THE GROSS REVENUE TAX
CALIFORNIA LIMITED LIABILITY COMPANIES

All California entities must pay an annual minimum franchise tax of $800; however, an LLC is also subject to an additional "fee" (CA Revenue and Taxation Code Section 17942a) determined by an entity's "total income" or gross revenues. The fee is assessed not only on LLCs formed under California law, but also on foreign LLCs qualified to do business in California and on foreign LLCs (whether or not formally qualified to do business in California) if they derive income from California based or intrastate business in California. The fee is assessed against "total income" plus the cost of goods sold that are paid or incurred in the trade or business of the entity. Here are the rates:

a) **$0 for LLCs with annual gross revenues of less than $250,000;**
b) **$900 for LLCs with annual gross revenues of at least $250,000 but less than $500,000;**
c) $2,500 for LLCs with annual gross revenues of at least $500,000 but less than $1,000,000;
d) $6,000 for LLCs with annual gross revenues of at least $1,000,000 but less than $5,000,000;
e) $11,790 for LLCs with annual gross revenues of $5,000,000 or more.

As you can see the actual amount of the fee is relatively small (at $250,000 in gross revenues, the fee is 0.36%; at $500,000 - 0.5% at $1,000,000 - 0.6%) <u>but</u> since it is assessed against gross revenues (not profits), it is payable even if the entity is operating at a loss. That's why an the LLC structure may not be the best choice for a business with high revenues but narrow profit margins or entities that anticipate incurring losses in their early stages of development. If investors intend to have straight-forward income and loss allocations and cash distributions, there may be little or no advantage to an LLC over an S corporation.

On the other hand, the LLC offers its members more flexibility in management and operations and less corporate formalities and is widely used for small business.