(c) of Title 22, California Code of Regulations (CCR), provides that wages for California payroll tax purposes does not include "Drawings by bona fide general partners, whether designated as salary or otherwise." Therefore, payments to LP *general* partners are generally not subject to California payroll taxes.
- Payments made to *limited* partners for services in the furtherance of the business are generally wages subject to California payroll taxes. However, payments made to a *limited* partner that are a return on investment are generally not considered wages.

Liability for LP California Payroll Taxes

The California Corporations Code Section 15904.04 provides that all general partners, from the date they became general partners, are liable jointly and severally for all obligations of a domestic LP. On the other hand, California Corporations Code Section 15903.03 provides that if the limited partner is not named as a general partner and does not participate in the control of the business, the limited partner is not liable for any obligations of a domestic LP.

The general liability of partners in a foreign LP is determined under the laws of the jurisdiction where the LP was organized.

LLP ENTITIES

The LLP is similar to a general partnership in that all partners take an active role in managing the day-to-day affairs. However, it has the added benefit of providing limited liability protection to all the partners. California limits the LLP form of ownership to professionals working in the practice of architecture, accountancy, engineering, land surveying, and law.

LLP as an Employing Unit

Since an LLP is a *partnership*, it is included in the definition of an employing unit under Sections 135(a)(2) and 13005(a) of the CUIIC. An LLP becomes an employing unit for California payroll tax purposes under the same conditions as shown for LLCs above.

California Payroll Taxes for LLP Partners

As a partnership, all partners in an LLP are categorized as *general* partners. Under Section 926-2(c) of Title 22, CCR, payments to LLP partners are generally not subject to California payroll taxes.

Liability for LLP California Payroll Taxes

Although the partners in a domestic LLP are *general* partners, California law shields them from responsibility for the LLP's debts solely by virtue of being a partner in an LLP. However, Section 1735 of the CUIIC specifically provides that any person having charge of the affairs of an LLP employing unit who willfully fails to pay contributions or withholdings for the California payroll taxes shall be personally liable for the amount due (including penalties and interest).

The general liability of partners in a foreign LLP is determined under the laws of the jurisdiction where the LLP was organized. In addition, Section 1735 of the CUIIC (described above) also applies.

LLL ENTITIES

An LLLP is a modification of the LP where general partners have limited liability for the obligations of the partnership. Some jurisdictions permit the formation of LLLPs. The California Corporations Code expressly prohibits the organization of LLLPs in this state. However, a foreign LLLP may register to do business in California and be treated as a foreign LP. Therefore, an entity that operates as an LLLP in another jurisdiction but has employees in California will be treated as a foreign LP for California payroll tax purposes.

ADDITIONAL INFORMATION

For further assistance, please contact the Taxpayer Assistance Center at 888-745-3886 or visit the nearest Employment Tax Office listed in the *California Employer's Guide* (DE 44) and on the EDD's website at www.edd.ca.gov/Office_Locator/. Additional information is also available through the EDD's no-fee payroll tax seminars and online courses. View the in-person and online course offerings on the EDD's website at www.edd.ca.gov/Payroll_Tax_Seminar/.

The EDD is an equal opportunity employer/program. Auxiliary aids and services are available upon request to individuals with disabilities. Requests for services, aids, and/or alternate formats need to be made by calling 888-745-3886 (voice) or TTY 800-547-9565.

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