

City of Los Angeles Business Tax - Law Firm Expense Reimbursement Settlement

Overview

On October 26, 2017, the Los Angeles County Superior Court of California granted a motion for a preliminary settlement of a class action suit in *Berkes Crane Robinson & Seal LLP v. The City of Los Angeles*, regarding the Los Angeles business tax ("LABT"),¹ specifically whether lawyers and law firms ("Firms") are required to include expense reimbursements in the measure of taxable gross receipts for purposes of computing their LABT. In the preliminary monetary settlement, the City of Los Angeles ("City") has agreed to set aside approximately \$4.5 million from which Firms can claim a refund of overpaid taxes for the refund period that covers tax years 2010-2016 (i.e., tax paid in years 2011 through 2017), if Firms paid tax on reimbursed expenses to the City.² Going forward, the City will no longer tax Firms on reimbursed expenses.³

This tax alert summarizes the preliminary settlement of the class action lawsuit and provides taxpayer considerations.

Background of Class Action

Pursuant to the Los Angeles Municipal Code ("LAMC"), the City imposes a tax⁴ on all businesses engaged in business within the City, which is generally based upon taxable gross receipts.⁵ In 2011, the plaintiff filed a class action lawsuit in the Los Angeles County Superior Court of California, on its behalf and on behalf of other similarly situated Firms, challenging the City's requirement to include reimbursed expenses in its calculation of gross receipts for purposes of the business tax owed by Firms.⁶ Specifically, reimbursed expenses at issue were those costs advanced by Firms on behalf of their clients as part of the necessary representation of these clients (e.g., expert witness fees and advanced travel expense).⁷ The class action lawsuit was filed to (1) change the policy by which gross receipts are calculated for purposes of the LABT, and (2) recover overpayments of taxes, penalties, and interest paid by these Firms.⁸ On October 26, 2017, the Court granted a motion for the preliminary settlement of the class action lawsuit.⁹

Summary of Settlement Agreement

Eligibility for a LABT refund generally fall into one of two classes:

- Class A(1) Monetary Settlement Class Members, which includes those Firms that were audited by the City between May 1, 2010 and December 31, 2013 and assessed additional tax because they did not include any or all reimbursed expenses¹⁰, and

¹ *Berkes Crane Robinson & Seal LLP v. The City of Los Angeles*, Case No. BC473557. Note that the Court's *Order Granting Motion for Preliminary Approval of Class Action Settlement* provides a timeline for next steps, which are discussed below, as well as the deadline for Class Counsel to file a motion for Final Approval of the class action settlement on February 6, 2018.

² *Order Granting Motion for Preliminary Approval of Class Action Settlement*, 7.

³ *Id.* at 10.

⁴ Los Angeles Municipal Code § 21.03.

⁵ "Gross receipts" are generally defined as "[t]he total amount charged or received for all sales and commissions for the performance of any act, service or employment of whatever nature it may be, whether such service, act or employment is done as part of or in connection with the sale of goods, wares, merchandise or not, for which a charge is made or credit allowed, including all receipts, cash, credits and property of any kind or nature, any amount for which credit is allowed by the seller to the purchaser without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, interest paid or payable, losses or any other expense whatsoever. Gross receipts shall also include the amount of any federal manufacturers or importers excise tax included in the price of the property sold, even though the manufacturer or importer is also the retailer thereof and whether or not the amount of such tax is stated as a separate charge." Los Angeles Municipal Code § 21.00(a).

⁶ *Order Granting Motion for Preliminary Approval of Class Action Settlement*, 1-3.

⁷ *Id.*

⁸ *Id.* at 1.

⁹ *Id.*

¹⁰ *Id.* at 4.

External Multistate Tax Alert

- Class A(2) Monetary Settlement Class Members, which includes those Firms that had voluntarily included reimbursed expenses in their LABT returns filed in 2011 through 2017.¹¹

Procedure for Obtaining Refunds. As noted above, the City has agreed to set aside approximately \$4.5 million from which Firms can claim a refund of taxes, penalties, and interest.¹² Although all Firms that paid tax on reimbursed expenses to the City during the refund period are eligible for a refund, the City is sending notices only to Firms that it has identified (i.e., those Firms eligible under Class A(1) that were previously audited by the City).¹³ Notices were to be mailed to such Firms by November 14, 2017¹⁴ and all Firms will have 35 days to object or opt-out of the settlement.¹⁵ Firms eligible for refunds under Class A(1) that do not object or opt-out of the settlement will automatically receive their refunds, and are not required to submit a refund claim form.¹⁶

Firms that voluntarily paid tax on reimbursed expenses to the City during the refund period, (i.e., Class A(2) Members) are required to file a claim for refund January 13, 2018.¹⁷

Reimbursed Expenses Excluded from Gross Receipts of Firms Going Forward. As part of the settlement agreement, the City has also agreed to an injunction that prohibits the City from prospectively requiring Firms to include reimbursed expenses (i.e., expenses reimbursed to the lawyer or law firm at cost by a client pursuant to an agreement that said expenses would be reimbursed) in their calculation of gross receipts.¹⁸

Taxpayer Considerations

The settlement of this class action lawsuit effectively changes the City's policy for calculating the gross receipts of lawyers and law firms for purpose of computing their LABT liability. Taxpayers engaged in other services within the City should discuss the potential implications of this settlement agreement with their tax advisers as it affects their LABT liability.

Contacts:

¹¹ *Id.* at 5. The class action also accounts for two additional classes: "Crossovers" and "Group of 25." *Order Granting Motion for Preliminary Approval of Class Action Settlement*, 5-6. "Crossovers" are generally those class members who fall within both definitions of Class A(1) and A(2) and as such, Crossovers may be entitled to a refund as a member of both classes A(1) and A(2). *Id.* Additionally, the City identified 25 Firms (i.e., "Group of 25") that its records indicate were audited, but the City cannot identify or locate actual records that evidence the amount of any assessment for failure to include Reimbursed Expense in the gross receipts reported as a result of the audit. *Id.*

¹² *Id.* at 7. According to the City's estimates, the value of the Class A(1) portion of the Monetary Class Settlement is approximately \$1 million, and the parties have agreed to set aside \$3.5 million for the Class A(2) portion of the Monetary Class Settlement. *Id.* at 8-9. To the extent the dollar amount of Class A(2) Class Member claims exceeds the total pool, then each Class A(2) Class Member will receive a proportionate share. *Id.* at 9.

¹³ *Order Granting Motion for Preliminary Approval of Class Action Settlement*, 8.

¹⁴ *Id.* 26.

¹⁵ *Id.* at 10.

¹⁶ *Id.*

¹⁷ *Id.* at 9.

¹⁸ *Id.*

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