AMERICA'S #1 CALIFORNIA TAX UPDATE

2023 CALIFORNIA FEDERAL TAX UPDATE

PRESENTED BY

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This manual and related lecture should not be used as a substitute for professional advice. If legal advice or other expert assistance is required, the services of a competent tax advisor should be sought.

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2023 CALIFORNIA FEDERAL TAX UPDATE

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We are all grateful to the edit and production staff at Western CPE for their hard work in the final production of this book.

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2023 CALIFORNIA TAX UPDATE
INDEXING AND FILING

INDEXING

The California rate of inflation of the period ending June 30, 2023, was 3.1%.

STANDARD DEDUCTION

The standard deduction for 2023 is as follows:

Single	$ 5,363
Married/RDP filing joint	$10,726
Married/RDP filing separate	$ 5,363
Qualifying widow(er)	$10,726
Head of household	$10,726

The minimum standard deduction for taxpayers who can be claimed as a dependent on another's return remains at $1,050. A dependent with earned income uses the lesser of the standard deduction for his/her filing status or earned income plus $300.

LIMITATION ON ITEMIZED DEDUCTIONS

California itemized deductions are limited for certain higher-income taxpayers. Deductions are limited by 6% of federal adjusted gross income (AGI) exceeding the thresholds below, not to exceed 80% of certain deductions.

Single	$237.035
Married/RDP filing joint	$474,075
Married/RDP filing separate	$237.035
Qualifying widow(er)	$474,075
Head of household	$355,558

PERSONAL EXEMPTION CREDIT

The personal exemption credits for 2023 are as follows:

Single	$144
Married/RDP filing joint	$288
Married/RDP filing separate	$144
Head of household	$144
Qualifying widow(er)	$288
Dependent (each)	$446

Blind and elderly taxpayers claim an additional exemption credit of $144 per qualified taxpayer.

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PHASEOUT OF PERSONAL EXEMPTION CREDIT

Exemption credits are phased out for taxpayers with federal AGI exceeding the following amounts:

Single	$237,035
Married/RDP filing joint	$474,075
Married/RDP filing separate	$237,035
Qualifying widow(er)	$474,075
Head of household	$355,558

Exemption credits are reduced by $6 per exemption for every $2,500 (and fraction thereof) ($1,250 for MFS) of federal AGI in excess of the above thresholds for all single status taxpayers and $12 per exemption for married/RDP filing joint and qualifying widow(er). California exemption credits may phase out entirely.

OTHER CREDITS

Joint Custody Head of Household Credit

The Joint Custody Head of Household Credit for 2023 is 30% of net tax, not to exceed $573. The credit applies to singles or married/RDPs filing separately who lived apart the entire year. Taxpayer must provide a home for a child, stepchild, or grandchild for at least 146 days but not more than 219 days during the tax year.

Dependent Parent Credit

The Dependent Parent Credit for 2023 is 30% of net tax, not to exceed $575. The credit applies to married/RDPs filing separately who lived apart the last six months of the year and provided over one-half the household expenses for a dependent mother or father, whether or not the parent lived with the taxpayer. This credit cannot be used on the same return as the Joint Custody Head of Household Credit.

Senior Head of Household Credit

The Senior Head of Household Credit for 2023 is 2% of taxable income not to exceed $1,748. The credit applies to taxpayers age 65 or older at the end of the tax year who qualified for head of household in either of the two preceding tax years for a qualified individual who died in one of those years and whose AGI for 2023 does not exceed $92,719.

Renter's Credit

The Renter's Credit for 2023 is $60 for singles and married/RDPs filing separately with California AGI of $50,746 or less. The credit is $120 for married/RDPs filing jointly, head of household, and qualifying widow(er)s with AGI of no more than $101,492.

Young Child Tax Credit

For taxable years beginning on or after Jan. 1, 2019, the AB 91 (Burke, Stats. 2019, Ch. 39) created the refundable Young Child Credit for a qualified taxpayer. The credit amount is limited to $1,176 multiplied

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by the earned income tax credit adjustment factor for the taxable year specified for §17052. The maximum credit was limited to $1,000 per taxable year.

The credit is available for each qualifying child of the taxpayer that is younger than six years old as of the last day of the taxable year.

> ***New!* No earned income required.** For taxable years beginning on or after January 1, 2022, SB 201 (Budget, Stats. 2022, Ch. 72) expanded the YCTC to include individuals with no earned income or a net loss, as specified. In addition, for taxable years beginning on or after January 1, 2022, the maximum amount of the YCTC, initially set at $1,000, will be indexed for inflation in the same manner as the income tax brackets. The maximum credit for taxable year 2023 is $1,117.

For 2023, the credit amount is reduced by $21.66 for every $100 by which the qualified taxpayer's earned income exceeds the threshold amount, initially set at $25,000. For taxable years beginning on or after January 1, 2022, the threshold for taxpayers with $0 or less of earned income for net losses or wages, salaries, tips, and other employee compensation is $32,490.

New! Foster Youth Tax Credit

For taxable years beginning on or after January 1, 2022, SB 201 (Budget, Stats. 2022, Ch. 72) enacted the Foster Youth Tax Credit (FYTC). The maximum amount of the FYTC, initially set at $1,000, will be indexed for inflation in the same manner as the income tax brackets. The maximum credit for taxable year 2023 is $1,117. The FYTC is available to a qualified taxpayer who is allowed the CalEITC, is 18 to 25 years of age, inclusive, as of the last day of the taxable year, and was in foster care, as defined. The credit amount phases out as earned income exceeds the "threshold amount" of $25,775, and completely phases out at $30,000.

For taxable years beginning on or after January 1, 2022, the phase-out amount is $21.66 per $100 in excess of the threshold amount.

For taxable years beginning after the taxable year in which the minimum wage, as defined in paragraph (1) of subdivision (b) of §1182.12 of the Labor Code, is set at $15.50 per hour, the "threshold amount" would be annually adjusted in the same manner as the income tax brackets.

INDIVIDUAL INCOME TAX RATES

The maximum individual rate for 2023 is 12.3%.

Mental Health Services Tax

The Mental Health Services Tax is 1% for taxable income in excess of $1 million. The rate applies per individual income tax return regardless of filing status.

ALTERNATIVE MINIMUM TAX

California's alternative minimum tax (AMT) rate is 7% for 2023. However, California automatically inflation adjusts some factors in the calculation of the individual AMT.

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AMT Exemption Amount

The exemption amounts for California AMT for 2023 are as follows:

Single	$87,171
Married/RDP filing joint	$116,229
Married/RDP filing separate	$58,111
Qualifying widow(er)	$116,229
Head of household	$87,171

Phaseout of AMT Exemption

The exemption amounts phase out for California AMT income in excess of:

Single	$326,891
Married/RDP filing joint	$435,855
Married/RDP filing separate	$217,924
Qualifying widow(er)	$435,855
Head of household	$326,891

The phaseout is 25% for each dollar AMT income exceeds the threshold.

LIMITED LIABILITY COMPANY ANNUAL FEE

The schedule of annual fees for limited liability companies remains unchanged for 2023:

Gross Receipts		
At least	**But not over**	**Fee**
0	249,999	$ 0
250,000	499,999	$ 900
500,000	999,999	$ 2,500
1,000,000	4,999,999	$ 6,000
5,000,000	and up	$ 11,790

CORPORATIONS

The California rate for corporations remains unchanged for 2023 at:

Corporations other than banks & financial corporations 8.84%

Banks and financial corporations 10.84%

The California AMT rate for corporations is 6.65%.

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S CORPORATIONS

The California rate for S corporations remains unchanged for 2023 at:

Corporations other than banks & financial corporations	1.5%
Banks and financial corporations	3.5%

Tax Year 2023 Tax Year Filing 2024 Due Dates

Federal Individual & Trusts

April 15 falls on a Monday in 2024, therefore the Individual, FBAR and Trust tax deadlines will be **Monday, April 15, 2024**, for 2023 calendar year filers.

> **NOTE:** It appears the federal holiday, Juneteenth, observed June 19, may be eliminating the occasional conflict with the regional holiday Emancipation Day, traditionally April 16, celebrated in Washington DC, which caused federal government offices to be closed in any years April 15 falls on a weekend, then subsequently rolls to the following Monday but bumps into Emancipation Day. For 2024, Emancipation Day will be observed in Washington, DC on June 19th. Federal offices will be open Monday, April 15, 2024, and then closed the day after, on Tuesday, April 16, 2024.

California Individual & Trusts

The 2024 filing due date will be Monday, **April 15, 2024,** the same as the Federal due date. Tuesday, October 15, 2024, will be the extended due date for 2023 Form 1040 and Form 540.

Federal Business Entities

The federal due date for 2023 pass through business tax returns such as Partnerships and LLC's filing Form 1065 and S corporations and LLC's filing Form 1120-S is **Friday, March 15, 2024**.

The due date for calendar year C corporations filing Form 1120 will be **Monday, April 15, 2024.**

California Extended Due Dates

California has announced extended due dates for business returns which do not conform with Federal. C Corp (Form 1120) does not conform with Federal and is due Friday, **November 15, 2024**. Other business returns conform to Federal due dues: S corps extended due date of Monday, **September 16, 2024**, and trusts are due Tuesday, **October 15, 2024.**

California PTET Elective Opt in Payment for tax year 2024 will be **Monday, June 17, 2024**.

California Individual Income Tax Changes for 2023 FTB 540

Form 540 is now 6 Pages

Besides the "prior name" fields added to page one, a checkbox was added if the taxpayer would like information related to low-cost health insurance. It appears the entire new page 6 is comprised solely of the taxpayer signature fields and paid preparer fields which were at the bottom of page 5 for 2022 and prior years.

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2023 new fields added for taxpayer or spouse's prior name.

Presumably this is to help California keep track of individual tax accounts when a taxpayer's name changes.

2023 checkbox added for health insurance information

The taxpayer may indicate yes or no, if they want information on no, or low, cost health insurance. Unlike the "check here if" box added for voter registration last year, this new health care inquiry requires a yes or no.

S Corporations May Pay Shareholder State Income Tax: PTET Election

In July, 2021 the state legislature in AB 150 (Budget, Stats. 2021, Ch. 8) created a new election allowing pass-through entities to pay state tax on behalf of their owners. See the complete analysis in ***Conformity and NonConformity.***

FILING ENFORCEMENT AND COLLECTION FEES

The personal income tax fees apply to individuals, partnerships, and limited liability companies that are classified as partnerships. The bank and corporation fees apply to banks, corporations, and limited liability companies that are classified as corporations. Interest does not accrue on these cost recovery fees.

Personal income tax filing enforcement fee	$ 86
Personal income tax collection fee	$314
Bank and corporation filing enforcement fee	$108
Bank and corporation collection fee	$332

California S Corporation & Partnership Basis May Need Adjustments for COVID Benefits

Also see "Transitioning Capital Accounts for 2022", later in the material.

Two COVID benefits may have caused errors in previous basis calculations.

CA ADJUSTMENT FOR ERTC REFUNDS

California basis issues for ERTC cannot be corrected until the Federal reporting has been corrected and any interest income has been identified. After the Federal reporting issues have been resolved, the California adjustments required may be as follows:

- Actual approved ERTC payroll tax refunds are tax free to California, and therefore non-taxable income and should be reported as an increase in partner or S corporation shareholder basis on the California basis worksheet for the year the refund was approved. The partner or S corporation shareholder's basis worksheet must reflect the amount of California tax free income as a miscellaneous basis adjustment. Remember, if the taxpayer refuses to amend the federal income taxes to reduce applicable wage or health care expense for the year the ERTC wages were paid, you won't make a federal basis adjustment, but you will make a California basis adjustment.

- If any of the ERTC refunds were held back by IRS for past due taxes, a California basis adjustment is not needed if the income tax preparer used the total "approved" ERTC refunds to make the California basis adjustment above.
- Any interest attributable to the federal ERTC refunds will be taxable for Federal and California in the year the refund is paid so the basis worksheets should be correct for federal and California as long as the interest income is reported correctly.

PPP loans which were ultimately forgiven, and any other tax-free grants should have been entered in Schedule M-1 of the business returns for partnerships and S corporations, which would then have generated correct basis reports related to these tax-free funds. If the business tax return did not include these M-1 adjustments, perhaps if the PPP loans or grants were just left off the tax returns because they were tax free, then the partners' or shareholder's basis may have been understated.

Both Form 7203, Part I, and partnership or S corp basis worksheets have lines for entering tax free income to increase basis. If Schedule M-1 was not reported or was incorrect for 2020 or 2021 either revise 2020 or 2021 basis reporting or make a catch-up adjustment on the 2022 or 2023 basis forms.

CA ADJUSTMENT FOR PPP and EIDL TAX FREE FUNDS

If the PPP funds or EIDL grants were not reported correctly as tax free income for federal, and therefore federal shareholder or partner basis is underreported. Make the same corrective adjustments for California partner or shareholder basis unless the PPP funds were taxable to California, in which case the California basis records should be correct.

> **Tax practitioner note.** The analysis above for ERTC refunds and PPP funds assumes the business tax preparer and the Form 1040 preparer are the same person or at the same firm. If this is not the case, the Form 1040 tax preparer may have an additional burden trying to resolve these basis issues for federal and California. Getting copies of the entity tax returns for 2020 through 2023 may help, but the Form 1040 preparer may also need information related to the approved ERTC refunds.
>
> **Tax practitioner note.** Keep in mind, taxpayers have until the last payment due on a PPP loan to apply for and receive PPP loan forgiveness, and if they apply at that late date, and are approved they will actually have all of their prior principal and interest payments refunded. IRS regs say the entity may choose the report tax free PPP loan funds in the year the funds were received, the year the funds were spent, the year the entity applies for forgiveness, or the year forgiveness is granted. And California conforms! So, we may have some straggling PPP loan forgiveness issues for a few clients for a few more years.

S Corp Basis When Some Years Beyond Statute

CA Technical Advice Memorandum:

2020-01 S Corp Basis When Some Years Beyond Statute

Calculation of Shareholder Basis in an S corporation When Some Years are Closed by the Statute of Limitations

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QUESTIONS PRESENTED

- Does the guidance contained in Internal Revenue Service Technical Advice Memorandum ("IRS TAM") 200619021 apply, under California law, to calculate a shareholder's basis in an S corporation when the shareholder improperly claimed losses in excess of stock and debt basis in a year closed by the statute of limitations?

  CONCLUSION: Yes. When the shareholder improperly claims losses in excess of stock and debt basis in a year closed by the statute of limitations, a shareholder's basis in an S corporation is calculated by the method provided for in IRS TAM 200619021 by holding the excess losses in a suspense account pursuant to Internal Revenue Code ("IRC") section 1366(d)(2) to be used in future years in computing the shareholder's basis in the S corporation.

- Does the guidance contained in IRS TAM 200619021 address how to calculate a shareholder's basis in an S corporation when the shareholder improperly failed to recognize income from a distribution in excess of stock basis in a year closed by the statute of limitations?

  CONCLUSION: No. The guidance contained in IRS TAM 200619021 does not address the situation where a shareholder improperly failed to recognize income from a distribution in excess of stock basis in a year closed by the statute of limitations.

Federal TAM 200619021 is persuasive authority interpreting S corporation pass-through income and losses and shareholder basis and may govern in the interpretation of these conforming California statutes. Accordingly, if a shareholder deducts losses in excess of the shareholder's basis in the S corporation in a closed year, then, in a subsequent open year, the shareholder's basis in the S corporation must be computed using the deducted losses in excess of basis from the closed year.

As detailed in IRS TAM 200619021, the excess loss claimed in the closed year must be held as a separate amount in the IRC section 1366(d)(2) suspense account. The amount of excess losses claimed in closed years are then used to reduce the shareholder's basis starting in the first open year. Finally, IRS TAM 200619021 does not address the situation of distributions in excess of basis in a closed year.

ELECTRONIC SERVICES

ENHANCEMENTS TO THE BUSINESS E-FILE PROGRAM – CA EXEMPT ORGANIZATION BUSINESS INCOME TAX RETURN

Starting January 2024, the CA business e-file program will enable charities and non-profits filing Form 109 California Exempt Organization Business Income Tax Return to file their returns electronically.

FTB's business e-file program already allows the ability to submit original, amended, or superseded returns for corporation, partnerships, limited liability companies, and exempt organizations filing the Form 199 California Exempt Organization Annual Information Return electronically.

Contact your software provider to see if they will support the ability to e-file CA Form 109 Exempt Organization Business Income Tax returns.

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MAKING PAYMENTS ELECTRONICALLY

Enhancements to the "Stand-alone" Electronic Payment Program

Beginning January 2024, exempt organizations will be able to submit an electronic fund withdrawal (EFW) request for certain payment types using tax preparation software.

These payment requests will be accepted as "stand-alone," and can be submitted separately from the e-file return. The return can be filed at a later date.

The following new payment types will be available:

- Extension payments
- Quarterly estimate payments

Corporations, partnerships, limited liability companies, and exempt organizations can still submit EFW requests for return and estimate payments with the e-filed return using tax preparation software.

As a reminder, the following stand-alone EFW payment types are currently available for the following programs:

- Individuals
  - Quarterly estimate payments
  - Extension payment
  - Fiduciary (Estate/Trust)
- Quarterly estimate payments
  - Extension payments
- Business Entities (Corporations/Limited Liability Companies/Partnerships)
  - Quarterly estimate payments
  - Extension payments
  - Annual tax payments
  - Estimated fee
  - PTE elective tax

Contact your software provider to see if they support "stand-alone EFW" payments for Exempt Organizations.

Certain Individuals Required to Pay Electronically

R&TC §19011.5 was added to the California Revenue and Taxation Code in September 2008. The law requires individuals to remit all future payments electronically once they:

- Make an estimated tax or extension payment (by check or electronic method) over $20,000 for a taxable year beginning on or after Jan. 1, 2009; OR
- File an original return with a tax liability over $80,000 for a taxable year beginning on or after Jan. 1, 2009.

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Fiduciaries, estates, and trusts are not required to make payments electronically, regardless of the amount owed. Unlike corporations, there is no registration process for individuals subject to the mandatory e-pay law.

Payments Covered by the Law

If a taxpayer makes a payment or files a return meeting the mandatory requirement, the FTB will send a form **FTB 4106 MEO, *Mandatory e-Pay Participation Notice*** advising the taxpayer that all future payments must be remitted electronically.

> ***Note:*** If an individual does not receive notification from the FTB, he/she is still required to remit payments electronically once that individual meets either of the above thresholds.

Some tax preparation software may also remind you about e-pay. If your tax preparation software generates paper Form 540-ES vouchers when you meet the mandatory e-pay threshold, the taxpayer must still pay electronically.

Once a taxpayer meets the mandatory e-pay threshold, he/she is required to make all subsequent payments electronically, regardless of the amount, type, or taxable year.

> ***Example:*** Karen makes her first quarter estimated tax payment of $25,000 on Apr. 15, 2022, by paper check. Any payment she makes after that (e.g., a bill payment from a previous year or her second quarter estimated tax payment) must be made electronically.

> ***Example:*** Sharon files her 2022 Form 540 electronically on Apr. 1, 2023, showing a total tax liability of $95,000. Sharon must pay her 2023 estimated tax payments (including the payment due Apr. 18, 2023) electronically.

When taxpayers are required to make electronic payments but pay by other means, the FTB can assess a penalty equal to 1% of the amount paid, unless the failure to pay electronically was for reasonable cause and not willful neglect.

> ***Note:*** Making a payment using a bank's online bill payment system is not an electronic payment. The bank mails a paper check to the FTB, which does not meet the requirement to pay electronically.

Caution! Watch Out for Disaster Delayed Payments!

California taxpayers in 2023 in the federally declared disaster areas are allowed to delay 2023 estimated tax payments until October 16, 2023. But bundling the April and June estimates into one payment may cause your taxpayer to exceed the $20,000 threshold for mandatory electronic payments. Instruct your clients to make separate first and second quarter estimates if the combined total will exceed $20,000.

FTB Notifies Taxpayers Required to E-Pay

Within a few days of a payment or return posting to the FTB that "triggers" the mandatory e-pay requirement, the FTB will send a notice to the taxpayers. The notice, **Mandatory e-Pay Program Participation Notice (FTB 4106 MEO)**, advises the taxpayers they are required to remit future payments electronically and provides them with their options. The notice includes information on how to request a waiver from the mandatory e-pay requirement.

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Waiving the Mandatory E-Pay Requirement

You can request a waiver from mandatory e-pay if:

- You have not made an estimated tax or extension payment in excess of $20,000 during the current or previous income year, or
- Your total tax liability reported for the previous income year did not exceed $80,000, or
- The amount you paid is not representative of your total tax liability.

You must complete and submit form FTB 4107, ***Mandatory e-Pay Program Election to Discontinue or Waiver Request***. The FTB will review your waiver request and notify you in writing when it approves or denies your request.

If the FTB grants a waiver and you subsequently meet the mandatory e-pay requirements, you must resume making your payments using an electronic method.

Permanent Waiver of Mandatory E-Payment Requirement

Beginning Mar. 29, 2012, taxpayers who are subject to the mandatory e-pay requirement can request a permanent waiver of the requirement.

To request the permanent waiver, taxpayers must submit FTB 4107, Mandatory e-Pay Election to Discontinue or Waiver Request with a signed physician's affidavit that a permanent physical or mental impairment prevents the taxpayer from using a computer. The FTB will deny the taxpayer's request if the physician affidavit of permanent physical or mental impairment is incomplete or not attached to **FTB 4107**.

The FTB will inform the taxpayer in writing whether the request for a permanent waiver is approved or denied.

Amended Tax Returns and Mandatory E-Payment

Once a taxpayer becomes subject to the mandatory electronic payment requirement, all payments of tax, penalties, and interest for any year must be made electronically (R&TC §19011.5). However, if a taxpayer files a paper amended tax return and makes the payment electronically, the FTB will likely refund the payment before the amended tax return is processed.

The FTB has proposed the following work-around:

> If your clients file an amended return with a balance due and use Web Pay to make the payment, they should select the following payment option: **Notice of Proposed Assessment, Amended Return (Form 540X)**, or **Form 3834 Payment** (Interest Computation Under the Look-Back Method for Completed Long-Term Contracts). This payment will be reflected in their MyFTB Account as a Notice of Proposed Assessment.

MyFTB ACCOUNT

Simplify your life – get free, secure, online access to your clients' most important California state tax information 24 hours a day, seven days a week.

TAX PROFESSIONAL ONLINE ACCOUNT ACCESS

As of January 2018, the Franchise Tax Board (FTB) now recognizes two formal relationship types to represent your client: Tax Information Authorization (TIA) and Power of Attorney (POA). The below table compares the two relationship types.

Relationship Type		
	TIA	**POA**
Authorization Definition	Grants a specific person (TIA representative) permission to obtain their client's confidential information for all tax years.	Grants a specific person (POA representative) permission to obtain their client's confidential information and represent them in FTB matters for the year(s) designated on the declaration.
Expiration	13 months from the: Signature date or Date the "TIAClient" was added on MyFTB	6 years from the signature date (for declarations submitted after Jan. 1, 2018). Note: FTB no longer revokes overlapping tax years or income periods.
Renewal	TIAs can be renewed for an additional 13 months, with the taxpayer's permission, on MyFTB.	Not applicable. A new declaration must be filed to continue the relationship.
Forms	FTB 3534, Tax Information Authorization FTB 3535, Tax Information Authorization Revocation	FTB 3520 PIT, Individual or Fiduciary Power of Attorney Declaration FTB 3520 BE, Business Entity or Group Nonresident Power of Attorney Declaration FTB 3520 RVK, Power of Attorney Declaration Revocation
Online Account Access[1]	When the TIA is approved by FTB, the Tax Professional2 will automatically receive limited online account access. A Tax Professional can request full online account access in MyFTB after the TIA is approved. Starting Jan. 1, 2019, the request for full online account access can be made on FTB 3524 or in MyFTB when adding a TIA Client.	When the POA Declaration is approved by FTB, the Tax Professional2 will automatically receive limited online account access. A Tax Professional can request full online account access in MyFTB after the declaration is approved. Starting Jan. 1, 2019, the request for full online account access can be made on FTB 3520-PIT or FTB 3520-BE when filing a new declaration; MyFTB will be updated with these changes.
How to File	MyFTB - Add TIA Client Mail - FTB 3534	MyFTB - File Power of Attorney Mail FTB 3520 PIT or FTB 3520 BE
Need more information?	Go to ftb.ca.gov/tia	Go to ftb.ca.gov/poa

1. Representative can receive information over the phone, in writing, by chat, or in person once the TIA or POA is approved by the FTB, regardless of the level of online account access authorized by the taxpayer.

2. Representative with a Tax Professional account in MyFTB.

Tax Professional Online Account Access Levels in MyFTB - Limited vs. Full

Representatives with a Tax Professional MyFTB account may be able to access their client's tax information online. There are two levels of online account access that a tax professional may have to his or her client's tax information on MyFTB:

1. Limited, or
2. Full

The information available to a tax professional in MyFTB is based upon both the online account access level and the approved relationship type: TIA or POA. See the below table.

> ***Note:*** The online account access level (Limited or Full) does NOT affect the information a representative can receive by phone, chat, in writing, or in person.

Online Access Levels		
Relationship Type	**Limited (Granted by the FTB when relationship is approved)**	**Full (Authorized by Taxpayer)**
TIA	• View available notices and correspondence issued from the FTB in the past 12 months. * • Chat with the FTB about confidential matters. * • Send the FTB a secure message with attachments. * • Request full online account access to client's information. * Applies to all tax years.	• View information for all tax years: • Available notices and correspondence. • Account balance and tax year details. • Estimate payments and credits. California wage and withholding for individual clients only. • Payment history. • List of returns filed. • Proposed assessments. • FTB-issued 1099 for individual clients. • Chat with about confidential matters. • Send the FTB a secure message with attachments. • File a nonresident withholding waiver request. • Calculate a balance due for a date in the future.
POA	All of the above applies for the year(s) listed on the POA declaration.	All of the above applies for the year(s) listed on the POA Declaration, **plus**: • View images of tax returns. • Update contact information. • Protest a proposed assessment. • Submit a quick resolution worksheet for a filing enforcement proposed assessment.

Access granted prior to Jan. 2, 2018, has been grandfathered for all clients.

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How the Process Works

- After the FTB approves the TIA or POA relationship between a taxpayer and a tax professional, you are immediately granted Limited Online Account Access to your client's MyFTB information.
- If you request Full Online Account Access, the FTB will mail your client an Authorization Code they can use to approve or deny your request.
- If your client approves your request, you will immediately have Full Online Account Access to their MyFTB account information.
- If your client denies your request or does not respond to the letter, you will retain Limited Online Account Access.

Request Full Online Account Access on Power of Attorney Declaration and Tax Information Authorization Forms

Starting Jan. 1, 2019, taxpayers are able to request their Tax Professional to receive full online account access to their tax information on forms FTB 3520 PIT or BE, Power of Attorney Declaration and FTB 3534, Tax Information Authorization.

POWER OF ATTORNEY

Filing Power of Attorney Declaration Using MyFTB

The FTB will process your POA Declaration faster if you use MyFTB than if you file by paper.

Estimated Times for POA Processing

- 15 business days or less for online submissions using MyFTB.
- 45 business days or less for paper processing with qualified exception marked.
- 90 business days or more for paper processing with no exception.

If you must paper process your POA, the FTB now says you should mail it to:

POA UNIT FRANCHISE TAX BOARD

PO BOX 2828

RANCHO CORDOVA, CA 95741-2828

Two Methods for a POA Representative to Submit a POA Declaration Using MyFTB

1. Taxpayer Approves using MyFTB

   Step 1. Representative files the POA Declaration online using MyFTB and does not attach a signed copy of the POA Declaration.

   Step 2. FTB reviews and processes.

   Step 3. The taxpayer client then approves using their MyFTB account. The POA Declaration is now active.

2. Upload Signed POA Declaration

   Step 1. Representative completes the declaration online using MyFTB AND uploads a signed, dated, and fully completed declaration. The declaration must exactly match the information entered using MyFTB.

   Step 2. FTB reviews and approves. The POA Declaration is now active.

The primary reason the FTB rejects MyFTB POA Declarations is the uploaded signed copy does not match the information entered in MyFTB.

The Top Five Reasons Why the FTB Rejects a POA Declaration

1. A POA Declaration is entered online using MyFTB with a single signed declaration uploaded; however, the information entered does not match the information found on the POA Declaration (e.g., tax years, authorization, # of reps, etc.).

   Solution: The declaration must exactly match the information entered using MyFTB.

2. A POA Declaration is entered online using MyFTB with two signed declarations uploaded for related taxpayers (joint filers).

   Solution: For every declaration entered using MyFTB, there may only be one signed matching declaration uploaded per entry.

3. A POA Declaration is entered online using MyFTB with a single, signed, and matching declaration; however, additional signed declarations are also uploaded for non-related taxpayers.

   Solution: For every declaration entered using MyFTB, there may only be one signed matching declaration uploaded per entry.

4. A POA Declaration for a Business Entity is entered online using MyFTB with a single, signed, and matching declaration; however, the declaration is not signed or dated or does not appear on the appropriate signature line.

   Solution: The declaration for a business entity must exactly match the information entered using MyFTB and include the proper signature and date on the appropriate signature line.

5. A POA Declaration for Fiduciaries is entered online using MyFTB with a single, signed, and matching declaration; however, there is no supporting documentation attached.

   Solution: The declaration for a Fiduciary must exactly match the information entered using MyFTB, and the upload must include all supporting documentation.

Acceptable forms of documentation are:

- A legal document naming the person authorized to sign the POA on behalf of the Estate or Trust.
- A completed copy of federal Form 56, Notice Concerning Fiduciary Relationship.
- A Court Order.
- A Governing Instrument.
- A Last Will and Testament.

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MyFTB Shows POA Status

You can view the status of your clients' POA declaration on MyFTB. POA clients will display with an Access Type of "POA" in the Access Type column. By default Active Individual clients, including Active Individual POA clients, will display on your Client List. You will need to perform a search to view Inactive or Pending POA clients and business, estate, or trust clients.

The POA statuses available for search are Active, Inactive, or Pending. Inactive statuses include Revoked, Rejected, Expired, and Canceled. Pending statuses include Pending and Pending Taxpayer Approval.

POA Status	Definition
Active	Declaration has been processed and accepted by FTB and is currently active.
Inactive	Declaration is not active. The declaration is revoked, rejected, expired, or canceled.
Pending	Declaration was submitted via MyFTB and is being processed by FTB.
Pending Taxpayer Approval	Declaration was submitted via MyFTB without a signed copy of declaration attached. FTB has processed and accepted the declaration, and the declaration is pending taxpayer approval (taxpayer must log in to their MyFTB account and approve the declaration).

POA Wizard on MyFTB

As of January 2018, practitioners use a newly designed POA Wizard for establishing a POA relationship using MyFTB. The process is crafted to closely match the POA Form itself, thus reducing the instances of errors. In addition, the new wizard allows FTB staff entering POAs received by mail to more efficiently and accurately enter the form into the system.

Other important details regarding the **FTB 3520PIT** and **3520BE** forms:

- Expire six years from the signature date, or when revoked.
- Includes all matters before the FTB (including nontax debt).
- The FTB will no longer automatically revoke overlapping tax years or account periods.
- Additional Authorizations, page 2, part 4 - must check either the "yes" or "no" box for each section.
- Page 4 can be used to add additional representatives when there are more than two representatives. If additional representatives are needed, you can attach as many pages of page 4 as needed.
- If Other Acts contradicts Parts 3 or 4 on the declaration, Parts 3 and 4 prevail.

Add Associates List

In January 2018, practitioners were able to enter and save their associates' information in MyFTB, to later be used when submitting POA declarations online. This feature allows practitioners to expedite the completion of declarations by only needing to enter common information once for multiple representatives.

How to Revoke a POA Declaration

There are two ways to revoke a POA relationship - via MyFTB or paper

1. MyFTB - On MyFTB, review the details of the client's POA declaration and select revoke (there is no form to enter or upload)

   OR

2. Paper - mail the signed and completed **FTB 3520RVK** POA Revocation form to FTB

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Important details regarding **FTB 3520RVK** POA Revocation:

- **FTB 3520RVK** covers the revocation of all declarations, including **3520PIT** and **3520BE** declarations and declarations filed prior to Jan. 1, 2018.
- All representatives can delete other representatives on a POA declaration.
- The POA declaration signature date is required.

The FTB will accept revocations in all formats. However, if not using MyFTB (fastest way), **FTB 3520RVK** will expedite the revocation.

SEND A SECURE MESSAGE

The FTB introduced a new channel for communication with the implementation of the enhanced MyFTB: Send Secure Message. This new feature allows you to electronically send the FTB a secure message on behalf of your client with the option to add attachments, and in most cases, eliminate the need to mail paper.

What Are the Benefits of Using Send Secure Message?

Send Secure Message is a faster and more efficient way to communicate with the FTB. It allows you to send correspondence electronically and optionally attach supporting documentation 24/7. Once the information is submitted, it is automatically associated to your client's account, allowing any of the FTB's agents to view the information.

A great benefit of this new functionality is it allows you to send information on behalf of your client any time of day, and if you contact FTB, the agent can view this information while you are on the phone. Additionally, if an agent requests additional information during a phone call, this option allows you to upload and send the requested information while on the call. Sending a message with this option also allows the FTB to respond online.

> **Note:** While you do not need an active POA to send a secure message to the FTB, you will need one to view any response or correspondence it sends to your client. File a POA online to view future FTB notices or correspondence sent to your client.

What Should Not Be Submitted Using This Option?

Do not submit live tax returns.

Do not submit a POA Declaration for processing.

Do not submit a protest. To respond to a proposed assessment that may not be protested or viewed online, select the "send FTB a message" link from the Proposed Assessment List page. Select "Proposed Assessments" from the Account drop-down menu from your client's account.

How Do I Submit a Message?

From your client's account, select "Send Message" from the Communication drop-down menu or select the "Send Secure Message" button in the lower left of the page.

> **Tip:** You can view messages you've initiated on your client's Notices and Correspondence page.

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When Can I Expect to Receive a Response to My Message?

Allow up to 30 business days for the FTB to respond to your message. If you do not have an active POA Declaration for your client, you will not be able to see the FTB's response online. Remember, if you sent the FTB a message and then you call, any agent can access and view your message including attachments to assist you with resolving your client's tax matters.

LIVE CHAT

Live Chat is the FTB's channel of providing taxpayer assistance via an interactive Internet-based connection accessed through the FTB's home page. It serves as a means for taxpayers who would otherwise have called the contact center or corresponded with the FTB to a more convenient service channel. Initiated in 2010-11 to handle general questions, Live Chat offers a number of advantages as a service delivery channel:

- Live Chat agents handle an average of six general information chats per hour as compared to the average four calls per hour for contact center line agents and 2.4 pieces of correspondence per hour for correspondence staff.
- Live Chat offers a seamless interaction with the FTB's webpage. Whenever possible, taxpayers are referred to web pages with comprehensive information about their topic. This encourages taxpayers to self-manage follow-up questions.

Secure Live Chat

Springboarding on the success of Live Chat, the FTB introduced Authenticated Live Chat in January 2016 as a companion to the vastly expanded MyFTB Account. With the new version of MyFTB, taxpayers have direct access to substantially more personal data. The FTB is encouraging self-service; however, many taxpayers will continue to have questions or wish to interact with the FTB. Taxpayers who might otherwise have called or corresponded with the FTB on specific account problems now have the opportunity to securely chat with the FTB through Authenticated Live Chat.

Messaging Takes Some Worry out of Chat

The FTB updated its messaging to improve your experience while chatting with them! You'll receive "we're still here" every two minutes and show your place in line while you wait.

TEXT MESSAGES FROM FTB?

FTB will only deliver texts if you request to receive text messages via the Interactive Voice Response (IVR) telephone line or select the text deliver option through your MyFTB account.

One-Time Text

If you call the Liens Program IVR at 916-845-4350 and select the option to receive a text, the text will include a link to ftb.ca.gov and instructions on how to make the payment.

Ongoing Texts

Individuals with a MyFTB account can update their profile to receive text message alerts when the following activities occur on their account:

- A new notice or document is available.

- We approved a new Tax Information Authorization (TIA) relationship or approved a tax professional's request to renew the TIA.
- A tax professional submitted a Power of Attorney (POA) declaration for approval.
- A tax professional with a TIA or POA relationship requested full online access to the taxpayer's MyFTB account and the request is pending the taxpayer's approval.
- Updates were made to contact preferences such as add, change, or remove SMS text notifications.

Individuals and tax professional representatives can manage the text message notifications through MyFTB, and choose to receive text messages, change which number FTB sends them to, or stop receiving text messages.

Security is Important

FTB does not send text messages asking for personal or financial information, or account numbers.

If you did not request to receive text messages from FTB, do not respond or click on any links. Report the issue to Scams.

TAX PAYMENTS

CALIFORNIA STILL ACCELERATING PAYMENTS

The California legislature continues to balance the budget by projecting "income" that it will never recognize. Because of statutory over-withholding and accelerated estimated tax payments, California's cash flow "sleight of hand" measures force taxpayers to prepay tax they may not owe.

Individuals

Safe Harbors for Taxable Income Under $1 Million

Current federal and state tax law provides two options in determining the required annual payment for personal income taxes (PIT). The required annual payment for an individual subject to the personal income tax is the lesser of the following:

- Option 1: 90% of the tax shown on the return for the taxable year, or
- Option 2: 100% of the tax shown on the return of the taxpayer for the preceding taxable year.

Option 2 does not apply if the preceding taxable year was not a complete taxable year of 12 months or if the taxpayer failed to file a return for the prior tax year. Current federal and state tax law increases the required annual payment under option 2 from 100% to 110% of the tax shown on the return if the AGI of the taxpayer for the preceding taxable year exceeds $150,000 ($75,000 in the case of a married individual filing a separate return).

Option 2 Not Allowed for Millionaires. For taxable years beginning on or after Jan. 1, 2009, the option for individual taxpayers to make estimate payments equal to 100% of the tax shown on the taxpayer's return for the prior year is eliminated if the AGI of the taxpayer shown on the return for the current taxable year exceeds $1 million ($500,000 for taxpayers with a married filing separate filing status). These taxpayers must use the first option only, paying at least 90% of the tax shown on the return for the taxable year.

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Estimated Tax Payment Schedule for 2023

The third quarter estimated tax payment was eliminated in 2010 by revising the estimated tax payment percentages for taxable years beginning on or after Jan. 1, 2010. The percentages are:

1st quarter installment	30% of estimated tax
2nd quarter installment	40% of estimated tax
3rd quarter installment	0% of estimated tax
4th quarter installment	30% of estimated tax

FTB Applies Wage Withholding Percentage Consistent with Estimate Payment Percentages

The FTB does apply wage withholding in percentages consistent with the percentages required for estimated tax payments for taxable years beginning on or after Jan. 1, 2009. In addition, the FTB is allowed to revise the percentages used to determine estimated tax payment requirements under the annualized income installment method to percentages consistent with the accelerated estimate percentages.

Corporations

Current federal law generally provides two options in determining the required annual payment for corporate income taxes. The required annual payment for corporations is the lesser of the following:

- Option 1: 100% of the tax shown on the return for the taxable year, or
- Option 2: 100% of the tax shown on the return for the preceding taxable year.

Corporations with taxable income of $1,000,000 or more are required to pay 100% of the tax for the current year.

> In general, current state law requires corporations to remit four estimated tax payments totaling 100% of tax shown on the return for the taxable year. If a corporation's estimated tax does not exceed the minimum franchise tax, the entire amount of the minimum franchise tax is payable as the first estimated tax payment. If the amount of estimated tax exceeds the minimum franchise tax after the last day of the third month and before the first day of the sixth month of the corporation's taxable year, the amount of the second, third, and fourth estimated tax payments must total the tax expected to be due.

For taxable years beginning on or after Jan. 1, 2010, the legislature eliminated the third quarter estimated tax payment for corporations too. The percentages are:

1st quarter installment	30% of estimated tax
2nd quarter installment	40% of estimated tax
3rd quarter installment	0% of estimated tax
4th quarter installment	30% of estimated tax

If the corporate taxpayer is not required to make an estimate payment installment in the first quarter (*e.g.,* it only owes the minimum franchise tax), the following installment payments are required in subsequent quarters:

2nd quarter installment	60% of estimated tax
3rd quarter installment	0% of estimated tax
4th quarter installment	40% of estimated tax

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Corporate taxpayers not required to make an estimate in either the first or second quarters would pay:

3rd quarter installment	70% of estimated tax
4th quarter installment	30% of estimated tax

LLC Annual Fees

Under current state law, an LLC not classified as a corporation must pay the $800 annual LLC tax and the annual LLC fee if it is organized, doing business, or registered in California. The annual LLC fee is based on total income from all sources derived from or attributable to this state.

For taxable years beginning on or after Jan. 1, 2009, the annual LLC fee must be estimated and paid by the 15th day of the 6th month of the current taxable year. For calendar-year LLCs the estimated fee must be paid by June 15.

A penalty of 10% of the underpayment of the estimated fee will apply if the estimated LLC fee is underpaid.

FTB Mails Summary of Payments Starting in 2019

In late January/early February the FTB now mails **FTB 3713 Summary of Account Payments, Transfers, and Credits** to business entities who made an Estimated LLC Fee or Estimated Tax Payment during the previous tax year. The account summary will provide payment, transfer, and credit information including payment amounts and effective dates.

The summary contains the same data available to FTB call center agents and is intended to assist business entities and/or their professional tax representatives in filing accurate and timely tax returns. This notice is part of a pilot project to proactively address the most common reason tax professionals contact the Tax Practitioner Hotline; thereby reducing the need to call to verify payments.

Payment information is also available online to businesses and their tax representatives who register for a MyFTB account.

FILING ISSUES

SPECIAL NEEDS TRUSTS – CA SOFTWARE GLITCH

If you file California Form 541 for a special needs trust, your client may have gotten a notice of tax due from the FTB because of an incorrectly reduced exemption amount. It wasn't your fault, and it wasn't really the FTB's fault. The problem was with your tax software. Several of the tax software packages were using last year's exemption amount ($129 in 2021, $140 in 2022). If that happened, the FTB's e-file kicked the return out and automatically reduced the exemption to $1 – the amount for ordinary trusts.

FTB has notified all software providers to be sure they are using the current year exemption amount. Be sure to check your software's latest update for the correct amount.

MIDDLE CLASS TAX REFUND PAYMENT AND MONEY NETWORK

The Middle Class Tax Refund (MCTR) payment is a one-time payment to provide relief to California taxpayers. Nearly 32,000,000 California taxpayers and their dependents have benefitted from MCTR payments. The MCTR payment is not taxable for California state income tax purposes and should not be reported as income. The majority of MCTR payments were direct deposited between October 2022 and January 2023.

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FTB partnered with Money Network to provide MCTR payments distributed by debit card. Debit card recipients that have not activated their payment card will receive a reminder letter that includes instructions on how to activate their debit card.

If a taxpayer was advised that a debit card was issued and needs additional assistance, refer the taxpayer to contact Money Network at 1-800-240-0223, weekdays from 8AM to 5 PM Pacific Standard Time for customer support, and 24/7 for card activation.

FTB TO NOTIFY TAXPAYERS OF PAPERLESS FILING OPTIONS

Under the provisions of AB 1863 (Irwin, Stats. 2022, Ch. 953), beginning January 1, 2023 the FTB is required to notify potential eligible individuals of available paperless (electronic) filing options offered through FTB, including CalFile, and free tax preparation services, including the VITA program. The notification would include information about available paperless filing options and CalEITC. The notification would be in a form and manner FTB determines would incentivize potential eligible individuals to timely file their federal and state tax returns.

FTB TO ADD HEALTH CARE COVERAGE OUTREACH ON TAX RETURNS

For taxable years beginning on or after January 1, 2023, SB 967 (Hertzberg, Stats. 2022, Ch. 170) requires the Franchise Tax Board to add a checkbox to the personal income tax return to ask taxpayers if they want health care coverage information, and to provide this information to the California Health Benefit Exchange (Covered California) for outreach and enrollment efforts.

For the individuals who check the box on their individual income tax returns, the FTB will be required to disclose to the Exchange only the following information:

- Taxpayer name, or for joint filers, the names of both spouses or domestic partners;
- Full mailing address listed on the return;
- Number and age of household dependents; and
- Gross income.

PRINCIPAL RESIDENCE ADDRESS REPORTED ON FORM 540

Effective January 1, 2021, FTB was directed to revise the California resident income tax return to include space for the taxpayer's address of his/her principal residence and the county of the principal residence.

Under the provisions of SB 592 (Wiener, *et al*, Stats. 2020, Ch. 230), the purpose of the change is so that, beginning November 1, 2021, and each November 1st thereafter, the FTB will provide the jury commissioner of each county with a list of resident state tax filers. The idea is to expand jury pools.

ALTERNATE IDENTIFYING INFORMATION FOR DEPENDENT EXEMPTION CREDIT

Retroactive to January 1, 2018, AB 2247 (Burke, Stats. 2020, Ch. 99) allows a taxpayer with a nonresident alien dependent who is ineligible to receive a federal ITIN the option of providing other identifying information, as prescribed by the FTB, for purposes of the dependent exemption credit.

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State Dependent Credit vs. Federal Dependent Exemption

The IRS recently ceased granting or renewing ITINs for nonresident alien dependents whose sole purpose for requesting an ITIN was to claim the personal exemption deduction amount. Since the deduction amount was set to zero for tax years 2018-2025, the IRS determined there was no longer a federal purpose to request the ITIN.

State law allows a California dependent exemption credit, rather than a deduction, for each dependent, as defined under federal law (R&TC §17054(d) and IRC §152). For taxable years beginning on or after January 1, 2015, a dependent exemption credit is only allowed if the dependent's identification number, as defined under federal law (IRC §6109), either an SSN or federal ITIN, is included on the return.

Procedures to Provide Alternative Identifying Information for Certain Dependents under RTC §17054(d), related to Claiming Dependent Exemption Credits

FTB Notice 2021-01 prescribes the procedures for providing alternative identifying information for dependents who are ineligible to receive either an SSN or ITIN, in order to claim a Dependent Exemption Credit.

Taxpayers must complete and attach form **FTB 3568, Alternative Identifying Information for the Dependent Exemption Credit**, for each foreign dependent with the taxpayer's completed California personal income tax return and provide supporting documentation such as a copy of each dependent's passport or national identification card.

It's important to note that the alternative identifying information procedures in this Notice may only be used for the Dependent Exemption Credit. They cannot be used for any other credits, such as the California Earned Income Tax Credit or Young Child Tax Credit.

CALLING TAX PRACTITIONER HOTLINE

The FTB continues to request (actually beg) practitioners to utilize the self-service options available on its website using "MyFTB Account." Accessing information on the website frees up hotline agents to handle cases that cannot be resolved without live contact.

Tax Practitioner Hotline (916) 845-7057

Tax Practitioner Hotline Implements Virtual Hold Technology

As a result of practitioner feedback, the Tax Practitioner Hotline successfully implemented Virtual Hold technology. Virtual Hold allows callers to save their place in the phone queue and receive a call back instead of waiting on-hold for a potentially extended period of time.

In March alone, over 24,000 tax practitioners utilized this service. And even more impressive, during the first month since the implementation, 86% received successful callbacks within the promised time! FTB will continue to modify the settings of the new technology to help it achieve 100% of callbacks within the estimated time.

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2023 CALIFORNIA TAX UPDATE
CONFORMITY AND NONCONFORMITY

In general, California income tax law is based on federal income tax law. Usually this is accomplished by conforming to specific provisions of the Internal Revenue Code (IRC) by reference as of a “specified date,” which is ***Jan. 1, 2015***. However, not all provisions of the IRC are applicable for California purposes. In addition, not all federal changes to a particular provision are applicable for California purposes for the same period and to the same extent the change is applicable for federal purdposes.

SECURING A STRONG RETIREMENT ACT OF 2022 UNDER THE CONSOLIDATED APPROPRIATIONS ACT OF 2023

California has automatic conformity to a number of the more notable changes made by the long awaited SECURE 2.0 (officially known as Securing a Strong Retirement Act of 2022).

1. Beginning in 2023, required minimum distributions (RMDs) begin at age 73. After 2032, RMDs begin at age 75. **California conforms.**

2. Penalties for failure to withdraw the RMD will drop from 50% to 25% in 2023. The penalty drops to 10% if the late RMD is taken by the end of the second year following the year it was due. **California does not conform.**

3. Beginning in 2023, employer matching contributions can be made to a ROTH (if the employer plan is modified to allow this change.) **California conforms.**

4. Beginning in 2023, the credit for small employer pension plan startup costs is enhanced. The 3-year small business startup credit is increased from 50% to 100% of administrative costs, up to an annual cap of $5,000 for employers with up to 50 employees. Employers with 51 to 100 employees are subject to old rules. **California does not conform.**

5. Beginning in 2023, eligible employers with 50 or fewer employees may be entitled to an additional credit for contributions to a newly established pension plan (other than a defined benefit plan.) Generally, the credit is a percentage of the amount contributed by the employer on behalf of employees, up to a per-employee cap of $1,000. The applicable percentage is 100% in the first and second years, 75% in the third year, 50% in the fourth year, 25% in the fifth year. Further reductions apply for employers with 51 to 100 employees and contributions to employees with compensation in excess of

6. $100,000, as indexed, are not taken into account. **California does not conform.**

7. Beginning in 2023, a qualified taxpayer may elect as part of their qualified charitable distribution (QCD) a one-time QCD of up to $50,000 (indexed for inflation) to certain charitable remainder annuity trusts, charitable remainder unitrusts, or charitable gift annuities. **California conforms.**

8. Continuing into 2023, withdrawals are penalty free if the taxpayer is affected by a federally declared disaster. The withdrawal can be made within 180 days of the disaster if the taxpayer’s

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personal residence is within the disaster area and if he or she has sustained a loss. For disasters after Jan. 26, 2021, the Act limits the penalty withdrawal to $22,000. **California conforms.**

9. Beginning in 2024, both ROTH IRAs and Roth 401(k) plans will be exempt from RMDs until death of the account holder. **California conforms.**

10. Beginning in 2024, IRA catch-up contributions (currently $1,000) will be indexed for inflation.

11. California conforms.

12. Beginning in 2024, employers may match student loan payments with plan contributions. **California conforms.**

13. Beginning in 2024, unused 529 account savings may be rolled over into a ROTH IRA without penalty, provided the rollover amounts fall within annual ROTH IRA contribution limits and the 529 is at least 15 years old. **California does not conform.**

14. Beginning in 2024, the annual qualified charitable distribution (QCD) limit of $100,000 will be indexed for inflation. **California conforms.**

15. Beginning in 2024, all catch up contributions at age 50 or older will need to be made to a ROTH account if the taxpayer had wages in the prior year of $145,000 or more. The $145,000 number is indexed for inflation. The pre-tax catch-up contribution for 2023 is $7,500. In 2024, the high-income taxpayer will lose the deduction for a catch up contribution. **California conforms.**

16. Beginning in 2025. For plan years beginning after Dec. 31, 2024, new employer plans are required to auto-enroll eligible workers in elective deferral accounts. Businesses with 10 or fewer employees and businesses less than three years old are exempt. Unless the employee opts out, employees will be enrolled at a minimum contribution rate of 3% of their salary, increasing 1% a year thereafter until reaching a 10% contribution rate. **California conforms.**

17. Beginning in 2025, individuals ages 60 through 63 may make catch-up contributions to their deferred contribution plan of up to $10,000 (or 150% of the regular catch-up if greater). For 2023, the catch-up amount is $7,500. Thus ignoring inflation, the 2025 catch up amount would be $11,250 ($7,500 + 50% of $7,500 = $11,250) **California conforms.**

INFLATION REDUCTION ACT OF 2022 (AUG. 16, 2022)

President Biden signed into law on Aug. 16, 2022, the Inflation Reduction Act of 2022, a 730-page slimmed down successor to the Build Back Better Act addressing climate, health care and taxes. Tax provisions in the Act include (1) funds allocated to the IRS to increase enforcement, particularly aimed at upper income individuals and businesses, (2) an expansion of electric vehicles credits, (3) new credits for energy efficient home improvements, and (4) an extension of expanded ACA credits through 2025. A 15% corporate minimum tax that impacts very large corporations and a tax on corporate stock buybacks is included.

California does not conform to any of the provisions of IRA 2022. The state has its own incentives for energy efficiency and premium credits for health care coverage. In addition, California has a different calculation for corporate AMT under R&TC §23455(a) and §23455(d), and did not conform to the federal TCJA repeal.

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INFRASTRUCTURE INVESTMENT AND JOBS ACT (NOV. 15, 2021)

The Infrastructure Investment and Jobs Act contained three pages adding new reporting requirements for certain virtual currency transactions for statements required to be submitted after Dec. 31, 2023.

California does not conform to IRC sections requiring information returns be filed, but instead provides in RTC §18631 that a copy of certain federal information returns, including the information return for the proceeds from broker and barter exchanges and returns relating to cash received in a trade or business, are required to be filed with FTB upon request.

AMERICAN RESCUE PLAN ACT OF 2021 (MAR. 11, 2021)

The American Rescue Plan Act of 2021 provides additional relief to address the continued impact of COVID-19 on the economy, public health, state and local governments, individuals, and businesses.

Generally, **California does not conform** to the ARPA 2021 changes, including:

- extend unemployment benefits and related services;
- make up to $10,200 of 2020 unemployment compensation tax-free;
- make student loan forgiveness tax-free through 2025;
- provide a third-round maximum recovery rebate of $1,400 per eligible individual;
- expand and otherwise modify certain tax credits, including the child tax credit, child and dependent care credit, and the earned income tax credit.
- provide premium assistance for certain health insurance coverage; and
- provide small business assistance, including specific programs for restaurants and live venues.

CONSOLIDATED APPROPRIATIONS ACT 2021

Enacted December 31, 2020, the Consolidated Appropriations Act of 2021 (CAA 2021) contained three tax-related acts:

- COVID-Related Tax Relief Act of 2020,
- Economic Aid to Hard-Hit Small Business, Nonprofits, and Venues Act of 2020, and
- Taxpayer Certainty and Disaster Tax Relief Act of 2020.

The various acts provided new and extended provisions to further mitigate the impact of the COVID-19 pandemic. A second stimulus rebate payment was the major provision that affects individual clients.

Except for certain retirement plan changes, generally **California does not conform** to the CAA 2021 changes including:

- Second Recovery Rebate stimulus payments (California has enacted its own stimulus rebate plan, see below), but these payments are not taxable in the state because they represent an advance federal tax credit.
- Deduction of expenses paid with forgiven Payroll Protection Program (PPP) loan proceeds (but see new California legislation below).

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- Forgiveness of EIDL grants (again, see below for new California legislation).
- Exclusion from income for discharge of qualified principal residence indebtedness.
- Exclusion for certain employer payments of student loans.
- Extension of PMI deduction as mortgage interest expense.
- Modification of AGI limits for certain charitable deductions.

CORONAVIRUS AID, RELIEF & ECONOMIC SECURITY (CARES) ACT

FTB has provided information regarding conformity to the CARES Act in response to questions it has received. The state legislature has also taken action in a couple of areas.

Non-Taxable Benefits

Economic Impact Payments received from the federal government (i.e., $1,200 [$2,400 for individuals filing a joint return] and $500 per qualifying child) under the federal CARES Act ***are not*** subject to California income tax.

Increased Unemployment Compensation Benefits (in the amount of $600 per week) that individuals receive under the federal CARES Act ***are not*** subject to California income tax.

Loan Forgiveness Related to the Paycheck Protection Program - see new conforming legislation under New Conformity below.

California Conforms

California generally conforms to the pension-related items such as early withdrawal penalty, minimum distribution rule changes, etc. However, California did not have automatic conformity to the changes made with regard to loans from a qualified retirement account - see new legislation under New Conformity below.

California does not conform to some of the other changes made by the CARES Act, including those related to:

- NOL Carrybacks
- Charitable contributions
- Student loan forgiveness
- Business interest limitations
- Prior year alternative minimum tax liability (corporations)
- Health-savings accounts changes (California does not conform to health-savings account rules generally speaking)

SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT (SECURE) ACT UNDER FURTHER CONSOLIDATIONS APPROPRIATIONS ACT OF 2020

Multi-Employer Plans

The Act amends the IRC rules relating to multiple employer plans to provide relief from the “one bad apple” rule for certain plans “covered multiple employer plans”. California conforms.

Increase in Automatic Enrollment Safe Harbor to 15%

An automatic enrollment safe harbor plan must provide that, unless an employee elects otherwise, the employee is treated as electing to make elective deferrals at a default rate equal to a percentage of compensation as stated in the plan and at least (1) three percent of compensation for the first year the deemed election applies to the participant, (2) four percent during the second year, (3) five percent during the third year, and (4) six percent during the fourth year and thereafter. Although an automatic enrollment safe harbor plan generally may provide for default rates higher than these minimum rates, the default rate cannot exceed 10 percent for any year.

Under the SECURE Act, the 10-percent limitation on the default rates under an automatic enrollment safe harbor plan is increased to 15 percent after the first year that an employee's deemed election applies. **California conforms.**

Certain Taxable Non-Tuition Fellowship & Stipend Payments Treated as Compensation

Under SECURE, an amount includible in an individual's income and paid to the individual to aid the individual in the pursuit of graduate or postdoctoral study (such as a fellowship, stipend, or similar amount) is treated as compensation for purposes of IRA contributions. **California conforms**.

Repeal of Maximum Age for IRA Contribution

The provision repeals the prohibition on contributions to a traditional IRA by an individual who has attained age 70½. The provision also reduces the amount of qualified charitable distributions (QCDs) that may be excluded from gross income by the excess of:

1. The aggregate amount of IRA deductions allowed to the taxpayer for all taxable years ending on or after the date the taxpayer attains age 70½, over.

2. The aggregate amount of the reductions for all taxable years preceding the current taxable year.

   California does not conform to the repeal of the prohibition on contributions to a traditional IRA by an individual who has attained age 70½.

Participation for Long-Term Employees Working More Than 500 Hours

SECURE requires an IRC §401(k) plan to permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has met the age requirement (age 21) by the end of the three consecutive year period (for this proposal, an employee is referred to as a long-term part-time employee after having completed this period of service). **California conforms**.

Penalty-Free Withdrawals in Case of Birth of Child or Adoption

Under SECURE, an exception to the 10-percent early withdrawal tax applies in the case of a qualified birth or adoption distribution from an applicable eligible retirement plan (as defined). In addition, qualified birth or adoption distributions may be recontributed to an individual's applicable eligible retirement plans, subject to certain requirements. **California conforms**.

Increase in Age for Required Minimum Distributions (RMDs)

SECURE changes the age on which the required beginning date for required minimum distributions is based, from the calendar year in which the employee or IRA owner attains 70½ years to the calendar year in which the employee or IRA owner attains 72 years. Under the provision, prior law continues to apply to employees and IRA owners who attain age 70½ prior to January 1, 2020. **California conforms**.

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Treating Excluded Difficulty of Care Payments as Compensation

SECURE amends §415(c)(3) and §408(o) to increase the contribution limit to qualified retirement plans and individual retirement accounts to include "difficulty of care" payments. **California conforms**.

Plans Can Be Adopted by Filing Due Date for Year

If an employer adopts a qualified retirement plan after the close of a taxable year, but before the extended due date of the return, the employer can elect to treat the plan as having been adopted as of the last day of the taxable year.

This provision does not override rules requiring certain plan provisions to be in effect during a plan year, such as the provision for elective deferrals under a qualified cash or deferral arrangement ("generally referred to as a 401(k) plan"). **California conforms**.

Change in After-Death Rules for Defined Contribution Plans

Under SECURE, the five-year rule is expanded to become a 10-year period instead of five years ('10-year rule'), such that the 10-year rule is the general rule for distributions to designated beneficiaries after death (regardless of whether the employee (or IRA owner) dies before, on, or after the required beginning date) unless the designated beneficiary is an eligible beneficiary as defined in the provision. Thus, in the case of an ineligible beneficiary, distribution of the employee (or IRA owner's) entire benefit is required to be distributed by the end of the tenth calendar year following the year of the employee or IRA owner's death. Eligible beneficiaries include any beneficiary who, as of the date of death, is the surviving spouse of the employee (or IRA owner), is disabled, is a chronically ill individual, is an individual who is not more than 10 years younger than the employee (or IRA owner), or is a child of the employee (or IRA owner) who has not reached the age of majority. In the case of a child who has not reached the age of majority, calculation of the minimum required distribution under this exception is only allowed through the year that the child reaches the age of majority. **California conforms**.

OTHER PROVISIONS UNDER APPROPRIATIONS ACT 2020

Expansion of §529 Plans

The provision makes four modifications to section 529 plans.

1. The provision allows tax-free treatment applicable to distributions for higher education expenses to apply to expenses for fees, books, supplies, and equipment required for the participation of a designated beneficiary in an apprenticeship program. The apprenticeship program must be registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act.

2. The provision allows tax-free treatment to apply to distributions made for certain expenses in connection with a homeschool. Under the provision, distributions for certain homeschool expenses are treated in the same manner as distributions for qualified higher education expenses, and like distributions for elementary and secondary school tuition, are also subject to an annual limit of $10,000 in aggregate 529 distributions, per beneficiary. **California does not conform**.

3. The provision allows tax-free treatment to apply to distributions of certain amounts used to make payments on principal or interest of a qualified education loan. No individual may receive more than $10,000 of such distributions, in aggregate, over the course of the individual's lifetime.

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4. The provision adds additional qualifying expenses for distributions made on behalf of designated beneficiaries attending elementary or secondary school. Under the provision, in addition to tuition, tax-free treatment would apply to a distribution made for expenses for fees, academic tutoring, special needs services, books, supplies, and other equipment, incurred in connection with enrollment or attendance at such elementary or secondary school. Expenses for the purchase of computer technology or equipment or Internet access and related services are not considered eligible expenses under the provision. **California does not conform**.

Partial Conformity to §529 Plans

AB 340 (Ward, Stats. 2021, Ch. 557) provides some conformity to federal changes made in 2020 to §529 plans. The conformity is effective beginning with the 2021 tax year.

Specifically, **AB 340** adds expenses associated with participation in a registered apprenticeship program and payment of principal or interest of a qualified education loan to the definition of "qualified higher education expenses" for purposes of the R&TC§s partial conformity to the qualified tuition program (QTP) distributions provisions under IRC §529.

The payments of principal or interest of qualified education loans would be allowed as "qualified higher education expenses" if made to a beneficiary or a beneficiary's sibling, and would be subject to a lifetime limit of $10,000 separately for both the beneficiary and sibling.

Also, under the R&TC for taxable years beginning on or after January 1, 2021, **AB 340** disallows the deduction available on qualified education loan interest to the extent such interest is paid from a tax-free distribution of a QTP.

Tax on Unearned Income of Children

This Act repeals the kiddie tax provisions added by the TCJA. Therefore, the unearned income of children is taxed under the pre-TCJA laws. California never conformed to the TCJA provisions, so now **federal law conforms to California**.

Exclusion of Discharge of Qualified Principal Residence Indebtedness

Extends for three additional years, before January 1, 2021, the exclusion from gross income for discharges of qualified principal residence indebtedness. The provision also provides for an exclusion from gross income in the case of those taxpayers whose qualified principal residence indebtedness was discharged on or after January 1, 2021, if the discharge was pursuant to a binding written agreement entered into prior to January 1, 2021. California has modified exclusion for tax years 2007 through 2013.

Reduction in Medical Expense Deduction Floor

Extends the current 7.5 percent of AGI medical expense deduction threshold to taxable years ending before January 1, 2021. The provision also permanently changes the AMT threshold to be the same as for regular tax.

California's modified conformity allows a deduction for the amount of medical expenses unreimbursed by insurance that exceed 7.5 percent of federal AGI. The state never conformed to the 10 percent limitation. As a result, the threshold percentage of unreimbursed medical expenses is the same for both federal and state purposes for the 2017 through 2020 tax years for purposes of the personal income tax. However, for taxable years beginning on or after January 1, 2021, the threshold for deducting unreimbursed medical expenses for federal and state taxes will differ B 10 percent of federal AGI for federal taxes and 7.5 percent of federal AGI for state.

TAX CUTS AND JOBS ACT OF 2017

At the time of enactment, the single provision out of the massive TCJA of 2017 that California automatically conformed to was the elimination of recharacterizations of Roth IRA conversions. Since December 2017 the legislature has produced some conforming legislation to a few more of the TCJA 2017 changes as outlined below.

NEW CONFORMITY

PAYCHECK PROTECTION PROGRAM (PPP) LOAN FORGIVENESS

AB 1577 (Burke, Stats. 2020, Ch. 39) conforms California law to the exclusion from income for PPP loan forgiveness and the non-deductibility of expenses paid from forgiven loan proceeds.

Under §1106 of the CARES Act, a recipient of a covered loan under the PPP is eligible for forgiveness of indebtedness on the loan in an amount generally equal to the sum of certain costs incurred and payments made during the eight-week period beginning on the date of the origination of the covered loan, including payroll costs, certain mortgage interest payments, certain rent payments and certain utility payments.

The CARES Act specifically excluded the income resulting from the discharge of PPP loans from gross income for federal purposes under §1106 of the Act (pursuant to the authority of Title 15 USCA 636(a) (7)).

The Paycheck Protection Program and Health Care Enhancement Act (Public Law 116-139), increased appropriations for the PPP. The Paycheck Protection Program Flexibility Act of 2020 (Public Law 116-142), amended the CARES Act and Small Business Act to modify certain provisions related to loan forgiveness under the PPP, including increasing the covered period to 24 weeks, among other provisions. AB 1577, under California's Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), excludes from gross income covered loan amounts forgiven pursuant to the federal CARES Act, Paycheck Protection Program and Health Care Enhancement Act, or the Paycheck Program Flexibility Act of 2020.

The bill also provides that any deduction or credit otherwise allowable under this section be reduced by the amount of exclusion allowed.

> ***Practitioner Pointer.*** The federal legislation did not specifically disallow the deduction for expenses paid from forgiven loan proceeds - the IRS provided that guidance. Congress stepped in and allowed deductibility in CAA 2021 in December 2020.

Deducting Expenses Paid with Forgiven PPP Loan Proceeds

In CAA 2021, Congress codified taxpayers' right to claim expenses paid with PPP Loan proceeds that were forgiven. On April 29, 2021 Governor Newsom signed AB 80 (Burke, Stats. 2021, Ch. 17) to allow deduction for eligible expenses paid with covered loan amounts, with modifications.

In addition, AB 80 clarified that for California tax purposes, gross income does not include any covered loan amounts and advances from Economic Injury Disaster Loan (EIDL) Program forgiven under California's conformity to the following federal laws:

- CARES Act
- Paycheck Protection Program and Health Care Enhancement Act
- Paycheck Protection Program Flexibility Act of 2020
- CAA 2021

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CAA 2021 further allows deductions for eligible expenses paid for with covered loan amounts. With enactment of **AB 80** California law conforms to these federal provisions with modifications.

For California purposes, certain entities are excluded from this treatment. Ineligible entities include:

- a publicly traded company or
- one that does not meet the 25% reduction from gross receipts requirements under Section 311 of the CAA 2021.

These ineligible taxpayers may not deduct expenses paid with amounts received from PPP loans under this provision. The exclusion does not apply to deductions for eligible expenses paid with amounts from EIDL loans.

FTB does not intend to provide a new form or worksheet to determine ineligible taxpayers.

Taxpayers may file tax year 2020 original or amended returns to claim expenses made deductible under **AB 80** that were not previously deductible.

For taxpayers who claim the deductions on their federal returns for the 2021 tax year (under IRS Revenue Procedure 2021-20), California will permit these taxpayers to carry the deductions through to their California 2021 returns as well (this is provided the taxpayer did not claim the deduction in any other taxable year).

In addition, for an ineligible taxpayer, as described above, FTB expects the taxpayer to follow the rationale of the guidance in Revenue Ruling 2020-27, where the IRS stated borrowers who had a reasonable expectation of forgiveness in the future must reduce deductions in the year the expenses were paid, even if the forgiveness happens in a later year.

> ***Caution!*** ARPA expanded the PPP to include certain nonprofit entities and certain internet publishing organizations. California law **does not conform** to this expansion of PPP eligibility.

The Paycheck Protection Program Extension Act (PPPEA) was enacted on March 30, 2021, and extended the covered period of the PPP from March 31, 2021, through June 30, 2021.

New! California Conforms to PPPEA Exclusion from Income

AB 194 (Budget, Stats. 2022, Ch. 55) excludes from income loans forgiven under the PPPEA of 2021.

Additional California Relief for Certain Grants

SB 113 (Budget, Stats. 2022, Ch. 3) was enacted to allow an income exclusion for Shuttered Venue Operator (SVO) grants provided under CAA for tax years beginning on or after January 1, 2019 and for Restaurant Revitalization Fund (RRF) grants provided under ARPA for taxable years beginning on or after January 1, 2020. **SB 113** also allows the deduction of expenses, basis adjustments, and tax attribution adjustments for qualifying taxpayers for SVO and RRF grants.

TAX BASIS METHOD FOR REPORTING CAPITAL ACCOUNTS

Beginning in tax year 2020 under federal law, a partnership was required to use the tax basis method- as defined in the federal instructions- for reporting its partners' capital accounts for federal income tax purposes.

Beginning taxable year 2021, the FTB follows the changes made to the federal Schedule K-1 (Form 1065), and requires an entity taxed as a partnership to report its partners' or members' capital accounts on the

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Schedule K-1 (565) and Schedule K-1 (568) using the same tax basis method as described in the 2021 Instructions for Form 1065 but calculated under California law.

The Franchise Tax Board became aware that certain persons required to file Schedule K-1 (565) and Schedule K-1 (568) may be unable to timely comply with the requirement to report partner capital on the tax basis method as calculated under California law for 2021.

They really mean it for 2022!

In FTB Notice 2022-01, or taxable year 2021 only, the FTB will permit a taxpayer who files Form 565 or Form 568 to report its partners' or members' capital accounts on Schedule K-1 (565) or Schedule K-1 (568) using the tax basis method as determined under federal law, as reported on Schedule K-1 (Form 1065), or by using the tax basis method as determined under California law. However, this is limited solely to the capital account analysis on Schedule K-1 (565) and Schedule K-1 (568) for the taxable year 2021 and does not allow taxpayers to use their federal tax basis in lieu of their California tax basis for any other purpose, including reporting or determining their California tax liability.

Beginning taxable year 2022, and for every taxable year thereafter, the FTB will require a taxpayer who files Form 565 or Form 568 to report its partners' or members' capital accounts on the Schedule K-1 (565) and the Schedule K-1 (568) using the tax basis method as determined under California law.

Transitioning Capital Accounts for 2022

For tax year 2022 only, California permits several methods to restate beginning capital account balances on Schedule K-1 if the ending balance for 2021 was not reported on the tax basis method using California amounts. All methods can be found in the Instruction booklets for Forms 565 and 568. Three of the permitted methods, modified outside basis method, modified previously taxed capital method, and the Section 704(b) method require either estimated fair market value figures, basis valuations from contributing partners, or deemed sale of liquidation calculations.

One method, the **California modified federal tax basis method**, will probably be the easiest to implement. To use this method California requires the following:

1. Start the California beginning 2022 partner's capital account calculation using the federal beginning capital account balance if the 2021 federal partnership or LLC tax return was prepared in compliance with federal regs requiring the federal capital accounts to be stated on the entity's tax basis.

2. Then modify the federal beginning capital account balance by adjusting the federal amount by all historical California and federal tax differences, since inception, which would affect capital accounts. Use this resulting number for the beginning California tax basis capital account on the 2022 Schedule K-1s. (See below for a list of historical adjustments which may be needed.)

3. Attach a statement to each partner or LLC members' 2022 California K-1 indicating the method used to determine each partner or LLC members' California beginning capital account for 2022, in this case the statement would indicate the California modified federal tax basis method was used.

To report California tax basis beginning capital account balances as of January 1, 2022, figure the federal and California capital account differences for the entire entity historically, since inception, and then allocate the basis adjustment pro rata based on each partner or LLC members' ownership percentage.

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To quantify historical federal and California capital account differences for the purposes of determining the federal and California differences for the entire entity, since inception, **consider the following tax differences:**

Depreciation: Compare the December 31, 2021, depreciation schedules for federal and California and determine the difference in federal versus California accumulated depreciation including §179 and bonus depreciation. Generally, federal accumulated depreciation will be higher than California which will result in an addition to the federal beginning capital account to conform to California historical capital at tax basis. You may ignore assets which have been fully depreciated for federal and California and you may also ignore depreciable assets which have been sold. The difference in the federal and California gain or loss on the sale of depreciable assets would be a result of the difference in accumulated depreciation and therefore would be a wash for historical fed/state capital account differences.

ERTC (Federal Employee Retention Credit):

Federal ERTC refunds applicable to 2020 or 2021 wages, may take a little work to correctly adjust the California beginning capital accounts. First, if the 2020 or 2021 federal tax returns have already accounted for the ERTC refunds by reducing federal wage expense, then the federal capital account should have already been adjusted for the reduced federal wage expense and the non-deductible wages, resulting in a wash related to the federal capital account. Therefore, **the amount of the ERTC refund should be added to the California capital account as "tax free income" for 2020 and 2021**. The challenge will occur as more taxpayers apply for ERTC refunds for 2020 and 2021 wages and federal returns will be amended subsequently. In this case, if the ERTC refunds are received in tax year 2022 or subsequent years perhaps report the ERTC tax free income for California in the year the funds were received.

> ***Note:*** Currently there is an open issue regarding federal basis for ERTC refunds, however that should not affect California treatment of the refunds.

But Not Amortization:

Generally, California amortization conforms with federal, so there may be no adjustments needed.

Adjustments may not be needed for federal tax-free income taxable to California, and items deductible on federal return, but not on California return: In either case, these items already increase or reduce the capital account. These include:

- Franchise Tax
- LLC Annual Tax and Annual Fee
- California Pass-Through Entity Tax
- PPP and Other COVID Grants
- Nondeductible Expenses When Using Federal R & D Credit Regular Method
- Nondeductible Expenses From Federal Employer Tips Credit
- Meals & Entertainment Expenses

QUALIFIED RETIREMENT PLAN LOANS UNDER CARES ACT

§2202(b) of the CARES Act modified the rules applicable to loans from qualified retirement plans by increasing the monetary limit on loans not treated as distributions to the lesser of (1) $100,000, reduced by the excess (if any) of the highest outstanding balance of loans from the plan during the one year period

ending on the day before the date on which the loan was made over (a) the outstanding balance of loans from The plan on the date the loan was made, or (b) the greater of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (2) $10,000. These modifications apply to loans made to qualified individuals during the 180-day period beginning on March 27, 2020.

This provision also delays by one year the due date for any repayment for an outstanding loan from a qualified employer plan if the due date falls during the period beginning on March 27, 2020, and ending on December 31, 2020. This same period is also not taken into account in determining the five-year repayment period and term of the loan. §2202(b) of the CARES Act also clarifies that amendments to any plan or annuity contract would be treated as complying with the terms of the plan during this period.

Without Legislation, Excess Loans Would Be Taxable Distributions

R&TC §17081 conforms to federal law regarding loans from qualified plans as of January 1, 2015, and generally allows a qualified employer plan, to provide specified loans to a participant or a beneficiary that are not treated as taxable distributions from the plan if specified conditions are met. The loan limit was $50,000.

AB 276 (Friedman, Stats. 2020, Ch. 62) amends R&TC §17085 to conform to §2202(b) of the federal CARES Act, relating to qualified retirement plan loans.

OTHER CONFORMITY FOR SECTION 529 AND 529A PLANS

AB 91 (Burke, Stats. 2019, Ch. 39) conforms, with modifications, to some of the amendments to IRC §529 and §529A made by the TCJA. More specifically, the bill conforms to the allowance of rollovers between IRC §529 accounts and between §529 account and ABLE accounts.

Long Overdue Conformity for §529 and §529A Plans Included

In order to maintain account qualification for the ABLE program and the IRC §529 qualified tuition program, the language also conforms to IRC §529A and §529 changes made by the Protecting Americans from Tax Hikes (PATH) Act of 2016. More specifically, the state now conforms to the revision to the definition of qualified educational expenditures allowing computer equipment, software, and Internet expenses if primarily used by the beneficiary while enrolled at an eligible educational institution, conforms to the allowance of recontributions of refunded amounts, and conforms to the elimination of the residency requirement for qualified ABLE programs.

No Tax-Free Distributions for K-12 Education

AB 91 specifically does not conform to §11032 of the TJCA, which would provide account funding for primary and secondary education, while it maintains IRC §529 account qualification for any distributions made pursuant to §11032 of the TCJA, and clarifies the California tax treatment of distributions made under the §11032 amendments. So while under federal law tax-free distributions can be made for payments of primary and secondary school tuition, those distributions are currently taxable under California law and would remain so under this legislation. However, such distributions would not disqualify the plan for California purposes.

EXCLUSION FOR CERTAIN STUDENT LOAN INDEBTEDNESS

AB 91 (Burke, Stats. 2019 Ch. 39) conforms, with modification to effective date, to the federal treatment of student loan cancellation that are discharged on account of death or total and permanent disability of the student for discharges of indebtedness after Dec. 31, 2018.

ELIMINATION OF NOL CARRYBACKS

AB 91 (Burke, Stats. 2019 Ch. 39) disallows NOL carrybacks under the PITL and CTL, with limited exceptions, for NOLs attributable to taxable years beginning after Dec. 31, 2018. This provision also disallows the special rules under IRC §172 for REITs, excess interest losses, and corporate equity reduction interest losses.

In addition, this provision repeals conformity to IRC §6164, related to the allowance of an extension of time for payment of taxes by corporations expecting NOL carrybacks.

AB 91 does not allow for indefinite carryforward C California's carryforward remains at 20 years. Also, the state did not conform to the 80% taxable income limitation in the carryforward years.

SMALL BUSINESS ACCOUNTING METHOD CHANGES

AB 91 (Burke, Stats. 2019 Ch. 39) generally conforms to the TJCA's revised definition of small business for method of accounting rules as well as the small business exceptions for UNICAP rules, inventory accounting, and accounting for long-term contract rules. In addition, a taxpayer may elect to apply the provision regarding accounting for long-term contracts to contracts entered into on or after Jan. 1, 2018, in taxable years ending after Jan. 1, 2018.

Any change in method of accounting made pursuant to this provision shall be treated for purposes of applying §481 of the IRC, as applicable for California purposes under §17551, as initiated by the taxpayer and made with the consent of the FTB. California does not conform to the six-year recognition period for income adjustments under §481(a).

EXCESS BUSINESS LOSS LIMITATIONS

AB 91 (Burke, Stats. 2019 Ch. 39) generally conforms to the applicable TJCA section with regard to excess business losses with modifications for taxable years beginning after Dec. 31, 2018.

The legislation modifies the TJCA section's treatment of excess business losses carryforwards. This provision will treat any disallowed excess business loss as a "carryover excess business loss" for the following taxable year as opposed to an NOL carryforward. Taxpayers will be allowed to include any "carryover excess business loss" into their calculation of excess business loss in the following tax year.

For 2023, the California limits for business losses are $578,000 for married individuals filing jointly and$289,000 for other individuals.

NonConformity Because of CARES Act

The federal CARES Act temporarily modifies the loss limitation for noncorporate taxpayers so they can deduct excess business losses arising in 2018, 2019, and 2020 (§461(l)(1)). Thus, CARES removes the excess business loss limitation for 2018 through 2020. As a result, taxpayers are able to use their business losses to fully offset their capital gains or non-business income. **California does not conform.**

TECHNICAL TERMINATIONS

AB 91 (Burke, Stats. 2019 Ch. 39) conforms to the TJCA's repeal of the technical termination of a partnership for taxable years beginning on or after Jan. 1, 2019. A partnership may elect to have the repeal of the technical termination apply for taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2019, in a manner determined by the FTB.

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LIKE-KIND EXCHANGES

AB 91 (Burke, Stats. 2019 Ch. 39) conforms with modifications to the TJCA's modifications with respect to like-kind exchanges.

However, with respect to individuals, the conformity only applies to:

1. A taxpayer who is a head of household, a surviving spouse, or spouses filing a joint return with adjusted gross income, as defined in §17072, of $500,000 or more for the taxable year in which the exchange begins; or

2. For any other taxpayer with adjusted gross income, as defined in §17072, of $250,000 or more for the taxable year in which the exchange begins.

If a taxpayer does not meet one of the qualifications described above, the pre-TJCA IRC §1031 like-kind exchange rules, unless otherwise modified by the R&TC, continue to apply.

> ***Example.*** In June 2021, Karen disposes of a commercial building for $1 million and a realized gain of $750,000. Of the gain, $650,000 is real property and $100,000 is tangible personal property. For federal tax purposes, Karen can defer the $650,000 gain by completing a §1031 exchange into like-kind real property of sufficient value. The $100,000 gain from the tangible personal property must be recognized.
>
> ***CA result if Karen's AGI is $250,000 or more.*** Under new law, Karen's California tax treatment of the exchange will be the same as for federal purposes C deferral of $650,000 gain and recognition of $100,000 gain.
>
> ***CA result if Karen's AGI is under $250,000.*** Karen can also defer the $100,000 gain from the tangible personal property by acquiring and completing an exchange into like-kind tangible personal property of sufficient value.
>
> ***Preparer's Note.*** Could they make it any more complicated???!!

Effective date. This provision shall not apply to an exchange where the property to be disposed of by the taxpayer in the exchange is disposed of by that taxpayer on or before Jan. 10, 2019, or where the property to be received by the taxpayer in the exchange is received by that taxpayer on or before Jan. 10, 2019.

NEW NONCONFORMITY

In 2022, as in 2021, the California legislature created several new items of nonconformity with federal law.

MIDDLE CLASS TAX REFUND

In an effort to provide financial relief for Californians who are adversely impacted by the economic pressures due to inflation, increase in gas costs, and the effects of COVID-19 emergency, the legislature enacted AB 192 (Budget, Stats. 2022, Ch. 51) to provide a one-time payment to certain California recipients.

Known as the "Better for Families Act" or the "Middle Class Tax Refund," the bill authorizes the state Controller to make a one-time payment of as much as $1,050 to certain qualified recipients. A "qualified recipient" must satisfy all of the following requirements:

- Have filed a California individual income tax return on or before October 15, 2021, for the taxable year beginning on or after January 1, 2020, and before January 1, 2021.
- Meet the California adjusted gross income (CA AGI) limits described below.
- Is a resident on the date the payment is issued by the Controller.
- Was a resident of California for six months or more of the taxable year beginning on or after January 1, 2020 and before January 1, 2021.
- Was not eligible to be claimed as dependent by another taxpayer in the 2020 taxable year.

If the individual or their spouse applied for and did not receive their federal Individual Tax Identification Number (ITIN) on or before October 15, 2021, and included on the return either their federal ITIN, or, if married, the federal ITIN of their spouse and filed the required return on or before February 15, 2022, the individual would be considered a qualified recipient, assuming they meet all the other requirements.

In addition, a "qualified recipient" ***does not include*** an individual that satisfies all of the following:

- Is an individual without a dependent as determined under the RTC.
- Filed their California individual income tax return using the single filing status for the 2020 tax year.
- Is either deceased or incarcerated on the date the payment would be issued.

A qualified recipient that files a joint return with their spouse is considered one qualified recipient and receives only one payment. This one-time payment is not a refund of an overpayment of income taxes.

How Much is the Payment?

The applicable amount is based on the qualified recipient's filing status and 2020 adjusted gross income as shown in the chart.

Filing status	2020 California Adjusted Gross Income (AGI)	Payment without dependent	Payment amount with dependent
Married Filing Joint	$150,000 or less	$700	$1,050
	$150,001 to $250,000	$500	$750
	$250,001 to $500,000	$400	$600
Head of Household or Surviving Spouse (Qualified Widow/er)	$150,000 or less	$350	$700
	$150,001 to $250,000	$250	$500
	$250,001 to $500,000	$200	$400
All other individuals	$75,000 or less	$350	$700
	$75,001 to $125,000	$250	$500
	$125,001 to $250,000	$200	$400

In addition, the one-time payment is excluded from California gross income and is not subject to withholding or levy for liabilities due.

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HOPE FOR CHILDREN TRUST ACCOUNTS

For tax years beginning January 1, 2023, AB 156 (Budget, Stats. 2022, Ch. 569) establishes the Hope, Opportunity, Perseverance, and Empowerment (HOPE) for Children Trust Accounts. The program provides a trust account to an eligible child, defined to include minor California residents:

- who are specified dependents or wards under the jurisdiction of juvenile court in foster care with reunification services terminated by court order, or
- who have a parent, Indian custodian, or legal guardian who died due to COVID-19 during the federally declared COVID-19 public health emergency and meet the specified family household income limit.

The bill also excludes from gross income, for purposes of the personal income tax:

- funds deposited,
- any investment returns accrued, and
- any accrued interest in a HOPE trust account,

Also excluded from income are any funds withdrawn or transferred from that account.

Funds deposited, any investment returns accrued, and any accrued interest in a HOPE trust account, and any funds withdrawn or transferred from that account, are not earned income for purposes of eligibility for the California Earned Income Tax Credit and the Young Child Tax Credit.

COVID-19 RELIEF GRANT PROGRAM

In February 2021 the legislature enacted a bill to provide grants to businesses that were impacted by COVID-19. SB 87 (Caballero, *et al.*, Stats. 2021, Ch. 7) provides grants to qualified small businesses that would be required to be awarded in a minimum of three rounds, which includes a closed round, in the following amounts:

- Five thousand dollars ($5,000) for applicants with an annual gross revenue of one thousand dollars ($1,000) to one hundred thousand dollars ($100,000) in the 2019 taxable year.
- Fifteen thousand dollars ($15,000) for applicants with an annual gross revenue greater than one hundred thousand dollars ($100,000), and up to one million dollars ($1,000,000), in the 2019 taxable year.
- Twenty-five thousand dollars ($25,000) for applicants with an annual gross revenue greater than one million dollars ($1,000,000), and up to two million five hundred thousand dollars ($2,500,000), in the 2019 taxable year.

The grants are administered by the Office of Small Business Advocate (CalOSBA). Through July 29, 2021, CalOSBA had funded 180,939 small businesses for a total of $2,034,395,811 in grants under the first six funding rounds.

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In July 2021 the legislature allocated an additional $1.5 billion for a total of $4 billion in direct grants to California's small businesses.

SB 87 also exempts grants from gross income under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) and provide authority to the Franchise Tax Board (FTB) to collect any grants identified for recapture by the CalOSBA. SB 151 (Budget, Stats. 2021, Ch. 74) also made the grants from the new funding rounds exempt from state tax.

NEW SMALL BUSINESS & NONPROFIT COVID-19 RELIEF GRANTS

AB 152 (Budget, Stats. 2022, Ch. 736) establishes the California Small Business and Nonprofit COVID- 19 Relief Grant Program within GO-Biz to assist qualified small businesses or nonprofits that are incurring costs for COVID-19 supplemental paid sick leave. The bill requires GO-Biz to provide grants to qualified small businesses or nonprofits. The bill would repeal these provisions on January 1, 2024.

The bill excludes, for taxable years beginning on or after January 1, 2020, and before January 1, 2030, from gross income grant allocations received by a taxpayer pursuant to the California Small Business and Nonprofit COVID-19 Supplemental Paid Sick Leave Relief Grant Program. The bill also sets forth procedures for recapturing grant amounts if GO-Biz determines that the grantee has failed to meet the criteria for a qualified small business or nonprofit.

ELECTIVE PASS-THROUGH ENTITY TAX: PTET

A budget trailer bill, AB 150 (Budget, Stats. 2021, Ch. 82), is California's attempt to provide some federal tax relief to individuals trapped by TCJA's state and local tax (SALT) limitation. The bill creates the Small Business Relief Act (SBRA), and, for taxable years beginning on or after January 1, 2021, and before January 1, 2026, allow pass-through entities (PTEs) taxed as a partnership or an S corporation to pay an additional elective tax, on behalf of partners and shareholders, at the entity level.

Then, under the PITL, a qualified taxpayer, who is an owner of a qualified entity that makes an annual election to pay an additional elective tax authorized by the bill, is allowed a tax credit in an amount equal to 9.3 percent (9.3%) of the qualified taxpayer's pro rata or distributive share, as applicable, of the qualified net income subject to the election made by an electing qualified entity for taxable years beginning on or after January 1, 2021, and before January 1, 2026.

Qualifying Entities

A qualifying entity is an entity taxed as a partnership or S corporation. A qualified entity does not include:

- Publicly traded partnerships
- An entity permitted or required to be in a combined reporting group
- An entity that has a partnership as a partner, member, or shareholder **see new legislation below**
- Qualified Taxpayer A qualified taxpayer: Can be individuals, fiduciaries, estates, or trusts subject to California personal income tax
- Must be a partner, member, or shareholder of an electing qualified entity

To be qualified, a taxpayer must consent to have his/her pro rata or distributive share of the qualified net income of the electing qualified PTE under the PITL or the CTL subject to tax under the PITL.

A qualified taxpayer is not a:

- Disregarded business entity and its partners and members
- Corporation
- Partnership

How to Make the PTET Election

An annual election is made on an original, timely filed tax return. Once the election is made, it is irrevocable for that year and is binding on all partners, shareholders, and members of the PTE.

2021 taxable year. The election must be made on a timely-filed tax return.

2022 to 2025 taxable years. Beginning on or after January 1, 2022, and before January 1, 2026, the election must be made when the tax return for the taxable year is filed and the PTE must make an initial payment by June 15 (For 2023, October 16 for most California counties.)

> ***Practitioner Point!*** For taxable years beginning on or after January 1, 2022, and before January 1, 2026, the PTE may not make an election if the initial payment is not made by June 15, (For 2023, October 16 for most California counties.)

When to Pay the Elective Tax

2021 taxable year. Pay the elective tax on or before the due date of the original tax return. 2022 to 2025 taxable years. Use the following table:

Payment Dates

Due	Payment
On or before June 15th of the taxable year of the election. (For 2023, October 16 for most California counties.)	Payment 1 Pay $1,000 or 50% of the elective tax paid in the prior taxable year, whichever is greater.
On or before the due date of the original return without regard to extensions	Payment 2 Pay the remaining amount.

PTE Elective Tax Calculation

The elective tax is 9.3% of the entity's qualified net income, which is the sum of the pro rata or distributive share of each qualified taxpayers' income subject to California personal income tax.

How to Claim the Tax Credit

Qualified taxpayers are eligible to claim a nonrefundable credit for the amount of tax paid on the qualified taxpayers' pro rata or distributive share of the qualified entity's qualified net income. Unused credits can be carried over for up to 5 years. Qualified taxpayers can claim the credit on their personal income tax return.

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What Form To File

FTB has developed the following tax forms for qualified entities to make the PTE elective tax payments and for qualified taxpayers to claim the tax credit:

- Pass-Through Entity Elective Tax Payment Voucher (FTB 3893)
- Pass-Through Entity Elective Tax Calculation (FTB 3804), filed with Forms 565, 568, or 100S
- Pass-Through Entity Elective Tax Credit (FTB 3804-CR), filed with Forms 540 or 540NR

FTB Issues FAQs to Assist with PTE Elective Tax

FTB continues to update and enhance its Frequently Asked Questions page for the pass-through entity elective tax. A small sampling here:

Q. Is the PTE elective tax included in the calculation of the underpayment of estimated tax penalty?

A. The PTE elective tax liability is not included when computing the qualified entity's estimated taxes due under R&TC) §19136.

However, the PTE tax credit does reduce the computation of estimated payments for qualified taxpayers.

Q. How are underpayments of the PTE elective tax treated?

A. The tax is based on the qualified net income of the qualified entity, and the correct amount of tax must be paid by the due date of the original return. Applicable penalties and interest will apply to underpaid amounts. For the PTE credit, the credit amount is based on the taxpayer's pro rata or distributive share of income subject to tax that is subject to the qualified entity's election.

> ***Caution!*** Underpayments of prepayments due by June 15 (Or Oct 16 for 2023) of taxable years beginning on or after January 1, 2022, and before January 1, 2026, will result in an inability to make the PTE tax election.

Q. How are overpayments of the PTE elective tax treated?

A. If the entity overpaid the tax, the overpayment will be applied to other liabilities or refunded to the entity after a tax return is filed. For the PTE credit, the credit amount is based on the taxpayer's pro rata or distributive share of income subject to tax that is subject to the qualified entity's election.

S Corporation, LLC & Partnership Mandatory Electronic Payments

In a news release in April 2022 FTB reminds taxpayers that S corporations and limited liability companies classified as S corporations whose total tax liability, including any AB 150 pass-through entity elective tax, exceeds $80,000 are required to make all future payments electronically (R&TC §19011(a)(2)).

New! Changes Made to California's Elective PTE Tax

SB 113 (Budget, Stats. 2022, Ch. 3) amended the Pass-through Entity Elective Tax and the Pass-through Entity Tax Credit. The following changes apply for taxable years beginning on or after January 1, 2021:

- The Pass-through Entity Tax Credit can reduce the amount of tax due below the tentative minimum tax.

- Qualified net income includes a qualified taxpayers' guaranteed payments received from the qualified entity subject to California personal income tax.
- A qualified entity can have a partnership as a direct owner.
- A qualified taxpayer who is a partner, member, or shareholder of a qualified entity can be a disregarded single member limited liability company (SMLLC), as long as the disregarded SMLLC is solely owned by an individual, fiduciary, estate, or trust subject to California personal income tax.

Additionally, for taxable years beginning on or after January 1, 2022, the Pass-through Entity Tax Credit should be applied after the other state tax credit.

Application of Payments

With the PTE elective tax being new, the question of whether **use tax** was to be satisfied prior to PTE elective tax arose. In Service Bulletin 2022-11, FTB announced that when use tax and PTE elective tax are reflected on the return and all liabilities are not paid, payments received will be applied following the existing rules. Once use tax is satisfied, any remaining balance will be applied to franchise, income, or PTE elective tax.

This follows the FTB's existing procedures. If a taxpayer includes use tax on their income tax return, payments and credits are applied to use tax first, then towards other taxes such as franchise or income tax, pass-through entity (PTE) elective tax, interest, or penalties.

New 2023 California instructions indicate if a balance due on a pass-through entity tax return, Form 100-S, Form 565, Form 568, or Form 541, includes any amount for CA PTET elective tax due, the entity should make the portion of the payment attributable to PTET on Form 3893 or pay online as a PTET payment, and do not combine payments due for any franchise tax due and PTET balance due with the same payment.

CALIFORNIA INDIVIDUAL HEALTHCARE MANDATE

SB 78 (Budget, Stats. 2019, Ch. 38) creates a California Individual Healthcare Mandate, a program similar to the Affordable Care Act (ACA) administered by the Internal Revenue Service (IRS), but the state program will be administered by the California Health Benefit Exchange (Exchange) and the Franchise Tax Board (FTB).

Beginning Jan. 1, 2020, California residents and their dependents are required to obtain and maintain monthly healthcare coverage, unless they qualify for an exemption from the mandate. The Exchange, the state's insurance marketplace, will provide financial assistance to households that meet certain income requirements and certify those who are exempt from the mandate.

If an individual required to obtain health insurance under the mandate fails to obtain healthcare coverage, a penalty per uninsured person may be imposed on the individual. This penalty is referred to as the Individual Shared Responsibility Penalty (Penalty).

At the end of each year, taxpayers will either verify they maintained minimum essential coverage or verify their exemption from the mandate. Those who lacked health insurance and were not exempt from the mandate will compute and pay the Penalty on their California individual tax return.

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Penalty Calculation Similar to Federal Mandate Penalty

The penalty is equal to the lesser of either of the following amounts, and is computed as follows:

1. The sum of the monthly penalty amounts for months in the taxable year during which one or more failures occurred.

2. An amount equal to one-twelfth of the state average premium for qualified health plans that have a bronze level of coverage for the applicable household size involved and are offered through the Exchange for plan years beginning in the calendar year with or within which the taxable year ends, multiplied by the number of months in which a failure occurred.

For purposes of computing (1) above, the monthly penalty amount for any month during which a failure occurred is an amount equal to one-twelfth of the greater of either of the following amounts:

An amount equal to the lesser of either of the following:

- The sum of the applicable dollar amounts for all applicable household members who failed to enroll in and maintain MEC during the month unless they did not maintain MEC for a continuous period of three months or less.
- Three hundred percent of the applicable dollar amount determined for the calendar year during which the taxable year ends.

An amount equal to 2.5 percent of the excess of the responsible individual's applicable household income for the taxable year over the amount of gross income that would trigger the responsible individual's requirement to file a state income tax return based on the applicable filing threshold for the taxable year.

The applicable dollar amount is subject to cost-of-living adjustments.

The 2023 applicable dollar amount for adults is eight hundred fifty dollars ($850). If an applicable individual has not attained 18 years of age as of the beginning of the month, the applicable dollar amount with respect to that individual for that month shall be equal to one-half of the applicable dollar amount ($425).

Penalty Capped for Household of Five or More

AB 85 (Budget, Stats. 2020, Ch. 8) limits the monthly penalty for a responsible individual with an applicable household size of five or more to the maximum monthly penalty for a responsible individual with an applicable household size of five individuals.

Gap in Coverage

A short gap coverage exemption applies for taxpayers who did not have coverage for 3 consecutive months or less. (The federal short gap coverage exemption was for not having coverage less than 3 consecutive months.)

Sample Penalty Amounts

Household Size	If you make less than	You may pay
Individual	$49,763	$850
Married Couple	$92,100	$1,700
Family of 4 (2 adults 2 children)	$142,000	$2,550

Penalty Calculator

FTB has a Penalty Estimator tool available on its website.

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FTB Collection Authority

SB 78 prescribes that FTB shall collect the Individual Shared Responsibility Penalty (ISRP) through use of all normal collection methods, except for liens or levies on real property and criminal prosecution. Therefore, taxpayers and their representatives can expect that the scope of collection activities will occur via the normal processes, with the exclusion of the items mentioned above.

FTB will continue to apply all payments in their normal application hierarchy. Payments cannot be applied to the ISRP before tax.

Premium Subsidies Available

In addition, taxpayers may be eligible to receive subsidies from the Exchange to help cover the cost of their required insurance.

At the end of each year, taxpayers are required to reconcile the subsidies received based on projected income against their subsidies they were entitled to based on actual income. The reconciliation may result in a refund or a liability depending on the difference between the actual subsidy received and the subsidy they were entitled to receive.

Federal and State Comparison Chart

	Federal	State
Mandate	Each resident, spouse, dependent obtain & maintain MEC for each month of the year	No difference
Exemptions	Marketplace will grant exemptions from mandate for: religious conscience, affordability, general hardship. Claimed on tax return: income filing threshold, affordability, short coverage gap, residency, healthcare sharing ministry, American Indian, incarceration, death, Medi-Cal, birth/adoption	No difference
Financial Assistance	Advanced premium assistance for households between 100% and 400% of Federal Poverty Level (FPL)	Advanced premium assistance for households at or below 138% and between 200% and 600% of Federal Poverty Level (FPL)
Reporters	Marketplace, Insurance Providers, All Employers	Marketplace, Insurance Providers, Certain Employers
Forms for Reporting	IRS Form 1095-A (Marketplace) IRS Form 1095-B Insurance Providers IRS Form 1095-C Employers	Form FTB 3895 (Marketplace) IRS Form 1095-B Insurance Providers IRS Form 1095-C Employers
Filing Due Dates	February 28 paper, March 31 e-file	March 31
Penalty for Failure to Report	$250 for each unreported individual	$50 for each unreported individual
Subsidy Reconciliation	IRS Form 8962 - reconcile amount of premium subsidy received with accrual income tax filing, limit on repayment of overpaid subsidy amount	Form FTB 3849 - reconciliation required, limit on repayment of overpaid subsidy amounts differ from IRS
Tax Penalty for not having insurance	IRS Form 8965 (discontinued) $0 penalty beginning in 2019	Form FTB 3853 - Calculated monthly, based on lowest level bronze plan, number in household, income level

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New Financial Assistance Coming in 2023

Beginning July 1, 2023, AB 2530 (Wood, Stats. 2022, Ch. 695) the Covered California will begin to administer a program of financial assistance to help Californians obtain and maintain health benefits through the Exchange if they lose employer-provided health care coverage as a result of a labor dispute. Under the bill, if specified eligibility requirements are met, an individual who has lost minimum essential coverage from an employer or joint labor management trust fund as a result of a strike, lockout, or other labor dispute would receive the same premium assistance and cost-sharing reductions as an individual with a household income of 138.1% of the federal poverty level, and, beginning January 1, 2024, would also not pay a deductible for any covered benefit if the standard benefit design for a household income of 138.1% of the federal poverty level has zero deductibles.

This bill also excludes from gross income any subsidy amount received pursuant to the above-described program of financial assistance.

NOLs SUSPENDED (AGAIN!)

In a budget trailer bill, AB 85 (Budget, Stats. 2020, Ch. 8), the legislature took steps to help relieve the current deficit.

For taxable years 2020, 2021 and 2022, the deduction for NOLs is suspended. However, the suspension of NOLs does not apply to a taxpayer:

- under the PITL, with modified adjusted gross income or net business income of less than $1 million,
- under the CTL, with income subject to tax of less than $1 million

The provision also extends the NOL carryover period by one year for NOLs incurred in taxable year 2021, two years for NOLs incurred in taxable year 2020, and three years for NOLs incurred in taxable years beginning before 2020.

“Modified adjusted gross income” would mean the amount required to be shown as adjusted gross income on the federal tax return for the same taxable year without taking into consideration the NOL deduction. “Net business income” means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.

New! NOL Suspension Lifted for 2022 & Beyond

SB 113 (Budget, Stats. 2022, Ch. 3) reinstates the NOL deduction one year early – for tax years beginning on or after January 1, 2022.

DEDUCTION RELATED TO CANNABIS ACTIVITIES

Federal law states that no deduction or credit is allowed for any amount paid or incurred during the taxable year in carrying on any trade or business that consists of trafficking in specified controlled substances, including cannabis.

The treatment of deductions and credits attributable to a trade or business that is engaged in commercial cannabis activities by a licensee under state law differs depends on whether the licensee is subject to the PITL or CTL.

Personal Income Tax Law Treatment

The PITL conforms to federal law with respect to the treatment of amounts paid or incurred with respect to commercial cannabis activity in that no deduction or credit is allowed for any amount paid or incurred during the taxable year related to that activity (except cost of goods sold).

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Corporation Tax Law Treatment

Under the CTL, a licensee engaged in commercial cannabis activity is allowed otherwise allowable deductions or credits assuming the entity has adequate records to substantiate these items.

Individual Cannabis Businesses Get a Break

Under the PITL, for taxable years beginning on or after Jan. 1, 2020, and before Jan. 1, 2025, AB37 (Jones-Sawyer, Stats. 2019, Ch. 792) allows licensees engaged in commercial cannabis activity to deduct expenses and claim tax credits related to that trade or business.

"Commercial cannabis activity" and "licensee" would have the same meaning as specified in §26001 of the Business and Professions Code.

CA FORM 4197, INFORMATION ON TAX EXPENDITURE ITEMS FOR CANNABIS BUSINESSES

Special Reporting for R&TC Section 41

Beginning in taxable year 2020, partners, LLC members, shareholders, or beneficiaries of pass-through entities conducting a commercial cannabis activity licensed under the California Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA) should file form FTB 4197, Information on Tax Expenditure Items.

Cannabis Pass-Through Entities Provide a Statement to Partners & Shareholders

Only individuals, or individual owners of a SMLLC, which have a cannabis business is required to file Form 4197. Partnerships and S corporations are required to provide a statement to each K-1 recipient reporting the applicable share of total deductions and credits related to the cannabis income reported on Schedule K-1. Then the partner or S corp shareholder is required to File Form 4197 using the information from this statement. The Franchise Tax Board (FTB) uses information from form FTB 4197 for reports required by the California Legislature.

Schedule K-1 Form 4197 Statement Required for K-1 Recipients (Attach to Ca K-1)

Activity code: CBIS

Pro-rata share of total deductions: $___________

Pro-rata share of total credits: $___________

Taxpayers required to file form FTB 4197 include the following:

- Individuals operating a commercial cannabis activity licensed under CA MAUCRSA.
- Individual owners of single member limited liability companies (SMLLCs) operating a commercial cannabis activity licensed under CA MAUCRSA.
- Individual shareholders, beneficiaries, partners, or members that received Schedules K-1 (100S, 541, 565, or 568), Share of Income, Deductions, Credits, etc., from an S corporation, an estate or trust, a partnership, or an LLC taxed as a partnership, that are operating commercial cannabis activities licensed under CA MAUCRSA.
- C corporations (including corporation filing a combined report) and S corporations which are partners in a partnership and received Schedule K-1 from a partnership that is operating a commercial cannabis activity licensed under CA MAUCRSA. (R&TC Section 41)

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LINGERING NONCONFORMITY DEPRECIATION AND §179 EXPENSING

Section 179

Federal §179 Chart	2022	2023
Maximum §179 Deduction	$1,080,000	$1,160,000
Maximum Annual Qualifying Property Before Phaseout	$2,700,000	$2,800,000

California's maximum §179 expense continues to be $25,000 in 2022 and 2023. Moreover, that allowance begins to phase out when total assets placed in service exceeds $200,000.

California §179 Chart	2022	2023
Maximum §179 Deduction	$25,000	$25,000
Maximum Annual Qualifying Property Before Phase-out	$200,000	$200,000

Special Bonus Depreciation

An additional first-year depreciation deduction equal to 80% of the adjusted basis of qualified property is allowed and applies to property placed in service after Dec. 31, 2022.

For 2022, the additional first-year depreciation deduction was equal to 100% of the adjusted basis of qualified property placed in service after Sep. 27, 2017, and before Dec. 31, 2022.

> **Example.** Assume that in June 2023, Sharon purchases new depreciable property and places it in service. The property's cost is $10,000, and it is a five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is $8,000. Sharon's total 2023 depreciation deduction is $8,000.

California does not conform to the 80% first-year bonus depreciation for assets placed in service in 2023. As a result, assets placed in service in 2023 will have a reduced depreciation expense for California, a different adjusted basis beginning after the first year, and resultant different (higher) depreciation expense in subsequent years.

> **Example of California Depreciation.** Sharon, in the above example, deducts only the standard first-year MACRS depreciation of $2,000 (20% of $10,000 basis) on her California return, instead of the $8,000 deductible federally.

Luxury Automobiles

TCJA 2017 increases the depreciation limitations under IRC §280F that apply to listed property. For passenger automobiles placed in service after Dec. 31, 2017, and for which the additional first-year depreciation deduction under IRC section 168(k) is not claimed, per Rev. Proc. 2023-14, the maximum amount of allowable depreciation in 2023 is $12,200 for the year in which the vehicle is placed in service, $19,500 for the second year, $11,700 for the third year, and $6,960 for the fourth and later years in the recovery period. The limitations are indexed for inflation for passenger automobiles placed in service after 2018.

The TCJA also removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the heightened substantiation requirements that apply to listed property.

California does not conform to the new luxury auto limits or the modification to listed property.

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HEALTH SAVINGS ACCOUNTS

California does not recognize Health Savings Accounts (HSAs). Californians with HSAs will find the following differences:

- Contributions to the HSA are not tax-deductible,
- Employer contributions are taxable wages to the employee,
- Earnings in the HSA are not tax-deferred,
- Contributions and earnings create California basis in the HSA,
- Distributions are not taxable, and
- Medical expenses paid with HSA proceeds are deductible on California return

Should California Employers Ignore HSAs?

Despite the lack of any state tax benefit, Californians can still benefit from HSAs. All of the federal benefits, particularly lower premiums, make HSAs an attractive alternative for many in the state.

REAL ESTATE PROFESSIONALS

Beginning in 1994 and for federal purposes only, rental real estate activities of taxpayers engaged in real property business are not automatically treated as passive activities (IRC §469(c)(7)). California did not conform to this provision. For California purposes, all rental activities are passive activities.

MORTGAGE INSURANCE PREMIUMS AS RESIDENCE INTEREST

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible. The federal Consolidated Appropriations Act of 2019 extends the deduction for private mortgage insurance premiums for three years (with respect to contracts entered into after December 31, 2017) and the Consolidated Appropriations Act 2021 further extends the deduction through December 31, 2021. Thus, the provision applies to amounts paid or accrued after December 31, 2017, and on or before December 31, 2021, (and not properly allocable to any period after 2021).

The R&TC specifically does not conform to the federal deduction for private mortgage insurance premiums. As a result, private mortgage insurance premiums are not deductible under California law, and taxpayers who deduct such premiums on their federal tax returns report the amount deducted for federal purposes as a California adjustment on Schedule CA (540/540NR).

S CORPORATION BUILT-IN GAINS TAX (BIG)

Under IRC §1374(d)(7)(A), a corporate level tax at the highest marginal rate applicable to corporations (currently 35%) is imposed on an S corporation's gain that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period (i.e., the 10-year period beginning with the first day of the first taxable year for which the S election is in effect).

The BIG tax also applies to gains with respect to net recognized BIG attributable to property received by an S corporation from a C corporation in a carryover basis transaction. In the case of BIG attributable to an asset received by an S corporation from a C corporation in a carryover basis transaction, the recognition

period rules are applied by substituting the date such asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.

Gains recognized in the recognition period are not BIG to the extent they are shown to have arisen while the S election was in effect or are offset by recognized built-in losses. The amount of the BIG tax is treated as a loss taken into account by the shareholders in computing their individual income tax.

Congress Shortens BIG Tax Recognition Period and California Does Not Conform

Under the provisions of **ARRA 2009**, for any taxable year beginning in 2009 and 2010, no tax is imposed on an S corporation under IRC §1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year. Also, in the **Small Business Jobs Act of 2010** (extended by the **American Taxpayer Relief Act of 2012**, the **Tax Increase Prevention Act of 2014**, and the **PATH Act**) for taxable years beginning in 2011 and later for purposes of computing the BIG tax, the "recognition period" is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation.

Under R&TC §17087.5, §23800, and §23809, California conforms by reference to IRC §1374, relating to tax imposed on certain BIG, as of the "specified date" of Jan. 1, 2009 (and now Jan. 1, 2015). Because the provisions in ARRA, SBJA, ATR, and TIPA (to reduce temporarily the recognition period for the BIG tax) were enacted between the "specified dates," California does not conform for 2009B2014.

CREDITS

CALIFORNIA EARNED INCOME TAX CREDIT

SB 80 (Budget Comm., Stats. 2015, Ch. 21) created the new California Refundable Earned Income Tax Credit (CA EITC). The new credit is operable for tax years beginning on or after Jan. 1, 2015. The CA EITC is an amount equal to an amount determined in accordance with IRC §32 as applicable for federal income tax purposes for the taxable year, except as discussed below.

The amount of the credit is multiplied by the EITC adjustment factor for the taxable year. Unless otherwise specified in the annual Budget Act, the EITC adjustment factor for taxable years beginning on or after Jan. 1, 2015, is 0%. (For taxable year 2020, the EITC adjustment factor in the Budget Act is 85%.)

Self-Employment Income Counts Starting in 2017

For taxable years beginning on or after Jan. 1, 2017, SB 106 (Budget, Stats. 2017, Ch. 96) modifies the CA EITC by including, in the definition of earned income, net earnings from self-employment, consistent with federal law.

Maximum AGI and Age Limitation Change

Although SB 855 (Budget, Stats. 2018, Ch. 52) increased the maximum AGI limits beginning in 2018 and revised the age limit for an eligible individual without a qualifying child to 18 years or older, rather than between the ages of 25 and 64 years, the 2019 budget brought more changes.

AB 91 (Burke, Stats. 2019, Ch. 39) modifies the California EITC by increasing the maximum AGI limits to $30,000 for an eligible individual with a qualifying child or without a qualifying child for taxable years beginning on or after Jan. 1, 2019. To accomplish the increase in the maximum AGI limit, this provision provides two new tables: 1) the credit and phase-out percentage table, and 2) the earned income and phase- out amount table. The $30,000 maximum AGI limit would be increased by the percentage change

as calculated under R&TC section 17041(h) for any taxable year, and the following taxable years, in which the minimum wage is set at 15 dollars an hour.

Additionally, AB 91 specifies that for taxable years beginning on or after Jan. 1, 2019, and before Jan. 1, 2020, the percentage change in the California Consumer Price Index (CCPI) would be deemed to be the greater of 3.5 percent or the percentage change in the CCPI as calculated under R&TC §17041(h) for that taxable year.

California Conforms to Make Permanent Federal Enhanced Credit

Beginning with the 2016 tax year, the enhanced federal 45% credit rate was made permanent and added to the permanent credit-rate table. The paragraph that contained the temporary enhanced 45% credit rate was repealed.

For taxable years beginning on or after Jan. 1, 2016, SB 1073 (Monning et al., Stats. 2016, Ch. 722) makes permanent the CA EITC's 45% credit rate for three or more qualifying children by adding the enhanced rate to the permanent credit table, consistent with recent federal changes.

Using Federal ITINs instead of Social Security Number

Under current law, there are specific requirements in order to be eligible for the CalEITC. AB 1876 (Budget, Stats. 2020, Ch. 87) expands eligibility by modifying the identification number requirements.

For each taxable year beginning on or after January 1, 2020, the CalEITC is revised by allowing eligible individuals, their spouses, and qualifying children to have either a (1) federal ITIN or (2) social security number (SSN) without regard to its being valid for employment. Use of a federal ITIN would no longer be conditioned on having a qualifying child younger than six years old as of the last day of the taxable year.

The bill requires that an eligible individual, eligible individual's spouse, or qualifying child using a federal ITIN, provide upon request of the FTB:

- Identifying documents acceptable for purposes of proving identity as authorized by Vehicle Code §12801.9(a) and (c), and related regulations for purposes of establishing documents acceptable to prove identity.
- Identifying documents used to report earned income for the taxable year.

Additionally, upon receiving a valid social security number, the individual shall notify the FTB in the time and manner prescribed by the FTB.

As a result of the expanded eligibility for the CalEITC, eligibility for the Young Child Tax Credit (YCTC) is expanded by allowing a "qualified taxpayer" and "qualifying child" to have either an SSN or federal ITIN.

Taxpayer Allowed Modified CalEITC without Qualifying Child

S. Hardison took the CalEITC on his 2019 tax return, claiming his three younger siblings as his dependents. To qualify for the EITC, taxpayers must have a qualifying child. A qualifying child must meet three criteria:

1. the child must be the taxpayer's child or stepchild, foster child, sibling or stepsibling or a descendent thereof.
2. the child must have the same principal residence as the taxpayer for more than half of the tax year; and

3. the child must be younger than the taxpayer and either under the age of 19 or under the age of 24 and a full-time student.

Furthermore, there is a special rule relating to two or more who can claim the same qualifying child. If the parents of an individual may claim such individual as a qualifying child but no parent so claims the individual, such individual may be claimed as the qualifying child of another taxpayer but only if the adjusted gross income of such taxpayer is higher than the highest adjusted gross income of any parent of the individual.

However, in this case the taxpayer's parents (who could but did not claim the children) had a higher AGI. Taxpayer was granted a lower, modified AGI available for taxpayers with no qualifying children (***Appeal of Hardison,*** OTA No. 21037392, December 2021).

Taxpayers Allowed CalEITC on Earned Income From IHSS Payments

F. and M. Akhtar filed a joint tax return for 2018 reporting wages of $6,308 and claimed refundable federal and California Earned Income Tax Credits (EITCs). The CalEITC was $1,279. FTB refused the refund because the wages reported were In-Home Supportive Services (IHSS) payments for caring for their disabled daughter.

FTB's position was that the wages were not taxable, and therefore not earned income, nor were they subject to withholding. The Akhtars were in receipt of a W-2 for the amount, but no withholding was reported. The Akhtars also reported the payments as taxable wages on their returns. The appellate board determined that because the wages were reported as taxable income (even though no withholding was taken), the taxpayers were entitled to the CalEITC (***Appeal of Akhtar,*** OTA No. 19105322, February, 2020).

New! CalEITC Qualification Expanded

In mid-March, 2022 FTB announced that Married/Registered Domestic Partner (RDP) Filing Separate no longer automatically disqualifies the taxpayer from being eligible for the California Earned Income Tax Credit (EITC).

The Federal American Rescue Plan Act (ARPA) of 2021 expanded the EITC qualifications for 2021 and future years to include married not filing a joint return under certain circumstances. California conforms through California R&TC §17052.

A Spouse/RDP can claim the CalEITC if married, not filing a joint return for the taxable year, had a qualifying child who lived with the spouse/RDP for more than half of the tax year, and either of the following apply:

- The spouse/RDP lived apart from their spouse for the last 6 months of the year, or
- The spouse/RDP is legally separated according to state law under a written separation agreement or a decree of separate maintenance and did not live in the same household at the end of the year

Options for Married/RDP not filing a joint return who meet the above requirements and have already filed a California return, but did not take advantage of the EITC, can do the following:

- Wait for a letter from FTB for instructions
- File an amended return

In addition, a spouse/RDP who meets the above requirements may also qualify for the Young Child Tax Credit if the spouse's/RDP's qualifying child was under the age of 6 at the close of the taxable year.

FOSTER YOUTH TAX CREDIT CREATED

For taxable years beginning on or after January 1, 2022, SB 201 (Budget, Stats. 2022, Ch. 72) creates the refundable FYTC for a qualified taxpayer. The credit amount will be $1,176 multiplied by the earned income tax credit adjustment factor for the taxable year. For taxable years beginning on or after January 1, 2022, this bill further provides for the amount of the FYTC to be indexed for inflation in the same manner as the income tax brackets.

The credit amount is reduced by $20 for every $100 by which the qualified taxpayer's earned income exceeds the threshold amount of $25,000. For taxable years beginning on or after January 1, 2022, the $20 phaseout amount is to be indexed for inflation in the same manner as the income tax brackets, with the resulting amounts rounded off to the nearest cent. In addition, the $20 phaseout amount indexed for taxable year 2022 applies to taxable years 2023 and forward.

For taxable years after the minimum wage as defined by §1182.12 of the Labor Code is set at $15 per hour, the threshold amount will be recomputed annually in the same manner as the income tax brackets.

The FYTC is only operative for taxable years for which resources are authorized in the annual Budget Act for the FTB to oversee and audit returns associated with the earned income tax credit allowed under the PITL §17052.

"Qualified taxpayer" means an individual who satisfies the following:

- Has been allowed a tax credit under Section 17052 (CalEITC) for the taxable year.
- Is 18 to 25 years of age, inclusive, as of the last day of the taxable year.
- Was in foster care while 13 years of age or older in an AFDC-FC placement, including a tribally approved home, or Approved Relative Caregiver Funding Program eligible placement, by a Title IV-E agency, pursuant to a voluntary placement agreement or a juvenile court order.

"Threshold amount" would be twenty-five thousand dollars ($25,000). "Title IV-E agency" means either of the following:

- A county child welfare agency or probation department that administers foster care placements under Title IV-E of the federal Social Security Act.
- An Indian tribe, tribal organization, or tribal consortium located in California or with lands that extend into the state that has an agreement with the State Department of Social Services to administer foster care placement under Title IV-E of the federal Social Security Act.

NEW! UNION DUES TAX CREDIT TO BEGIN IN 2024

AB 158 (Budget, Stats. 2022, Ch. 737) creates a new refundable tax credit beginning January 1, 2024, for union dues paid. The credit will be equal to the greater of:

- the union dues they paid during the year, multiplied by an adjustment factor (to be specified in the annual budget or a related appropriations bill); or
- the union dues they paid during the year, not to exceed a specified amount (to be set in the annual budget or a related appropriations bill) of up to $100 (recomputed annually).

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If the state does not provide funding for the credit in the annual budget or a related appropriations bill, the credit amount will be zero.

Taxpayers may not claim any other credit or deduction for amounts taken into account in calculating the union dues tax credit. The tax credit, instead of a deduction, allows taxpayers a tax benefit even if they do not itemize their deductions.

COLLEGE ACCESS TAX CREDIT

In an effort to rebuild the state's funds for education, SB 798 (DeLeon, Stats. 2014, Ch. 367) establishes an income tax credit under the Personal Income Tax Law and Corporation Tax Law for cash contributions made to the College Access Tax Credit Fund (College Fund) beginning Jan. 1, 2014, through Dec. 31, 2016.

Sunset Date for College Access Tax Credit Extended

AB 490 (Quirk-Silva, Stats. 2017, Ch. 527) extends the sunset date for the College Access Tax Credit from Jan. 1, 2018, to Jan. 1, 2023, and the repeal date from Dec. 1, 2018, to Dec. 1, 2023.

AB 2880 (M. Bonta, Stats. 2022, Ch. 976) extends the sunset date to tax years beginning before January 1, 2028.

Calculation of Credit

Taxpayers, upon receipt of certification from the California Educational Facilities Authority (Authority), are allowed a tax credit for a specified percentage of cash contributions made to the College Fund. Unused credits can be carried forward to the subsequent six years. The maximum aggregate amount of credit that can be allocated and certified by the Authority for each calendar year is $500 million plus any previously unallocated and uncertified amounts.

The credit amount is calculated as:

- 60% of the amount contributed that is certified and allocated for the 2014 taxable year.
- 55% of the amount contributed that is certified and allocated for the 2015 taxable year.
- 50% of the amount contributed that is certified and allocated for the 2016 and later taxable year.

No tax deduction is allowed for amounts included in the calculation of the credit.

Contributions to Fund Cal Grants

The legislation creates the College Fund as a special fund in the state treasury. The fund is used to provide additional Cal Grants to eligible students.

Amounts contributed to the College Fund would first be allocated to reimburse the General Fund for the aggregate amount of the credit allowed. The allocated funds would be considered General Fund revenues for purposes of §8 and 8.5 of Article XVI of the California Constitution. Then, upon appropriation by the state legislature, the funds would be allocated to the FTB, the Authority, the State Controller, and the Student Aid Commission to reimburse all administrative costs incurred in connection with this credit and to the Student Aid Commission for the purpose of awarding Cal Grants.

Certification for Credit

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SB 798 requires taxpayers claiming the credit to have received a certification from the California Educational Facilities Authority (CEFA). Instructions for the 2017 Forms reiterate the need for taxpayers to have obtained certification. Applications can either be filed online or downloaded and printed from CEFA's website, under the State Treasurer's oversight.

Federal Deduction for Contributions to College Access Tax Credit Fund Changes

Although in previous Chief Counsel Advisories (CCAs) the IRS suggested that these kinds of contributions in exchange for state income tax credits might create a *quid pro quo* situation, thus making them not deductible as charitable contributions, the CCAs stopped short of disallowing them. The argument at the time was that the tax credits were really just disguised tax payments, which is generally true. However, or to 2018, whether the payments were charitable donations or state tax payments really didn't matter for purposes of the federal Schedule A deductions.

In light of TCJA 2017 and the limitation on the SALT (state and local tax) deduction federally, many state tax legislatures were considering additional credits of this type to overcome the federal SALT limits.

The IRS issued proposed regulations, adding a new paragraph (h)(3) to Reg. §1.170A-1 that limits any charitable deduction by the amount of the state tax credit received.

College Access Tax Credit Revisions

SB 81 (Budget Comm., Stats. 2015, Ch. 22) allows the College Access Tax Credit to reduce tax below the tentative minimum tax for all years beginning Jan. 1, 2014. In addition, the bill extends the credit (at 50% of amounts contributed) for taxable years beginning on or after Jan. 1, 2017, and before Jan. 1, 2018.

According to CEFA, for the 2020 taxable year, $479,875 in credits were allocated (a slight increase over 2019, but a dramatic drop from almost $5 million in 2018). As of Mar. 1, 2021, CEFA reported it still had

$491,000,000 credits available for 2021.

CANNABIS BUSINESS TAX CREDITS

For taxable years beginning on or after January 1, 2023, and before January 1, 2028, AB 195 (Budget, Stats. 2022, Ch. 56) provides two new tax credits for cannabis business:

- The Commercial Cannabis Business Tax Credit, and
- The Cannabis Equity Tax Credit

Commercial Cannabis Business Tax Credit (Also known as the High-Road Cannabis Tax Credit: Form FTB 3820)

> **Note:** High-Road Cannabis Tax Credit is Closed until July 1, 2024
>
> The 2023 window for applying for a tentative credit reservation from the Franchise Tax Board has ended for this year, and the $20M in funds available for the credit for 2023 was exhausted before July 31 this year. Therefore, the earliest a qualified business may apply for the HRCTC will be July 1, 2024.

This provision allows a credit to a qualified taxpayer equal to 25% of the qualified taxpayer's qualified expenditures in the taxable year, not to exceed $250,000.

The taxable year maximum of $250,000 would apply to the aggregate amount of credit claimed by all taxpayers that are required to or are authorized to be included in a combined report under R&TC §25101 and §25101.15.

The provision defines the following terms:

"Full-time employee" means an individual who is either of the following:

- Paid wages subject to withholding under the Unemployment Insurance Code (UIC) by the qualified taxpayer for services not less than an average of 35 hours per week.
- A salaried employee who was paid compensation during the taxable year for full-time employment, as described in §515 of the Labor Code (LAB), which defines "full-time employment," as employment in which an employee is employed for 40 hours per week that is paid wages subject to withholding under the UIC.

"Qualified expenditures" means amounts paid or incurred by a qualified taxpayer for any of the following:

- Employment compensation for the employees of the qualified taxpayer. For the purposes of this provision, "employment compensation" means wages paid to full-time employees who are paid no less than 150 percent but no more than 350 percent of the applicable minimum wage. "Employment compensation" may include the monetary value to the full-time employee of health insurance benefits, childcare benefits, retirement benefits, or pension benefits.
- Safety-related equipment, training, and services. For purposes of this provision, "safety-related equipment, training, and services," means:
- Equipment primarily used by employees of cannabis licensees to ensure their personal and occupational safety or the safety of customers of the cannabis licensees;
    - Training for nonmanagement employees on workplace hazards, including but not limited to, the Cal/OSHA (Division of Occupational Safety and Health) 30-hour training general industry outreach course as defined in Business and Professions Code (BPC) section 26051.5(a)(11)(A); and
    - Services including, but not limited to, safety audits, security guards, security cameras, and fire risk mitigation.
- Workforce development for employees of the qualified taxpayer. For purposes of this provision, "workforce development" includes, but is not limited to, joint labor management training programs, membership in a joint apprenticeship training committee registered by the Division of Apprenticeship Standards, and a state-recognized high road training partnership, which is an initiative or project that models strategies for developing industry-based, worker- focused training partnerships, including labor-management partnerships.

"Qualified taxpayer" means a commercial cannabis business, licensed pursuant to Division 10 (commencing with Section 26000) of the BPC, related to cannabis, and who provides full-time employees with all of the following:

- Employment compensation as described in this provision.
- Employer-provided group health insurance.

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- Employer-provided retirement benefits, including stock in the duly licensed commercial cannabis employer to employees under employee stock ownership plans where the employers pays for the full value of the stock.
- Possess a Retailer or Microbusiness cannabis license pursuant to §26050 of the BPC.

To be eligible for this credit, a qualified taxpayer would be required to obtain a tentative credit reservation from the Franchise Tax Board (FTB), in the form and manner prescribed by the FTB, during the month of July for each taxable year or within 30 days of the start of their taxable year if the qualified taxpayer's taxable year begins after July.

Any deduction or credit otherwise allowed for any qualified expenditure made by the qualified taxpayer as a trade or business expense must be reduced by the amount of this credit.

Cannabis Equity Tax Credit: File Form 3821

This provision allows a credit to a qualified taxpayer in an amount equal to $10,000.

The provision defines a "qualified taxpayer," as an equity applicant or licensee eligible for the fee waiver and deferral program established, pursuant to §26249 of the Business and Professions Code, as administered by the Department of Cannabis Control (DCC). The DCC will be required to provide the FTB with a list of equity applicants and licensees eligible for the fee waiver and deferral program, on January 1, 2024, and every six months thereafter, for purposes of administering this credit. The DCC may meet this requirement by maintaining a database that would make available this information to the FTB.

Unused credits could be carried over for eight years until exhausted.

REHABILITATION OF CERTIFIED HISTORIC BUILDING CREDIT

SB 451 (Atkins, Stats. 2019, Ch. 703) creates for taxable years beginning on or after Jan. 1, 2021, and before Jan. 1, 2026, a tax credit for the rehabilitation expenses of certain homes and historic buildings determined in accordance with federal law (§47 of the IRC) except as follows:

- A general 20 percent credit would be allowed for the qualified rehabilitation expenditures of a certified historic structure (other than expenses that qualify for the 25 percent credit), and
- A 25 percent credit would be allowed for the qualified rehabilitation expenditures of a certified historic structure if that structure meets any of the following conditions:
  - The rehabilitated structure is located on certain federal surplus property, surplus state real property, or on surplus land.
  - The rehabilitated structure includes affordable housing for lower-income households.
  - The structure is located in a designated census tract.
  - The structure is part of a military base reuse authority.
  - The structure is a transit-oriented development that is a higher-density, mixed-use development within a walking distance of one-half mile of a transit station.

Unlike the federal credit;

- A state credit would be unavailable for expenditures with respect to a qualified building unless it is a certified historic structure.
- A state credit would be allowed for qualified rehabilitation expenditure amounts for an owner-occupied residence if the expenses are determined to rehabilitate the historic character and improve the integrity of the residence in the year of completion. The credit would be allowed for amounts equal to or more than $5,000 but does not exceed $25,000.
- The state credit is zero dollars unless appropriations are provided in a bill related to the Budget Act.
- "Certified historic structure" would have the same meaning as defined in §47(c)(3) of the IRC, that is a structure in this state and is listed on the California Register of Historical Resources.
- "Qualified rehabilitation expenditure" would have the same meaning as that term is defined in
- §47(c)(2) of the IRC, except that qualified rehabilitation expenditures may include expenditures in connection with the rehabilitation of a building without regard to whether any portion of that building is or is reasonably expected to be a tax-exempt use property.
- "Qualified rehabilitation expenditure" has the same meaning as that term is defined in §47(c)(2) of the IRC and also means rehabilitation expenditures incurred by the taxpayer with respect to a qualified residence for the rehabilitation of the exterior of the building or rehabilitation necessary for the function of that home, including, but not limited to, rehabilitation of electrical, plumbing, or foundation of the qualified residence.

In addition, this bill specifies the following:

- The Allocation Committee and the Office of Historic Preservation may charge a reasonable fee in an amount sufficient to cover expenses.
- No deduction would be allowed for that expense for which this credit is allowed, and if a credit is allowed with respect to property, the basis of that property would be reduced by the amount of the credit.
- Any unused credits could be carried over for up to eight years.
- The credit could reduce the regular tax plus the tax relating to the separate tax on lump-sum distributions, below tentative minimum tax for taxpayers subject to the PITL and the CTL.
- Section 47(c)(1)(B)(ii) of the IRC, relating to special rules for rehabilitation that may be expected to be completed in phases would not apply.
- The recapture provisions described in subsection (a) of §50 of the IRC would apply when the property (or interest in the property) is sold within the recapture period.
- The credit provisions would remain in effect regardless of the expiration or repeal of §47 of the IRC, relating to the federal rehabilitation credit.

The bill specifies that unlike the federal credit, the entire credit generated shall be claimed the year the building is placed in service.

The tax credit provisions would remain in effect until Dec. 1, 2026, and as of that date would be repealed.

Historic Preservation Credit Extended

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AB 150 (Budget, Stats. 2021, Ch. 82) extends the operative date of the credit under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL) to taxable years beginning before January 1, 2027.

LOW-INCOME HOUSING CREDIT EXPANDED

Current federal tax law allows an LIHC for the costs of constructing, rehabilitating, or acquiring low-income housing. The LIHC amount varies depending on several factors including when the housing was placed in service and whether it was federally subsidized and varies between 30% and 70% of the present value of the qualified low-income housing. The LIHC is claimed over 10 years.

Current state tax law generally conforms to federal law with respect to the LIHC, except that the state LIHC is claimed over four taxable years, is limited to projects located in California, must be allocated and authorized by the Allocation Committee, rents must be maintained at low-income levels for 30 years (15 years for federal), and the Allocation Committee must have authorized a federal credit to the taxpayer or the taxpayer must qualify for the federal credit.

For taxable years beginning on or after Jan. 1, 2009, and before Jan. 1, 2020, current law requires allocation of the LIHC to partners based upon the partnership agreement, regardless of how the federal LIHC is allocated to the partners, or whether the allocation of the credit under the terms of the agreement has substantial economic effect.

The Allocation Committee certifies the amount of LIHC allocated. In the case of a partnership or an S Corporation, a copy of the certificate is provided to each taxpayer. The taxpayer is required, upon request, to provide a copy of the certificate to the FTB.

Any unused credit may continue to be carried forward until the credit is exhausted.

Additionally, for a project that receives a preliminary reservation on or after Jan. 1, 2016, and before Jan. 1, 2020, a taxpayer may make an election in its application to the Allocation Committee to sell all or any portion of any LIHC allowed to one or more unrelated parties for each taxable year in which the LIHC is allowed, as specified in provisions administered by the Allocation Committee.

CA Low-Income Housing Credit (LIHC) Extended and Certain Provisions Eased

For calendar years beginning in 2020, AB 101 (Budget, Stats. 2019, Ch. 159) provides an additional $500,000,000 that may be allocated to specified low-income housing projects. For calendar years beginning in 2021 and thereafter, an annual amount up to $500,000,000 may be available for allocation pursuant to an authorization in the annual Budget Act or related legislation and specified regulatory action by the Allocation Committee.

For taxable years beginning on or after Jan. 1, 2019, for purposes of the LIHC, the bill makes various changes to allow the credit to be claimed more easily, including changes to restrictions on the sale of the credit, the allocation of the credit among partners, and eliminating the rental passive activity loss limitation.

Eligibility for LIHC Expanded

AB 447 (Grayson, Stats. 2021, Ch. 344) expands the LIHC beginning January 1, 2022. Specifically, the bill:

- expands the eligibility criteria for buildings that are at risk of conversion for the allocation of Low-Income Housing Tax Credit (LIHTC) by the California Tax Credit Allocation Committee (CTCAC), and

- expands allocations for eligible projects of new buildings to include retrofitting and repurposing of existing nonresidential structures.

New! Developers Will Be Required to Submit Diversity Plans

Under the provisions of AB 2873 (Jones-Sawyer, Stats. 2022, Ch. 316) California will require some affordable housing developers that receive state low-income housing tax credit allocations to submit an annual report, including a diversity plan, to the Tax Credit Allocation Committee (TCAC).

Who does the new requirement apply to?

The requirement applies to developers that receive an allocation on or after January 1, 2024, that have:

- completed five or more housing projects by January 1, 2023; or
- received an annual allocation of $1 million or more.

For those that have not completed five or more housing projects by January 1, 2023, or received an annual allocation of $1 million or more, the requirement will apply in the year following commencement of their fifth housing project or receipt of an annual allocation of $1 million or more.

NATURAL HERITAGE PRESERVATION CREDIT

AB 1219 (Berman, Stats. 2021, Ch. 419) renews, under the PITL and the CTL, the Natural Heritage Preservation Tax Credit for qualified contributions made on or after January 1, 2021, and not later than June 30, 2026, to the state, local governments, or designated nonprofit organizations. The amount of the credit will be 55 percent of the fair market value of the qualified contribution.

BUSINESS TAX CREDITS LIMITED

In the budget trailer bill, AB 85 (Budget, Stats. 2020, Ch. 8), the legislature tries to further narrow the budget deficit by temporarily limiting business tax credits. For taxable years 2020, 2021, and 2022, business tax credits may reduce tax liability by no more than $5 million.

Specifically, the bill makes the following changes under the PITL and CTL:

- Limit the amount of allowable business credits, as specified, to $5 million for taxable years beginning on or after January 1, 2020, and before January 1, 2023. For taxpayers included in a combined report, this determination is made at the group level.
- Exclude the Low-Income Housing Credit (LIHC) from the credit limitation.
- Increase the carryforward period for credits subject to the limitation by the number of taxable years the credit was not allowed by operation of this limitation.
- Specify that amounts included in an election under R&TC §6902.5 to apply film credits against qualified sales and use tax would not be included in the credit limitation.
- Exempts guidance issued by the FTB from the requirements of the Administrative Procedures Act

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SMALL BUSINESS HIRING CREDIT (MAIN STREET SMALL BUSINESS TAX CREDIT)

With unemployment rates rising because of the COVID-19 pandemic, the legislature has provided an additional tax incentive to small businesses that increase staffing. SB 1447 (Bradford, *et al*, Stats. 2020, Ch. 41) allows a qualified small business employer a small business hiring credit, subject to receiving a tentative credit reservation. In lieu of the credit under the PITL or CTL, an irrevocable election can be made to apply the credit amount against qualified sales or use taxes.

$1,000 Credit for Each Increase in Qualified Employees

For each taxable year beginning on or after January 1, 2020, and before January 1, 2021, the law allows a small business hiring credit to a qualified small business employer that receives a tentative credit reservation under §6902.8 of the R&TC, equal to $1,000 for each net increase in qualified employees, as specified. The credit shall not exceed $100,000 for any qualified small business employer.

New! Small Business Hiring Credit Extended for 2021 and 2022 (Main Street Small Business Tax Credit Part II)

For tax years beginning on or after January 1, 2021, and before January 1, 2022, AB 150 (Budget, Stats. 2021, Ch. 82) allows the small business hiring credit to a qualified small business employer that receives a tentative credit reservation from the California Department of Tax and Fee Administration (CDTFA). A tentative credit reservation amount would be an amount equal to one thousand dollars ($1,000) for each net increase in qualified employees, as specified, not to exceed one hundred fifty thousand dollars ($150,000) for any qualified small business employer.

The aggregate amount of credit that may be allocated under this provision would be limited to seventy million dollars ($70,000,000), plus any amount of credit not allocated, and not required to be allocated, under Main Street Small Business Tax Credit for the 2020 taxable year.

New! Main Street Small Business Tax Credit Extended & May Be Taken on Amended Returns

AB 194 (Budget, Stats. 2022, Ch. 55) extended the repeal date for the credit provisions to December 1, 2026. In addition, the bill removed the requirement that the credit be claimed on a timely filed original return.

Qualified Small Business Employer

"Qualified small business employer" means a taxpayer that meets both of the following requirements:

- As of December 31, 2019, employed a total of 100 or fewer employees.
- Has a 50% decrease in gross receipts determined by comparing gross receipts for the three-month period beginning on April 1, 2020, and ending June 30, 2020, with the gross receipts for the three-month period beginning on April 1, 2019, and ending June 30, 2019, if it would have met the requirement of having a significant decline in gross receipts for that quarter as determined under §2301(c)(2)(B)(i) of Public Law 116-136.

"Qualified small business employer" does not include a taxpayer required to be included in a combined report under §25101 or §25110 or authorized to be included in a combined report under §25101.15.

Calculating the Net Increase in Qualified Employees

The net increase in qualified employees of a qualified small business employer shall be determined by subtracting the amount determined in paragraph (1) from the amount determined in paragraph (2).

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- The average monthly full-time equivalent qualified employees employed during the three-month period beginning April 1, 2020, and ending June 30, 2020, by the qualified small business employer. The average monthly full-time equivalent qualified employees is determined by adding the total monthly full-time equivalent qualified employees employed by the qualified small business employer for all three months and dividing the total by three.
- The average monthly full-time equivalent qualified employees employed during the five-month period beginning July 1, 2020, and ending November 30, 2020, by the qualified small business employer. The average monthly full-time equivalent qualified employees is determined by adding the total monthly full-time equivalent qualified employees employed by the qualified small business employer for all five months and dividing the total by five.

Example. From April 1, 2020, to June 30, 2020, Karen employed 3 full-time equivalent employees.

During the period July 1, 2020, through November 30, 2020, Karen had 4 full-time equivalent employees. Karen had an increase of 1 (paragraph 2 amount:4 - paragraph 1 amount: 3) in qualified employees.

Monthly full-time equivalent means either of the following:In the case of a qualified employee paid hourly qualified wages, the total number of hours worked per month for the qualified small business employer by the qualified employee, not to exceed 167 hours per month per qualified employee, divided by 167.

- In the case of a salaried qualified employee, the total number of weeks worked per month for the qualified small business employer by the qualified employee divided by 4.33 multiplied by the time base the qualified employee worked.

Qualified employee means an employee who is paid qualified wages by a qualified small business employer and shall not include an employee whose wages are included in calculating any other credit allowed under the PITL or CTL.

Time base means the fraction of full-time employment that the qualified employee works.

Other Provisions

The bill also provides the following:

- Unused credits could be carried over for five years or until exhausted.
- Any deduction otherwise allowed for qualified wages shall be reduced by the amount of the credit allowed.
- All employees of the trades or businesses that are treated as related under §267, §318, or §707 of the Internal Revenue Code shall be treated as employed by a single qualified small business employer.

Claiming the Credit

To be eligible for the credit, the qualified small business employer is required to do the following:

- Submit a timely application to the CDTFA, described below, for a tentative credit reservation amount for the small business hiring tax credit, including the following information:

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- The net increase in qualified employees.
- Whether the credit will be applied under the PITL, CTL, or both.
- Whether, in lieu of the credit under the PITL or CTL, the business makes an irrevocable election to apply the credit against qualified sales and use tax.
- Any other information as deemed necessary by the department.
- Claim the credit on a timely filed original return.

CDTFA will accept applications for tentative credit reservation amounts through a reservation system that will be available on its website at www.cdtfa.ca.gov beginning on December 1, 2020. Tentative credit reservations will be allocated to qualified small business employers on a first-come, first-served basis.

NEW! HOMELESS HIRING TAX CREDIT

AB 150 (Budget, Stats. 2021, Ch. 82) also created a new credit available to qualifying taxpayers who hire new employees deemed to be eligible homeless individuals (as defined by R&TC §17053.80 and R&TC §23629). The credit amount is based on the number of hours the eligible individual (employee) works during the taxable year and will be available for the 2022 through 2026 taxable years.

To claim the credit, qualifying taxpayers must obtain an eligible individual certification and receive a tentative credit reservation for each eligible individual from the FTB.

The credit is available for taxable years beginning January 1, 2022 through December 31, 2026. Employers may receive $2,500 to $10,000 in tax credit per eligible employee based on hours worked in the taxable year. Employers may claim up to $30,000 of credit per taxable year.

Additional information on the Homeless Hiring Tax Credit, including how to obtain the required certification and tentative credit reservation is available on FTB's webpage.

Eligible Employee Requirement

Eligible employees must meet the following requirements:

- Be currently/recently homeless (within 180 days of hire) or be receiving services from a homeless services provider, and
- Receive a certificate through a certifying organization. The certificate expires 1 year after issuance.

Eligible Employer Information

To claim the HHTC, employers will need to:

- Obtain a certificate for each eligible employee from a certifying organization.
- Pay wages equal to or greater than 120% of the state minimum wage.
- Make a tentative credit reservation within 30 days of completing the New Hire reporting requirement with the Employment Development Department.

Make A Reservation

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Employers need an HHTC Tentative Credit Reservation from FTB to claim the credit. You will need a reservation for each eligible employee and reservations can be made beginning in January 2022.

Credit Amount

The credit amount is based on the number of hours worked by the eligible employee in the taxable year.

Hours worked	Credit amount
0 – 499	$ 0
500 – 999	$ 2,500
1.000 – 1,499	$ 5,000
1,500 – 1,999	$ 7,500
2,000 or more	$10,000

New! Expansion of Homeless Hiring Credit

AB 194 (Budget, Stats. 2022, Ch. 55) expands the credit to include qualified taxpayers that employ a person who has recently received services from a homeless services provider. The bill also allows a continuum of care or a community-based service provider to issue recertifications.

2013 ECONOMIC DEVELOPMENT INITIATIVE

Two complex budget trailer bills, AB 93 (Budget, Stats. 2013, Ch. 69) and SB 90 (Budget, Stats. 2013, Ch. 70), overhauled California's enterprise zone (EZ) and other economic development area (EDA) credits and incentives and replaced them with a new hiring credit (New Employment Tax Credit) and a GO-Biz credit (California Competes Tax Credit) effective with the 2014 tax year. The legislation also provides a new sales and use tax exemption for purchases of manufacturing and biotech equipment effective July 1, 2014.

New Employment Tax Credit - The New Hiring Credit

This credit is available for businesses that hire qualified full-time employees to work in a designated census tract or EDA, provided that the employer pays the employee qualified wages, applies for and receives a credit reservation from the FTB, and claims the credit on a timely filed original return.

A "designated census tract" is a census tract determined by the Department of Finance to be in the top 25% of California census tracts in terms of civilian unemployment and poverty rates. For purposes of this credit, an "EDA" is a former EZ or Local Agency Military Base Recovery Area. The credit is available for the 2014 through 2020 tax years and may continue to be claimed after the 2020 tax year for those qualified employees hired prior to 2021.

Credit Extended Through 2025

SB 855 (Budget, Stats. 2018, Ch. 52) modifies the New Hiring Credit by extending for five years the sunset date, to taxable years beginning before Jan. 1, 2026, and the repeal date, to Dec. 1, 2029.

FTB Tools for the New Employment Credit

The FTB has published complete resources and applications for businesses eligible for the New Employment Credit. These include:

New Employment Credit - Quick Facts;

New Employment Credit Reservation - Online; Designated Geographic Area (DGA) Mapping Tool; and Annual Certification of Employment.

California Competes Tax Credits - The New GO-Biz Credits

A new GO-Biz credit is also available for the 2014 through 2024 taxable years. Taxpayers must apply to GO-Biz for the credit, which will be awarded on a competitive basis based on the following criteria:

- The number of jobs to be created or retained;
- The compensation paid or proposed to be paid, including wages and benefits; The amount invested in California by the taxpayer;
- The unemployment or poverty level in the area where the business is located or proposed to be located; The incentives available to the taxpayer in California and also outside California;
- The duration of the project and how long the taxpayer commits to remaining in California; and Other economic factors and impacts in the locality, the region, and the state.

Proposed written agreements will be reviewed by the California Competes Tax Credit Committee (CCTCC), which is comprised of the Treasurer, the Director of Finance, and the Director of GO-Biz, or their designated representatives, and one appointee each from the Assembly and the Senate.

Prior to awarding the credit, the taxpayer must enter into a written agreement with the CCTCC specifying certain terms and conditions such as the wages to be paid, the number of jobs to be created and a minimum retention period, how the credit will be allocated, and any recapture provisions.

If the credit allocated to a taxpayer exceeds the taxpayer's net tax for the year, the excess may be carried forward for up to five years.

Legislation Increases Aggregate Amount of California Competes Credit

AB 1560 (Quirk-Silva, Stats. 2014, Ch. 378) increases the aggregate amount of the economic development credits that may be allocated to taxpayers each fiscal year by $25 million per fiscal year through the 2017B2018 fiscal year.

Legislation Allows California Competes Credit to Reduce Tentative Minimum Tax

AB 2754 (R&TC Comm., Stats. 2014, Ch. 478) allows the California Competes Credit to reduce the regular tax below tentative minimum tax under the Personal Income Tax and the Corporation Tax for taxable years beginning on or after Jan. 1, 2014.

Credit Extended and Modified

SB 855 (Budget, Stats. 2018, Ch. 52) modified and extended the sunset for the California Competes Tax Credit. The credit has been extended for five years, to taxable years beginning before Jan. 1, 2030, and the repeal date has been extended to Dec. 1, 2030.

The bill also modifies the conditions for GO-Biz to consider when allocating this credit and provides for additional allocations of $180,000,000 for each fiscal year from 2018-2019 to 2022-2023, inclusive. Additional factors to be considered are:

- the extent to which the credit will influence the taxpayer's creation of jobs in California, and
- the training opportunities the taxpayer offers its employees.

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Additionally, the bill removes the requirement that the FTB notify GO-Biz as to whether a business is considered a small business.

New! **Credit Further Extended and Modified**

AB 192 (Budget, Stats. 2022, Ch. 55) further extends the California Competes Credit through the 2027-2028 fiscal year.

In addition, beginning in the 2023-2024 fiscal year, the bill modifies certain criteria the Governor's Office of Business and Economic Development (GO-Biz) should consider in determining qualifications for the credit. Among other items to be considered, are the taxpayer's commitment to fair workforce treatment, and to creating quality, full-time jobs in the state.

GO-Biz will also examine the taxpayer's willingness to relocate jobs to California from states that discriminate against same-sex couples or their families, discriminate on the basis of sexual orientation, gender identity, or gender expression, or deny or interfere with a woman's right to choose to bear a child or to choose and obtain an abortion.

2021 – 2022 Allocation Increased

AB 150 (Budget, Stats. 2021, Ch. 82) established the aggregate amount of credit that may be allocated under the California Competes tax credit program for the 2021–22 fiscal year is now $290 million (previously, $180 million).

GO-Biz Announces Application Periods and Amounts

As required under the legislation, GO-Biz announced that for fiscal year 2022-2023, applications for the California Competes Tax Credit will be accepted during the following periods:

- July 25, 2022 - Aug. 15, 2022 ($80 million tax credits and $120 million grants available);
- Jan. 3, 2023 - Jan. 23, 2023 ($120 million tax credits available); and
- Mar. 6, 2023 - Mar. 20, 2023 ($99.7 million plus any remaining unallocated amounts).

FAQs Available Online

GO-Biz maintains a page of Frequently Asked Questions at: GoBiz FAQs.

In addition, the FTB provides information on how to claim the credit on a tax return, the FTB's review procedures, and when and how the credit may be recaptured on its Frequently Asked Questions - California Competes Credit web page.

NEW MOTION PICTURE PRODUCTION CREDIT

For tax years beginning on or after Jan. 1, 2016, AB 1839 (Gatto, Stats. 2014, Ch. 413) creates a New Motion Picture Credit subject to a computation, ranking, and allocation by the California Film Commission (Commission) for an amount equal to 20% or 25%, whichever is the applicable credit percentage of the qualified expenditures for the production of a qualified motion picture in California.

The bill prohibits a credit for any qualified expenditures for the production of a motion picture in California, if a credit for those same expenditures has been claimed under the Original Motion Picture Credit.

The applicable credit percentage for the New Motion Picture Credit will be as follows:

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- 20% of qualified expenditures attributable to either:
- The production of a qualified motion picture in California, including, but not limited to, a feature, up to $100 million dollars in qualified expenditures, or
- A television series that relocated to California that is in its second or subsequent year of receiving a tax credit allocation under the New Motion Picture Credit or under the Original Motion Picture Credit.

An additional credit, in an aggregate amount not to exceed 5% of the qualified expenditures would be allowed to a qualified motion picture as follows:

- 5% of qualified expenditures relating to original photography outside the Los Angeles zone;
- 5% of qualified expenditures relating to music scoring and music track recording by musicians attributable to the production of a qualified motion picture in California; and
- 5% of the qualified expenditures relating to qualified visual effects attributable to the production of a qualified motion picture in California.
- 25% of qualified expenditures attributable to the production of a qualified motion picture where the qualified motion picture is a television series that relocated to California in its first year of receiving a tax credit allocation
- 25% of qualified expenditures, up to $10 million dollars, attributable to the production of a qualified motion picture that is an independent film

The Commission would be required to allocate tax credits to applicants as follows:

- In one or more allocation periods per fiscal year on or after July 1, 2015, and before July 1, 2016; and
- In two or more allocations periods per fiscal year on or after July 1, 2016, and before July 1, 2020.

The amount of the credit allowed to a qualified taxpayer, except as otherwise provided, would be limited to the amount specified in the credit certificate issued by the Commission. Certificates may not be issued prior to July 1, 2016.

For pass-through entities, a "qualified taxpayer" determination would be made at the entity level and the credit would not be allowed to the pass-through (including an S corporation with respect to the tax imposed on S corporations under Corporate Tax Law) but passed through to the entity's partners or shareholders.

Sale of the Credit

A qualified taxpayer may sell any credit allowed that is attributable to an independent film to an unrelated party. A party acquiring the credit would be subject to the requirements of this bill and any credit sold by an owner of a disregarded entity would not be subject to the normal credit limitation applicable to owners of disregarded entities.

The qualified taxpayer would be required to report prior to the sale of the credit all required information regarding the purchase and sale of the credit, including the Social Security or other taxpayer identification number of the unrelated party to whom the credit has been sold, the face amount of the credit sold, and the amount of consideration received by the qualified taxpayer for the sale of the credit.

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A qualified taxpayer would be prohibited from assigning or selling any tax credit to the extent the tax credit allowed is claimed on any tax return of the qualified taxpayer. In the event more than one taxpayer claims the same credit allocated by the Commission, the FTB could disallow the credit of either taxpayer if the statute of limitations remains open. An unrelated party that purchases a credit would be treated as a qualified taxpayer and subject to the requirements of this bill.

Credits in excess of the tax liability may be carried over for six years, if necessary, until the credit has been exhausted.

Assignment of the Credit

Under the Corporate Tax Law, where the credit allowed exceeds the taxpayer's tax liability, a qualified taxpayer may elect to make an irrevocable assignment of any portion of the credit allowed to one or more affiliated corporations, as defined, for each taxable year the credit is allowed. The election may be based on any method selected by the qualified taxpayer that originally receives the credit, changed for any subsequent taxable year if the election to make the assignment is expressly shown on each of the returns of the qualified taxpayer and the qualified taxpayer's affiliated corporations that assign and receive the credits and must be reported to the FTB, along with all required information regarding the assignment of the credit, as specified.

The law would treat an affiliated corporation or corporations, unrelated party or parties that are assigned a credit, as a qualified taxpayer.

The New Motion Picture Credit could reduce a corporate taxpayer's tax below tentative minimum tax.

Credit Amount Can Be Applied Against Sales and Use Tax

The legislation allows a qualified taxpayer, in lieu of claiming the New Motion Picture Credit on the income tax return, to make an irrevocable election to apply the credit amount against the qualified sales and use tax under R&TC §6902.5.

The Board of Equalization (BOE) would be required to provide an annual listing of qualified taxpayers or affiliates that made an irrevocable election, including the credit amount, or portion of the credit amount claimed by each qualified taxpayer or affiliate in a form or manner agreed upon by both the BOE and the FTB.

In the event that a qualified taxpayer fails to provide the copyright registration number on the return claiming the credit as required, the credit would be disallowed and assessed, and collected until the requirements are satisfied. A disallowed credit would be treated as a math error.

Annually, the Commission would be required to provide the Legislative Analyst's Office, the FTB, and the BOE with a list of qualified taxpayers and the tax credit amounts allocated to each qualified taxpayer by the Commission. The list would include the names and taxpayer identification numbers, including taxpayer identification numbers of each partner or shareholder, as applicable, of the qualified taxpayer.

Credit Regulations Adopted

The California Film Commission has adopted new regulations governing the film and television credit available for tax years beginning after 2015 against the state's corporate income and franchise tax, personal income tax, and sales and use tax. The regulations contain definitions for relevant terms and information concerning the application process, eligibility determinations, qualified expenditures, tax credit allocation, approved applicant responsibilities, issuance of credit certificates, job ratio ranking process, and on-screen credit and promotional requirements.

New! **Motion Picture Credit After 2021**

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SB 871 (Budget, Stats. 2018, Ch. 54) provides a new Motion Picture Credit beginning Jan. 1, 2020, that includes job growth as criterion for receiving a credit allocation from the California Film Commission.

California's new, third-generation Film & TV Tax Credit Program 3.0 launched on July 1, 2020, to replace Program 2.0, which was launched in 2015.

The projects selected for Program 3.0's first two allocation rounds bode well for the resumption of production in the Golden State. They include nine feature films and two relocating TV series with a wide range of budgets and diverse storylines, as well as lots of production planned for outside the Los Angeles 30-Mile Studio Zone.

New provisions for Program 3.0 include a pilot skills training program to help individuals from underserved communities gain access to career opportunities. Program 3.0 also requires tax credit projects to have a written policy for addressing unlawful harassment, and enhanced reporting of employment diversity data.

New! **Credit Carryover Period Extended**

AB 85 (Budget, Stats. 2020, Ch. 8) extends the carryover period for the Film Credit from six years to nine years.

New! **Credit Program Expanded**

SB 144 (Portantino et al., Stats. 2021, Ch. 114), increases the funding for the existing motion picture and film tax credit for the 2021-2022 and 2022-2023 fiscal years exclusively for new television series that relocate to California and for recurring television series. In addition, this bill allows a new tax credit in an amount equal to 20 percent (20%) or 25 percent (25%), or as modified by up to 4 percent (4%), of qualified expenditures paid or incurred by a qualified motion picture (QMP) produced at a certified studio construction project (certified project) in the state. This credit would be certified and allocated by the California Film Commission (CFC).

The new law also adds new qualifications for the credit and provisions relating to the CFC application process. It also specifies new rules relating to the CFC's allocation of the credits and modifies the reporting requirements for the Legislative Analyst's Office (LAO) and the CFC to provide annual reporting related to diversity to the Legislature.

California R & D Credit (Form 3523)

California does not conform to the TCJA federal requirement that research and experimental expenditures (R&D) paid or incurred in tax years beginning after 2021 be amortized ratably over five years (15 years for foreign research).

Use California form FTB 3523, Research Credit, to compute and claim the California research credit for increasing the research activities of a trade or business. Also, use this form to claim pass-through research credits received from S corporations, estates, trusts, partnerships, and limited liability companies (LLCs).

S corporations, estates, trusts, partnerships, and LLCs should complete form FTB 3523 to compute the amount of research credit generated. Show the distributive share of the passthrough credit for each shareholder, beneficiary, partner, or member on Schedule K-1 (100S, 541, 565, or 568), Share of Income, Deductions, Credits, etc.

In general, California allows the R&D tax credit in accordance with federal IRC §41, as modified by California Revenue & Taxation Code §§ 17052.12 (Personal Income Tax) and 23609 (Corporation Tax). To claim the California research credit, you do not have to claim the federal research credit.

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The California R&D Credit is available only for certain types of qualified research activities that take place in California and exceed a certain base level of R&D expenditures (as determined by the level of R&D expenditures undertaken by the taxpayer in prior years). The credit may both be used to offset current-year tax liabilities and "carried forward" to offset tax liabilities in future years but may not be "carried back" to offset past years' liabilities.

Two Specific Program Characteristics.

- ***Qualified Research Credit.*** The credit for *qualified* research is available for certain types of research activities conducted by the taxpayer and is available to both individuals and entities. The credit is equal to 15% of the amount of qualified incremental expenditures over a calculated "base amount" of R&D expenditures.
- ***Basic Research Credit.*** The credit for *basic* research is available for certain types of research activities conducted by selected outside entities on behalf of the taxpayer and is available to C corporation taxpayers only, not S corps. The credit is equal to 24% of expenditures over a calculated base amount for certain types of research carried out by independent research institutions and universities.

California Gross Receipts

The computation of California gross receipts is substantially different from federal, which often confuses California tax preparers. California gross receipts only include sale of real, tangible, or intangible property held for sale to customers in the ordinary course of the taxpayer's trade or business delivered or shipped to a purchaser within California. This includes sales to the U.S. government which can be identified as delivered in California. Excluded receipts include receipts from services, rents, operating leases, and interest.

Similar to the federal R&D credit, California R&D QREs are reduced by the calculated base amount determined by a percentage of average gross receipts for the four years prior to the year of the credit. Because many service firms and software licensing firms do not generate California gross receipts for the purposes of the California R&D credit, calculations for the fixed base would result in a value of zero, putting the California R&D credit out of reach using the gross receipts method. However, FTB provides a minimum fixed base equal to 50% of R&D expenditures in the credit year of the claim (FTB Legal Division Guidance 2012-03-01).

Therefore, many firms which do not have California gross receipts for R & D purposes may calculate a fixed base and claim the California Regular R&D credit. And the federal and California gross receipts for R & D may differ substantially, with the California minimum base providing a valuable credit for California taxpayers.

OTHER NONCONFORMITY ELECTIONS

May a taxpayer make an election for California purposes that is different from the election made for federal tax purposes with regard to the same item? In FTB Notice 95-1, the FTB clarified its position regarding the circumstances in which a taxpayer may make a different election for California purposes from what was made for federal purposes.

R&TC §17024.5(e) and 23051.5(e) state as follows:

Whenever this part allows a taxpayer to make an election, the following rules shall apply:

1. A proper election filed with the Internal Revenue Service in accordance with the Internal Revenue Code or regulations issued by "the secretary" shall be deemed to be a proper election for

purposes of this part, unless otherwise expressly provided in this part or in regulations issued by the Franchise Tax Board.

2. A copy of that election shall be furnished to the Franchise Tax Board upon request.

3. To obtain treatment other than that elected for federal purposes, a separate election shall be filed with the Franchise Tax Board at the time and in the manner which may be required by the Franchise Tax Board.

Example. In 2022, Karen, a sole proprietor, buys and places in service a piece of equipment worth $50,000. Before taking the purchase into consideration, Karen's business has a net profit of $30,000. Instead of electing §179 expensing on her federal return, Karen elects to use special first-year bonus depreciation, deducting the full $50,000 resulting in a net loss of ($20,000).

If Karen does nothing else for California, she will only deduct a maximum of $10,000 on her state return (MACRS 20% first year depreciation) resulting in a net profit of $20,000 - a difference of $40,000 from her federal return!

Instead, Karen will make a separate §179 election for California, allowing her to deduct $25,000 as §179 expense plus $5,000 (MACRS 20% first year depreciation on the adjusted basis of $25,000), resulting in a net profit/loss of $0. R&TC §17024.5(f) and 23051.5(f) state as follows:

> Whenever this part allows or requires a taxpayer to file an application or seek consent, the rules set forth in subdivision (e) shall apply to that application or consent.
>
> It is the position of the FTB that the language in R&TC §17024.5(e)(3) and 23051.5(e)(3) generally allow taxpayers to make a different election for California purposes than for federal purposes, unless otherwise provided in the R&TC or FTB regulations. For example, R&TC §17279(b)(2)(A) and 24355.5(b)(2)(A), pertaining to the amortization of intangible assets, specifically state that any federal election made under IRC §197 is binding for California purposes. Therefore, a different California election shall not be permitted for federal elections made under IRC §197.

In addition, under R&TC §17024.5(f) and 23051.5(f), the general language of R&TC §17024.5(e)(3) and 23051.5(e)(3) also applies to applications for changes of accounting periods and methods. In these instances, the FTB has the right not to approve the request to adopt a different method for California purposes than adopted for federal purposes where the adoption of such different method is for the avoidance or evasion of income tax or does not clearly reflect income.

MENTAL HEALTH SURTAX

Individuals are subject to a tax surcharge at the rate of 1% on taxable income in excess of $1 million (including the surcharge, the maximum rate is 13.3%). The mental health tax:

- May not be reduced by any credits;
- Must be included in the estimated tax computation to avoid an underpayment penalty;
- Is not included for purposes of computing the other state tax credit;
- Is not included in the AMT computation (i.e., the taxpayer computes regular tax, adds AMT, and then adds the surtax); and
- Because the surcharge is based on the same taxable income for all filing statuses, married couples with income in excess of $1 million should consider filing separate returns.

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File Separate Returns

R&TC §17043 provides that the surcharge is imposed on "a taxpayer's taxable income in excess of $1 million." Since a joint return is "a taxpayer," a married couple filing joint gets the use of only a single million-dollar "exemption" before the surcharge takes effect. The same couple can get the benefit twice by filing separately. At 1%, that extra $1 million benefit can save the couple up to $10,000. Remember, however, that if the couple files separately for California, they must generally file separately for federal (R&TC §18521(a)).

> **Example.** Vern and Sharon have total W-2 income of $2.5 million in 2022. They have no other income and take the standard deduction. If they file a joint return, their California tax will be $290,375. If they file separate and each report $1.25 million, they will each have a tax of $140,187.44 for a grand total of $280,375. They save exactly $10,000 in California tax.
>
> ***Warning!*** Because federal AMT imposes harsher calculations on MFS taxpayers, this strategy may not be beneficial if the couple is already subject to federal AMT. Filing these clients separately for federal purposes may increase federal AMT as much or more than the California tax savings. Be sure to compare the combined federal and state tax results both ways.

Making the Decision to Split the Returns

It may be beneficial to split if:

- California taxable income exceeds $1 million;
- Income is entirely or almost entirely made up of ordinary income; or
- Income is all community income to be split 50-50. It probably is not beneficial to split if
- Taxpayers are already subject to federal AMT;
- Taxpayers have a federal Minimum Tax Credit carryover; or
- Most income has retained separate property status and one spouse's income is minimal or zero.

DISASTERS

2023 WINTER STORMS RELIEF

56 California Counties Named as Federally Declared Disaster Areas

IRS notices CA-2023-01 and IR-2023-03, issued January 10th and 11th, announced California residents of counties identified by FEMA as "federally declared disaster areas" due to the winter storms have until May 15, 2023, to file various federal individual and business tax returns and make tax payments. Notice CA-2023-03, issued March 17, 2023 further increased those deadlines until October 16, 2023.

This tax relief postpones several tax filing and payment deadlines that occurred starting on January 8, 2023. As a result, affected individuals and businesses will have until October 16, 2023, to file returns and pay any taxes that were originally due during this period.

> **Warning**. See the exception below for payroll tax returns and Form 1099-MISC and Form 1099-NEC (also known as information returns).

California Counties Listed as Federally Declared Disaster Areas.
Individuals and businesses in the following counties qualify for federal tax relief:

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Alameda	Glenn	Mendocino	Plumas	Santa Clara	Trinity
Alpine	Humboldt	Merced	Sacramento	Santa Cruz	Tulare
Amador	Inyo	Merced	San Benito	Shasta	Tuolumne
Butte	Kern	Modoc	San Bernadino	Sierra	Ventura
Calavaras	Kings	Momo	San Diego	Siskiyou	Yolo
Colusa	Lake	Monterey	San Francisco	Solano	Yuba
Contra Costa	Los Angeles	Napa	San Joaquin	Sonoma	
Del Norte	Madera	Nevada	San Luis Obispo	Stanislaus	
El Dorado	Marin	Orange	San Mateo	Sutter	
Fresno	Mariposa	Placer	Santa Barbara	Tehama	

Individuals. Tax year 2022 individual income tax returns originally due April 18, 2023, are now due October 16, 2023, for taxpayers in declared California counties. Other individual deadlines extended to October 16, 2023, include 2022 contributions to IRAs and health savings accounts. Individual quarterly estimated tax payments, 4th quarter 2022 originally due January 17, 2023, may now be paid by October 16, 2023, or with Form 1040 or Form 1040 extension, if filed and paid by October 16, 2023, and 1st quarter 2023 quarterly estimated tax, originally due April 18, 2023, may also be paid by October 16, 2023, without penalty.

Individuals	Original Due Date	Postponed Due Date
2022 Q4 1040-ES Payment	Jan 17, 2023	October 16, 2023
2022 Form 1040	April 18, 2023	October 16, 2023
2022 IRA Contribution	April 18, 2023	October 16, 2023
2022 H.S.A. Contribution	April 18, 2023	October 16, 2023
2023 Q1 1040-ES Payment	April 18, 2023	October 16, 2023

Businesses. This IRS disaster relief, under §7508A, also applies to many business tax returns. Business taxpayers in the declared counties have until October 16, 2023, to file most business tax returns including employment tax returns, corporate, S corporation, partnership, non-profit, trust, estate, gift, generation-skipping transfer tax, and Form 5500 series returns that have either an original or extended due date occurring ***on or after*** January 8, 2023, and before October 16, 2023.

Affected taxpayers that have payments related to any of the above business or other tax filings originally due on or after January 8, 2023, and before October 16, 2023, are postponed through October 16, 2023, and will not be subject to penalties for failure to pay as long as such payments are paid on or before October 16, 2023.

Business, Estate, Trust, Gift, and Other Tax Filings

Business, Estate, Trust, & Gift, etc.	Original Due Date	Postponed Due Date
2022 Form 1120-S	Mar 15, 2023	October 16, 2023
2022 Form 1065	Mar 15, 2023	October 16, 2023
2022 Form 1120	April 18, 2023	October 16, 2023
2022 Form 1041	April 18, 2023	October 16, 2023

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2022 Estate, Gift, FBAR, and Other Tax Returns	Between Jan 8, 2023 & October 16, 2023	October 16, 2023
2022 Fiscal Year Business and Other Tax Returns	Between Jan 8, 2023 & October 16, 2023	October 16, 2023

Payroll Tax and Form 1099-NEC & Form 1099-MISC.

IR-2023-03 states "The October 16 deadline also applies to the quarterly payroll and excise **tax returns** normally due on January 31 and April 30, 2023. In addition, penalties on payroll and excise **tax deposits** due on or after January 8, 2023, and before January 23, 2023, will be abated as long as the tax deposits are made by January 23, 2023."

Year-end tax filing obligations namely W2s and 1099s are not listed in Rev. Proc. 2018-58 as eligible for postponement. And CA-2023-01 states "the postponement of time to file and pay does not apply to information returns in the W-2, 1094, 1095, 1097, 1098 or 1099 series; Forms 1042-S, 3921, 3922 or 8027; or employment and excise tax deposits."

However, CA-2023-01 also states "In addition, **penalties** on payroll and excise tax deposits due on or after January 8, 2023, and before January 23, 2023, will be abated as long as the tax deposits are made by January 23, 2023."

Payroll Tax, Form 1099s & Tax Filings

Payroll Tax & 1099s	Original Due Date	Postponed Due Date
2022 Q4 Form 941 Monthly deposit	Jan 15, 2023	Jan 23, 2023
2023 Q1 Form 941 3-day banking deposits	Jan 8 to Jan 22	Jan 23, 2023
2022 Q4 Form 941	Jan 31, 2023	October 16, 2023
2022 Form 940	Jan 31, 2023	October 16, 2023
2022 Form W-2 & W-3	Jan 31, 2023	Jan 31, 2023
2022 Form 1099-NEC	Jan 31, 2023	Jan 31, 2023
2022 Form 1099-INT	Feb 15, 2023	Feb 15, 2023
2022 Form 1099-DIV	Feb 15, 2023	Feb 15, 2023
2022 Form 1099-MISC, Box 8,10	Feb 15, 2023	Feb 15, 2023
2022 Form 1099-MISC, Box 1-7,9	Mar 31, 2023*	Mar 31, 2023*
2023 Q1 Form 941	Apr 30, 2023	October 16, 2023
*2022 Form 1099-MISC, Box 1-7, 9 due February 28, 2023, if not e-filed		

Other Federal Tax and Time Sensitive Deadlines. The IRS also gives affected taxpayers until October 16, 2023, to perform other time-sensitive actions described in Treas. Reg. § 301.7508A-1(c)(1) and Rev. Proc. 2018-58, 2018-50 IRB 990 (December 10, 2018), that are due to be performed on or after January 8, 2023, and before October 16, 2023. Rev. Proc. 2018-58, 139 pages, consists primarily of lists of all actions eligible for postponement related to a federally declared disaster, such as 1031 exchange (see Section 6 and Section 17), S corporation elections, tax court and bankruptcy deadlines, etc.

For more information, see IRS website: Disaster Assistance and Emergency Relief for Individuals and Businesses

California Franchise Tax Board Notice of Tax Filing Relief Postponement. On Jan. 13, 2023, California released the following notice: "Tax Relief for Californians Impacted by Storms".

> "*To help alleviate some of the stress many have endured during this trying period, the FTB has extended the filing and payment deadlines for individuals and businesses in California until October 16, 2023 (as updated March 10, 2023).*
>
> *This relief applies to deadlines falling on or after January 8, 2023, and before October 16, 2023, including the 2022 individual income tax returns due on April 18 and the quarterly estimated tax payments, typically due on January 17, 2023, and April 18, 2023."*

California offers paperless tax extensions for individual and business filers, therefor the postponed filing date to October 16, 2023, will mainly impact taxpayers who owe taxes with their individual and business tax returns or extensions including PTET payments due on March 15, 2023. The California notice also confirms the 4th quarter 2022 California estimated tax payments and the 1st quarter 2023 estimated tax payments may be paid by October 16, 2023, without penalty.

> **Note**: California has not released any information related to waiving California payroll tax filing or deposits or sales tax filing or paying deadlines. It's best to assume those deadlines are still in place for the 4th quarter 2022 year-end obligations.

In addition, FTB will suspend the mailing of collection notices to affected taxpayers for the next 30 days, beginning January 13, 2023.

New California Minimum Wage Increases for 2024

Beginning January 1, 2024, California minimum wage increases to $16.00 per hour, up from $15.50 per hour. If an employer operates in a locality with a higher minimum wage the higher wage prevails.

This increase in minimum wage also increases the salary test for overtime exemptions in California. The test is double minimum wage, so employees who earn less than $66,560 annually ($1,280 weekly) will not be exempt from earning overtime pay, regardless of their job title or duties.

Beginning April 1, 2024, California minimum wage for employees working at all national fast-food chains (limited-service restaurants consisting of 60 or more establishments including their franchised locations) rises to $20 per hour. Which will raise the salary test for exemption from over-time pay for these workers to $83,000 annually.

California Senate Bill 616: Increased sick days, paid sick days accrual and use.

Beginning January 1, 2024, SB616 modifies employers' current paid sick leave obligations to require that employees have no less than 40 hours of accrued sick leave or paid time off by the 200th calendar day of employment or each calendar year, or in each 12-month period. Before SB616 employers were required to accrue hours for paid sick leave at a rate of no less than one hour for every 30 hours worked, and to be available for use beginning on the 90th day of employment. SB616 adds to this requirement.

Employers may satisfy these new requirements as follows:

- Accrue 1 hour of sick pay for every 30 hours worked, and then increase this accrual to provide an additional 16 hours of paid sick leave by the 200th day of the tax year or the employment year, ***or***

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- Provide a lump sum of 40 hours of available paid sick leave to each employee at the beginning of the tax year or within 30 days of employment.

These benefits are required once an employee has worked 30 days or more during the year. Employers are required to keep track of the paid sick days available for each employee and report the amounts on pay stubs or similar statements. If any local cities' Paid Sick Leave ordinances are lower than the requirements in SB616, then this bill will supersede the local ordinance.

The act excludes specified employees from its provisions, including an employee covered by a valid collective bargaining agreement, and railroad carrier employees.

This bill would raise the employer's authorized limitation on the use of carryover sick leave to 40 hours or 5 days in each year of employment, redefining "full amount of leave" to mean 5 days or 40 hours. Prior to Jan. 1, 2024, accrual of sick pay benefits or carryover of benefits was required if the full amount of leave was not allocated to the employee at the beginning of each year of employment, calendar year, or 12-month period. Now SB616 raises the employer's authorized limitation on the use of carryover sick leave to 40 hours or 5 days in each year of employment.

CALIFORNIA Mandatory Employer CalSavers Employee Retirement Plan

The initial three-year phased rollout of the CalSavers program has ended. If an employer's mandated deadline was September 30, 3020, June 30, 2021, or June 30, 2022, and they have not registered with CalSavers, then they are out of compliance and must register immediately or face enforcement action which will include financial penalties.

Employers with 5 or more employees:

Each spring, we assess employer mandate status using employee data that employers submit to the Employment Development Department (EDD). Employers who reported an average of five or more employees on the four DE9C filings for the prior year are mandated and have a registration deadline of December 31.

Employers with 1-4 employees:

California recently passed legislation to expand the CalSavers mandate to employers with at least one employee. Starting on January 1, 2023, employers with 1-4 employees can register with CalSavers. This segment of mandated employers has until December 31, 2025, to register their business.

2022 WILDFIRE RELIEF

From January 1, 2022, through October 24, 2022 CalFire reports 7,095 fires consuming 362,232 acres in its state responsibility area combined with US Forest Service fires.

FTB Relief

California follows federal extended deadlines. There are extended deadlines for:

- Filing tax returns
- Paying income taxes

Making contributions to a traditional Individual Retirement Account (IRA) or Roth IRA Extended deadlines are up to 1 year (See IRS Tax Relief in Disaster Situations) Interest and penalties are canceled on the underpaid income tax for the length of any extended deadline period.

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CDTFA Relief

Emergency tax or fee relief is available from the California Department of Tax and Fee Administration (CDTFA) for taxpayers who have been directly affected by disasters declared as state of emergencies, both within California and nationally. Available services may include the extension of tax return due dates, relief of penalty and interest, or replacement copies of records lost due to disasters.

Extension of Filing Deadline

An extension of up to three months to file and pay taxes or fees is available for the CDTFA administered programs, including sales and use tax.

This relief is offered to any taxpayer who was directly affected by the disasters in the listed counties, and who, as a result, cannot meet their filing and payment deadlines. The CDTFA may also extend the deadline for filings that were delayed by disruption of service from the United States Postal Service or private mail and freight companies.

BOE Relief

R&TC ‘170 provides that if a calamity such as fire, earthquake, or flooding damages or destroys your property, you may be eligible for property tax relief if the county where your property is located has adopted an ordinance that allows property tax relief to owners of damaged or destroyed property, without fault from the assessee. In such cases, the county assessor will reappraise the property to reflect its damaged condition. In addition, when it is rebuilt in a like or similar manner, the property will retain its prior value (Proposition 13) for tax purposes. All California counties have adopted an ordinance for disaster relief.

To qualify for property tax relief, you must file a claim with the county assessor within the time specified in your county ordinance, or 12 months from the date of damage or destruction, whichever is later. The loss estimate must be at least $10,000 of current market value to qualify the property for this relief. The property will be reassessed according to its damaged state and property taxes will be adjusted accordingly.

This property tax relief is available to owners of real property, business equipment and fixtures, orchards or other agricultural groves, and to owners of aircraft, boats, and certain manufactured homes B it is not available to property that is not assessable, such as state licensed manufactured homes or household furnishings.

EDD Relief

Employers statewide directly affected by the fires and extreme weather may request up to a 60-day extension of time from the EDD to file their state payroll reports and/or deposit payroll taxes without penalty or interest. This extension may be granted under ‘1111.5 of the California Unemployment Insurance Code (CUIC). A written request for extension must be received within 60 days from the original delinquent date of the payment or return.

AUTOMATIC DISASTER RELIEF FOR AREAS PROCLAIMED BY GOVERNOR

SB 35 (Wolk, Stats. 2015, Ch. 230) automatically allows disaster loss treatment for losses sustained in an area declared by the Governor to be in a state of emergency. The law is operative for taxable years beginning on or after Jan. 1, 2014, and before Jan. 1, 2024.

The reason for the bill was to streamline the disaster tax relief process, to reduce the burden of multiple disaster loss bills on the state legislature, and to expedite disaster-related tax relief for taxpayers that suffer losses related to governor-declared states of emergency. Prior to this legislation, if the Governor had

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declared a disaster area but the President had not, California law required the legislature to enact disaster relief for the affected area.

FTB GRANTED POWER TO POSTPONE DEADLINES AND ABATE INTEREST

Effective Jan. 1, 2013, SB 1158 (Price, Stats. 2012, Ch. 382) allows the FTB to do the following:

- Postpone certain tax-related deadlines for taxpayers affected by a gubernatorially declared disaster, and
- Abate interest accrued against liabilities owed by taxpayers located within a disaster area if the accrued interest is the result of the FTB's decision to delay notices sent to the disaster area.

HOW CAN I REPLACE CALIFORNIA TAX RETURNS LOST OR DAMAGED IN A DISASTER?

If the taxpayer's returns are lost or damaged due to a disaster, the FTB will replace the California tax returns at no cost. Complete Form FTB 3516, Request for Copy of Tax Return. Be sure to print the name of the disaster at the top of the form and the FTB will send copies of the most recently filed tax return.

For Personal Income Tax Returns:

RID UNIT PIT

Franchise Tax Board PO BOX 1468

Sacramento, CA 95812-1468

For Business Income Tax Returns:

RID UNIT CORP

Franchise Tax Board PO BOX 1468

Sacramento, CA 95812-1468

You can also request a copy of lost or damaged return by writing a letter that includes all of the following:

- Taxpayer's name;
- Taxpayer's address;
- Taxpayer's Social Security number (for personal income tax returns);
- Taxpayer's corporation number, California Secretary of State number, or federal employer identification number (for corporate tax returns);
- The tax year requested; and
- Taxpayer's signature.

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2023 CALIFORNIA TAX UPDATE
CALIFORNIA RESIDENCY

Residency is primarily a question of fact to be determined by examining all the circumstances of a taxpayer's particular situation.

RESIDENTS VS. NONRESIDENTS FTB DEFINITIONS

A resident is any individual who meets any of the following:

- In California for other than a temporary or transitory purpose.

Domiciled in California, but outside California for a temporary or transitory purpose. A nonresident is any individual who is not a resident (CA §17014).

Domicile

The term "domicile" has a special legal definition that is not the same as residence. While many states consider domicile and residence to be the same, California makes a distinction and views them as two separate concepts even though they may often overlap. For instance, a taxpayer may be domiciled in California but not be a California resident, or he/she may be domiciled in another state but be a California resident for income tax purposes.

Domicile is defined for tax purposes as the place where an individual voluntarily establishes himself/herself and family, not merely for a special or limited purpose but with a present intention of making it a true, fixed, permanent home and principal establishment. It is the place where, whenever the individual is absent, he/she intends to return.

Change of Domicile

An individual can have only one domicile at a time. Once someone acquires a domicile, he/she retains that domicile until acquiring another. A change of domicile requires all of the following:

- Abandonment of prior domicile.
- Physically moving to and residing in the new locality.
- Intent to remain in the new locality permanently or indefinitely.

Taxpayer Becomes California Resident Too Soon!

David Beckwith moved from California to Tennessee in 2008 after accepting the position as president of operations for Eco-Energy. He purchased a home near his brother and his brother's family in Franklin, Tennessee. David's brother served as Eco-Energy's chief executive officer for many years, and David and his brother were the principal shareholders of the company. He remained a Tennessee resident through 2011. In 2012, Eco-Energy's board of directors began soliciting proposals for the sale of the company. Under the terms of a purchase agreement, David received $9,204,406 in redemption of his shares on December 19, 2012. He filed a 2012 Nonresident or Part-Year Resident Income Tax Return (Form 540-NR) claiming he was a nonresident for all of 2012.

David sold his personal residence in Tennessee on November 6, 2012, and purchased a home in California in July 2012. In 2012, he spent approximately 170 days in California, 128 days in Tennessee, and 54 days in a location other than California or Tennessee, with 14 days unaccounted for.

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The Office of Tax Appeals held that since David was a California domiciliary and was physically in California for a majority of the time leading up to and on the date of the sale of Eco-Energy, his strongest connections were with California. David maintained a permanent home in California, his fiancé was located in California and had no intention of moving. He spent the most time in California and did not spend much time in Tennessee. Thus, he availed himself of the benefits and protections of California the most, and consequently, was a California resident for tax purposes. Therefore, on December 19, 2012, the date of the sale of Eco-Energy, OTA determined David was a resident of California (***Appeal of David Beckwith,*** OTA No. 20056187, July 2022).

Safe Harbor

For taxable years beginning on or after Jan. 1, 1994, a safe harbor is available for certain individuals leaving California under employment-related contracts. The safe harbor provides that an individual domiciled in California who is outside California under an employment-related contract for at least 546 consecutive days will be considered a nonresident ***unless*** any of the following is met:

1. The individual has intangible income exceeding $200,000 in any taxable year during which the employment-related contract is in effect.

2. The principal purpose of the absence from California is to avoid personal income tax.

The spouse/RDP of the individual covered by this safe harbor rule will also be considered a nonresident while accompanying the individual outside California for at least 546 consecutive days. Return visits to California that do not exceed a total of 45 days during any taxable year covered by the employment contract are considered temporary.

Individuals not covered by this safe harbor determine residency status based on facts and circumstances. The determination of residency status cannot be solely based on an individual's occupation, business, or vocation. Instead, consider all activities to determine residency status. For instance, students who are residents of California leaving this state to attend an out-of-state school do not automatically become nonresidents nor do students who are nonresidents of California coming to this state to attend a California school automatically become residents. In these situations, individuals must determine their residency status based on their facts and circumstances.

GUIDELINES FOR DETERMINING RESIDENCY

The underlying theory of residency is that a taxpayer is a resident of the place where he/she has the closest connections. The following list shows some of the factors the FTB uses to determine residency status. Since an individual's residence is usually the place where he/she has the closest ties, the FTB will compare ties to California with ties elsewhere. In using these factors, it is the strength of the ties, not just the number of ties, that determines residency.

Factors to consider are as follows:

- Amount of time spent in California versus amount of time spent outside California.
- Location of spouse/RDP and children.
- Location of principal residence.
- Where driver's license was issued.

- Where vehicles are registered.
- Where taxpayer maintains professional licenses.
- Where registered to vote.
- Location of the banks where accounts are maintained.
- The origination point of financial transactions.
- Location of doctors, dentists, accountants, and attorneys.
- Location of the church, temple or mosque, professional associations, or social and country clubs.
- Location of real property and investments.
- Permanence of work assignments in California.
- Location of social ties.

This is only a partial list of the factors to consider. Consider all the facts of the taxpayer's particular situation to determine his/her residency status.

FTB Web Pages Dedicated to Residency and Non-Residency Issues

In the past, information for nonresidents and part-year residents required you to read the FTB's publications:

1. Publication 1031 - Guidelines for Determining Resident Status, and
2. Publication 1100 - Taxation of Nonresident and Individuals Who Change Residency

The FTB now has new web pages dedicated to nonresidents and part-year residents. You can view all content in one place as well as find useful links to forms and publications, sourcing information, and rules for withholding on California source income.

Temporary or Transitory Purposes

Nonresidents who are in California for temporary or transitory purposes are still nonresidents of California. For instance, if an individual comes to California for a vacation, or to complete a transaction, or is simply passing through, his/her purpose is temporary or transitory. As a nonresident, he/she is taxed only on income from California sources.

> **Example.** James and Janice are domiciled in Minnesota where they have maintained their family home for seven years. James works for a state agency in Minnesota. In October 2020, James took a six-month leave of absence to become a temporary consultant for a California company. James and Janice moved to Los Angeles in October 2020, where they rented an apartment and opened a checking account. Their home in Minnesota was left vacant and they retained their Minnesota bank accounts. They stayed in California from October 2020 to April 2021 and returned to Minnesota in April 2021.
>
> James and Janice were in California for a short period in order for James to complete a particular engagement as a temporary consultant. James and Janice are nonresidents of California because they were in California for a temporary or transitory purpose.

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When someone is in California for other than a temporary or transitory purpose, he/she is a California resident. For instance, if an employer assigns the individual to an office in California for a long or indefinite period, if he/she retires and comes to California with no specific plans to leave, or if someone is ill and in California for an indefinite recuperation period, his/her stay is other than temporary or transitory. As a resident, he/she is taxed on income from all sources.

An individual will be considered to be in California for other than temporary or transitory purposes, and therefore a California resident, if he or she is in this state:

- To recuperate from injury or illness for a relatively long or indefinite period.
- For a business purpose which will require a long or indefinite period to accomplish.
- For employment in a position that may last permanently or indefinitely.
- For retirement with no definite intention of leaving shortly.

> **Example**. Bob is domiciled in Ohio and has lived there for 50 years. Two years ago, Bob developed a serious medical condition. His doctor told him to live in California until he recovers. The illness may last for several years. Bob took his doctor's advice and moved to California two years ago.

An individual will be presumed to be a California resident for any taxable year in which he/she spends more than nine months in the state. Although he/she may have connections with another state, if the stay in California is for other than a temporary or transitory purpose, that individual is a California resident. As a resident, income from all sources is taxable by California.

A resident of California continues to be a resident when absent from the state for a temporary or transitory purpose.

Failure to Sever Ties with California Retains Residency

L. Mazer and M. Mazer, husband and wife, were residents of California. In February 2013, L. Mazer moved from California to Malaysia for the purpose of employment as a manager for Symmid Corporation SDN BHD. His wife, M. Mazer, remained in California living their home. Although he had a contract with Symmid to work in Malaysia for two years, Mr. Mazer ceased employment and returned to California in March 2014. FTB determined that wages earned while working in Malaysia were all taxable to California on the Mazers' 2013 return, because Mr. Mazer failed to become a nonresident.

OTA found that Mr. Mazer was still domiciled in California, and, in part, because his living quarters, vehicle and other bills in Malaysia were paid by his employer, he did not have any facts supporting he had severed his ties to California by establishing ties in Malaysia. (***Appeal of L. And M. Mazer,*** OTA No. 19064883, July 2020).

Sale of Corporation Taxable to California for Almost Nevada Residents

J. and J. Bracamonte were residents of California in 2007, having owned a home in Escondido since 1998. They subsequently sold the home in 2017. On July 18, 2008, sold their corporation, Jimsair Aviation Services, Inc. in the amount of $16,699,000 received in 2008 and $617,522 received in 2009.

In February 2008 the taxpayers spent 3 days in Henderson, NV during which time they signed a 6-month lease to rent an apartment, opened a post office box, registered to vote and obtained Nevada driver's licenses. Between February 25 and July 18, 2008, the Bracamontes made numerous trips between their properties in California, Arizona and Nevada.

Altogether, the Bracamontes spent 28 days in Henderson, Nevada, 90 days at their property in Escondido, California, and 19 days at their property in Lake Havasu City, Arizona. They closed on the purchase of a home in Henderson on September 22, 2008.

The appellate board found that at the time of the sale of the corporation, the Bracamontes had failed to surrender their California domicile because they had not established a permanent domicile in Nevada. Moreover, during the time of the company sale, the taxpayers maintained their California post office box address, numerous bank accounts, and established care with healthcare professionals in California. Prior to the sale of Jimsair, they conducted business in San Diego, including holding meetings with attorneys about ongoing litigation and meetings that ultimately led to the sale of Jimsair. The Board found that these connections favor California residency (***Appeal of J. and J. Bracamonte,*** OTA No. 18010932, March 2021).

RESIDENT/NONRESIDENT UNDER THE PERSONAL INCOME TAX INCOME TAXABLE BY CALIFORNIA

Residents of California are taxed on ***all*** income, including income from sources outside California.

Nonresidents of California are taxed only on income from California sources. Nonresidents of California are not taxed on pensions received after Dec. 31, 1995.

Part-year residents of California are taxed on all income received while a resident and only on income from California sources while a nonresident.

SOURCING INCOME

Under R&TC §17041(b) and (I), nonresidents and part-year residents of California are taxed on income attributable to California. Taxable income of a nonresident is determined by taking into account only gross income from sources within California (R&TC §17951).

In the case of services, it is well-settled that the source of income is determined by examining the location where services are performed, without regard to a taxpayer's state of residency (see ***Appeal of Robert C. Thomas and Marian Thomas***, 55-SBE-006, Apr. 20, 1955; ***Appeal of Charles W. and Mary D. Perelle***, 58-SBE-057, Dec. 17, 1958; ***Appeal of Janice Rule***, 76-SBE-099, Oct. 6, 1976; and ***Appeal of Oscar D. and Agatha Seltzer***, 80-SBE-154, Nov. 18, 1980). Furthermore, California Code of Regulations §17951-2 states that "income from sources within this State includes income from real or tangible personal property located in this State; from a business, trade or profession carried on within this State.

California follows federal law, which provides special rules concerning the taxation of "qualified retirement income." Title 4 of the United States Code, §114 provides that "no state may impose tax on any retirement income of an individual who is not a resident or domiciliary of such State." R&TC §17952.5 implements that federal law by excluding "qualified retirement income" from a nonresident's California gross income from sources within this state. Thus, regardless of source, "qualified retirement income" is not subject to California tax if it is received by a nonresident.

California's sourcing principles apply even though the results may be contrary to the other states' principles. The following describes the sources of various types of income:

- Compensation for services rendered by employees or independent contractors has a source where the services are performed.
- Income from tangible personal property and real estate has a source where the property is located.

- Income from intangible personal property (such as interest and dividends) generally has a source where the owner resides.
- Business income has a source where the sale occurred the benefit of the service was received.
- Income Sourcing for NonResidents Temporarily Relocated to California During COVID-19

As mentioned elsewhere, FTB has developed and continues to add to its COVID-19 FAQs. Here's an excerpt for nonresidents temporarily relocated to California:

Scenario 1: You work for an out-of-state employer and receive a W-2 from them. You temporarily relocate to California. Do you need to file a California return and pay California income tax?

Answer: Yes. As a nonresident who relocates to California for any portion of the year, you will have California source income during the period of time you performed services in California. You will need to file a California Nonresident or Part-Year Resident Income Tax Return (Form 540NR) return to report the California sourced portion of your compensation. One way to calculate the portion of your income that is California sourced is to multiply your total amount of income for the year by a ratio of your total number of days performing services in California over your total number of days performing services worldwide.

Scenario 2: You work for a California employer and receive a W-2 from them. You relocate temporarily to California. Will you need to file a California return and pay California income tax?

Answer: You need to file a California personal income tax return if you performed services in California for wages. Where you performed services determines how you file your taxes (not the location of your employer). Review Scenario 1 for more information.

Scenario 3: You're an independent contractor who relocates temporarily to California. You have not had a previous source income from California. Will you need to file a California return?

Answer: Maybe. If you are a nonresident independent contractor whose income was not previously considered California source, you would not create California source income simply by relocating temporarily to California. If a customer in California receives the benefit of your services in California, you will need to file a return.

California source income for independent contractors is determined by looking to where the benefit of the service is received. The location where the independent contractor performs the work is not a factor.

Independent Contractor Had Income Sourced to California

California imposes a tax on the entire taxable income of a nonresident to the extent it is derived from sources within this state (R&TC, §17041(b), 17951(a)).

Blair Bindley is a self-employed screenplay writer providing services to companies producing films and television shows. On or around Sept. 1, 2014, Blair contracted with Mindbender Enterprises, LLC (Mindbender), a motion picture producer, for his writing services to write a screenplay. The contract specifies that Blair's work would be considered "work-for-hire" and Mindbender would therefore be considered the author and copyright owner of his screenplay. On or around Dec. 18, 2015, Blair similarly contracted with Lakeshow Films, LLC to write an original screenplay for the producer. The contract specifies that the screenplay would be considered a "work-made-for-hire" for Lakeshow. Both Mindbender and Lakeshow (collectively, "LLCs") were headquartered and registered in California.

In 2015, Blair received $25,000 of income from Mindbender and $15,000 of income from Lakeshow but did not file a California tax return. When the FTB requested a return, Blair explained that he did not have

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California-source income because he performed all services for Mindbender and Lakeshow in Arizona. During the 2015 tax year, he was an Arizona resident.

The FTB held and the OTA agreed that pursuant to the provisions of R&TC §25136 and Regulation 25136-2(c) relating to the sale of services, Blair's physical presence does not determine whether he had income derived from California, but rather it is determined by where the benefits of his services were received. Having established that income from Mindbender and the income from Lakeshow are sourced to California, the $40,000 was reportable to the state (***Appeal of Blair S. Bindley***, OTA No. 18032402, May 2019).

Income from Exercising Non-Qualified Stock Options (NSO)

When a taxpayer is granted an NSO while a California resident and later exercises it while a nonresident, the income from its exercise is compensation for services with a source in the state where the taxpayer performed the services C California (***Appeal of Charles W. and Mary D. Perelle*** (Dec. 17, 1958) 58-SBE-057). However, where the taxpayer performed services both within and outside of California, allocate to California only that portion of total compensation reasonably attributed to services performed in California (18 Cal. Code Regs. §17951-5).

One reasonable method is an allocation based on time.

$$\frac{\text{California workdays from date of grant to date of exercise}}{\text{Total workdays from date of grant to date of exercise}} = \text{Allocation ratio}$$

Income taxable by California = Total stock option income x Allocation ratio

The ratio applies only to options exercised after the taxpayer becomes a nonresident. If a taxpayer performs services for the corporation entirely within California but exercises the option after terminating employment and becoming a nonresident, the difference between the fair market value of the stock on the date of exercise and the option price has a source in California even though the underlying value of the stock may have increased after the taxpayer became a nonresident.

The state board decision in the ***Appeal of Spencer W. Kimball*** (Jan. 15, 2013) California State Board of Equalization Case No. 527783 follows the FTB's long-standing method of apportioning some or all of the income from NSOs as sourced to California when the options were originally awarded to a California resident but not exercised until after the taxpayer became a nonresident.

Ruling Regarding Sourcing of Restricted Stock Units (RSUs)

Following the methodology the FTB uses for reporting stock option income (above), the FTB released Chief Counsel Ruling 2013-02 (in February 2014) regarding the proper method of determining the portion of California source income received by an employee who was granted RSUs as a California resident but did not recognize income on them until he became a nonresident.

Apportion using stock option formula.

According to Chief Counsel, taxpayers must use a reasonable apportionment method to determine the portion of California source income received. The most reasonable apportionment method to determine the portion of California source income received is to multiply the compensation received by a ratio of California working days from the grant date to the vest date over the total working days anywhere during the same period.

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Vesting of Long-Term Incentive Plan Mirror Shares

On November 10, 2010, while G. Stabile was working for Renewable Services in North Palm Springs, California, the Board of Directors voted to offer a Long-Term Incentive Plan (LTI) that granted mirror shares to key United States (U.S.) employees. A letter to Mr. Stabile dated January 10, 2011, explains the award and vesting of his LTI mirror shares. Mr. Stabile was awarded 1,000 mirror shares as of November 10, 2010. Half of these units were to be paid on the first vesting date, on November 12, 2012, and the remaining units were to be paid on the second vesting date, on November 12, 2013.

Mr. Stabile continued to work in California for Renewable Services until 2012 when he accepted a position with EDF Energy Renewables, a related company in London. His work assignment in the U.K. began on January 5, 2012, but he remained and worked in California periodically until April 1, 2012. Upon vesting of the 500 LTI mirror shares in November 2012 the company reported wage income of $73,455 which Mr. Stabile did not report on his California return claiming it was paid after he was no longer a California resident.

Although FTB agreed that Mr. Stabile had ceased to be a resident of California as of March 15, 2012, FTB asserted, and OTA agreed that a portion of the LTI income was subject to California tax based on the number of working days in California versus the number of working days everywhere from the grant date to the vesting date. (***Appeal of G. Stabile,*** OTA No. 18073403, April 2020)

INCOME FROM TAX-EXEMPT MUTUAL FUNDS

Article XIII of the California constitution states "interest on bonds issued by the State or local government in the State is exempt from taxes on income." R&TC §17145 provides that an RIC (regulated investment company) is qualified to pay exempt interest dividends if, at the close of each quarter of its taxable year, at least 50 percent of the value of its total assets consists of obligations which, when held by an individual, the interest therefrom would be exempt from taxation.

Ronald D. and Pamela S. Mass bought shares in a company that invests in government bonds. They received dividends derived from interest on those bonds. Because RIC received 12.41% of its interest income from its holdings in California municipal bonds, the FTB assessed tax on the dividends. The Masses contend that their dividends were unconstitutionally taxed.

But the Second Court of Appeal in California disagreed on the constitutionality issue. Citing that the R&TC taxes dividends from RICs that might be derived from municipal bond income is different than actually taxing the bond income itself, the Court did not find R&TC §17145 in violation of the state's constitution (***Mass v. FTB,*** CA Court of Appeal, 2nd Dist., No. B286857, August 2019).

LIKE-KIND EXCHANGE INFORMATION REPORTING

Under federal and state law, an exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like-kind that is to be held for productive use in a trade or business or for investment; such an exchange is referred to as a "like-kind exchange."

Generally, no gain or loss is recognized at the time of the exchange. The amount of unrecognized gain or loss is deferred and will generally be recognized upon the sale of the property acquired in the exchange, unless a taxpayer subsequently exchanges property acquired in an exchange for another property of like-kind. However, if as part of the exchange a taxpayer also receives other (not like-kind) property or money, gain is recognized to the extent of the other property and money received but a loss is not recognized.

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The federal rules for like-kind exchanges are under IRC§§1031, and California generally conforms under R&TC §§18031 and 24941. Taxpayers are allowed to exchange California property for out-of-state property as long as the exchange meets the federal like-kind exchange requirements. A gain or loss from the exchange of real or tangible personal property located in California is sourced to California at the time the gain or loss is realized, regardless of whether or not the taxpayer that realized the gain is residing in or doing business in California at the time that the gain is recognized.

> **Example.** If Karen is a California resident and exchanges real property located in California for real property located outside of California, the deferred gain or loss is California source income. Even if Karen moves to another state and resides there for several years before the gain or loss is recognized, she is required to report to California the deferred California-sourced gain or loss in the year the gain or loss is recognized and pay any California tax attributable to the recognition of that gain or loss.

This creates an unusual record keeping burden on taxpayers, as tax records may not generally be retained beyond the normal four-year statute of limitations, and individuals may not have had a California filing requirements for several years. Thus, it is not uncommon for such individuals to neglect to file a California return and report that California-sourced gain or loss in the year it is recognized. Additionally, it is challenging for the FTB to track deferred gains or losses of individuals who have been nonresidents for several years and have not been required to file California income tax returns.

Legislation Requires Annual Reporting Starting in 2014

Effective for exchanges beginning on or after Jan. 1, 2014, AB 92 (Budget, Stats. 2013 Ch. 26) provides an annual information reporting requirement for taxpayers that claim nonrecognition of gain or loss for a like-kind exchange when property in California is exchanged for property located outside of California. For such an exchange, taxpayers would be required to file an information return in the taxable year of the exchange and in each subsequent taxable year in which the gain or loss attributable to the exchange has not been recognized.

For taxpayers that fail to comply with that reporting requirement and fail to file a return to properly report the recognition of the gain or loss attributable to the exchange, the FTB could make an estimate of the net income from the exchange using any available information, including the amount of deferred gain or loss reported in the year of the exchange, and may propose to assess the amount of tax, interest, and penalties due in the same manner as assessments that are proposed for the failure to file a return.

Taxpayers Use FTB Form 3840

Form 3840 provides information about the relinquished California properties and the non-California replacement properties in the like-kind exchange. Form FTB 3840 must be filed in the year in which the like-kind exchange is completed and each subsequent year that the gain or loss is deferred, regardless of whether the seller/exchanger has any other California filing requirement.

Who Must File

All taxpayers who complete a like-kind exchange of California property for non-California property are required to file Form FTB 3840. The mandatory filing requirement applies to all individuals, estates, trusts, and all business entities regardless of their residency status or commercial domicile.

Where to File

As an Attachment: Taxpayers attach Form FTB 3840(s) to their California return and submit it to the normal mailing address (or e-file) with the particular California tax return being filed.

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As an Information Return: Taxpayers filing Form FTB 3840 separately from the California tax return and as an information return will mail the form to:

FRANCHISE TAX BOARD

PO BOX 1998

RANCHO CORDOVA, CA 95471-1998

When to File

As an Attachment: Taxpayers with a California filing requirement must attach Form FTB 3840 to their California tax return and file by the return's due date (plus extensions).

As an Information Return: Taxpayers without a California filing requirement must file Form FTB 3840 by the return due date (plus extensions) as if the taxpayer had a California filing requirement.

Failure to File

For taxpayers required to file Form FTB 3840(s) who fail to file as required, the FTB may issue an NPA to adjust their income for the previously deferred gains plus any applicable penalties and interest.

> ***Preparer's Note!*** California conforms to IRC §1031 as of Jan. 1, 2015. Therefore, the state does not completely conform to the restriction that only real property qualifies for tax-deferred exchange. See the discussion in ***Conformity and Nonconformity*** for more information.

FTB Issues Letters for Form 3840

The FTB mailed an initial letter to over 3,000 taxpayers who either failed to file or filed an incomplete FTB 3840 for 2016. Approximately 47% responded by filing or correcting FTB 3840.

In early August, FTB sent about 1,700 follow-up letters to those taxpayers who did not respond, requesting FTB 3840 be filed or corrected within 30 days. It will be sending a third letter in the form of a Demand for Information to taxpayers who failed to respond.

The plan is to make up to three attempts to contact taxpayers to give them an opportunity to file or correct their FTB 3840. Failure to respond to the third letter by submitting a FTB 3840 or continuing to file incomplete forms may result in the FTB opening an audit to confirm the accuracy of the deferred gain(s).

If the taxpayer fails to respond to an audit request and the FTB has reason to believe the taxpayer no longer owns the property, it may issue a Notice of Proposed Assessment (NPA) including the gain in the year the FTB believes the property was sold.

INCOME FROM WORLDWIDE SOURCES FOR NONRESIDENTS

A common question nonresidents ask is "Why do I have to report my worldwide income if California can only tax California sourced income?" For tax years beginning on or after Jan. 1, 2002, the first step in calculating a nonresident or part-year resident's California tax is to calculate the taxpayer's effective tax rate as if the taxpayer were a California resident. If the taxpayer fails to report this income, a statutory adjustment will be made to the 540NR return.

These adjustments are usually made based upon information received from the IRS regarding the adjusted gross income reported on the 1040.

Why does California calculate the tax this way? Both the IRS and California assess tax based on tax brackets, which are the divisions at which tax rates change in a progressive tax system. Progressive tax systems

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attempt to reduce the "tax incidence" of people with a lower "ability-to-pay," as they shift the incidence increasingly to those with a higher ability-to-pay. California law requires the FTB to compute California tax at the effective tax rate that would be equal to the effective tax rate of a resident with the same level of income.

The effective tax rate, based on worldwide income, is then applied only to the California taxable income of the nonresident to determine the tax amount owed to California.

Failure to include worldwide income results in a statutory adjustment to a 540NR return. These adjustments are usually made after FTB receives information from the IRS on the adjusted gross income reported on the 1040.

Using the "California Method" to Calculate Tax Determined to be Correct

In 2012, Robert Nguyen moved from California to Washington on January 11 and although he worked for Boeing Company the entire year, he only worked six days working in California. Boeing allocated $6,347.83 of his total wages of $102,003.11 as sourced to California. When filing his 2012 return, Robert incorrectly subtracted the non-California source income of $95,655 from the all-source column to arrive at his tax liability. OTA reiterated that including income from all sources merely uses the $95,655 for purposes of computing, among other things, the appropriate California tax rate to apply to Mr. Nguyen's income that has a California source. (***Appeal of Robert Nguyen,*** OTA No. 18042880, October 2019)

GROUP NONRESIDENT RETURNS

On an individual return, a nonresident must report all income from all sources in addition to the California source income. On the group nonresident return, only the California source pass-through income or director's compensation is reported.

A full-year nonresident who meets other requirements can be included in the group nonresident return.

In filing a group nonresident return, a business entity acts as the authorized agent and may also choose to file a group nonresident return for certain nonresidents. To participate, nonresidents must receive distributive shares of income from business entities that derive income from California sources or from those who are doing business in California. The business entity pays the tax on behalf of the nonresident individuals who elect to file a group return. A group nonresident return is considered a group of individual returns that meets the California individual income tax return filing requirement. Thus, a qualified nonresident individual who elects to be included in the group nonresident return is not required to file a separate income tax return for the tax year.

The upside to the group return is that worldwide income does not need to be reported individually; however, the income reported on the group nonresident return is taxed at the highest marginal rate of 12.3%.

Does Your Taxpayer Really Want to Be Included in a Group Nonresident Return?

Lately, it seems business entities are often quick to file the group nonresident tax return on behalf of its nonresident individual shareholders/partners/members without full consideration of their specific facts and circumstances.

Election to Be Included in the Group Nonresident Tax Return is Irrevocable.

If your clients are considering this option, remember this is an irrevocable election. This is an annual election in which the electing individual is authorizing the business entity to report the individual's California

sourced income and pay the tax on behalf of the electing nonresident individual. Once the group nonresident tax return is filed, it cannot be amended to either include or exclude a nonresident individual.

Not all shareholders/partners/members can be included in the group nonresident tax return.

To be included in the group nonresident return, all of the following requirements must be met:

- Only individuals can be included on the group tax return.
- The individual must be a full-year nonresident of California.
- The income from the business entity/corporation must be the only California source income of the individual, other than California source income that is being reported on another group nonresident return.

Claiming other sources of California losses will not disqualify the individual from being included in a group nonresident tax return.

> **Example.** Karen, a nonresident individual, has California source income from the Kreider/Brosi partnership and is a partner in Hoven/Brosi partnership with a net loss. Karen does not have income from any other California source. Karen can elect to be included in the group nonresident tax return of Kreider/Brosi partnership. If Hoven/Brosi partnership had income, Karen can elect to be included in the group nonresident return of both partnerships. Karen cannot elect to be included in the group nonresident return of only one of the partnerships.

> **Example.** Sharon, a nonresident individual, has California source income from a business entity and from an individually owned California rental property. Sharon cannot be included in the group return of the business entity because the income from the business entity is not Sharon's only California source income, and that additional California source income is not going to be reported on another nonresident group tax return.

Tiered partnerships (and other tiered ownership structures) are not allowed to file a group tax return to combine all of their business entities and individual nonresident partners on one group tax return. Each partnership must file a separate group nonresident tax return for their electing individual nonresident partners and cannot include any business entities in the group nonresident tax return.

NonResident Group Return with Nonresident Aliens

For taxable years beginning on or after January 1, 2021, and until January 1, 2026, AB 2660 (Burke, Stats. 2020, Ch. 102) allows an entity authorized by the taxpayer to include that taxpayer's income in a group return filed on his or her behalf. As the agent for the electing nonresident aliens, the entity would make all tax payments, additions to tax, interest, and penalties otherwise required to be paid by the electing nonresident alien.

For a nonresident alien electing to be included in a group return, the tax rate or rates applicable to each nonresident's taxable income for services performed in this state for that taxpayer would consist of the highest marginal rate or rates, plus, if applicable, the additional mental health tax, and no deductions or credits would be allowed. Payments of tax made by the entity filing the nonresident group return would be excluded from the electing nonresident alien's income. Any withholding payments made would be allowed as a credit against the tax of the nonresident alien electing to file in a group return. In addition, the Franchise Tax Board (FTB) may adjust the income of an electing nonresident alien taxpayer included in a group return.

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The nonresident alien, or entity authorized on their behalf, would be allowed to file a return without providing a SSN or ITIN. If the nonresident alien subsequently becomes eligible for and is issued a SSN or ITIN, the FTB may require the nonresident alien to provide a letter or other form documenting the nonresident alien's SSN or ITIN.

OTHER STATE TAX CREDIT (OSTC)

Taxpayers may qualify for a credit for income taxes paid to another state when the same income that is taxed by the other state is also taxed by California. Effective for all open taxable years, other state income taxes which are paid to the other state do not necessarily have to be in the same year, as long as the taxes relate to the same transaction.

In order for a California resident to claim another state tax credit (OSTC), the income subject to double taxation must be sourced to the other state pursuant to California sourcing rules. In order for a California nonresident to claim an OSTC, the income subject to double taxation must be sourced to California pursuant to California sourcing rules.

OSTC for a California Resident

An OSTC is available for net income taxes imposed by and paid to another state on income that is also taxed by California, where that income is derived from sources within the other taxing state. No credit is allowed if the other state allows California residents a credit for net income taxes paid to California.

States that allow California residents a credit for net income taxes paid to California:

1. Arizona
2. Oregon
3. Virginia (dual residents)

Indiana No Longer a Reverse Credit State for California

Effective Jan. 1, 2017, California and Indiana dropped the agreement wherein a California resident with Indiana source income would take a credit on the nonresident Indiana return for taxes paid to California.

OSTC for a California Nonresident.

An OSTC is allowed for net income taxes imposed by and paid to the taxpayer's state of residence on income that is also taxed by California, if the state of residence either:

1. does not tax the income of California residents derived from sources within that state; or
2. allows California residents an OSTC.

However, an OSTC is not allowed for taxes paid to a state which allows its residents an OSTC for net tax paid to California irrespective of whether its residents are allowed a California OSTC.

OSTC and Group Nonresident Returns

California residents included in other state composite (group) returns may claim a credit for their share of income taxes paid to the other state, as long as the state does not allow a credit for taxes paid to California for the group. Although the credit is not normally allowed for taxes paid to Arizona, Indiana, Oregon, and

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Virginia, the credit will be allowed for a California resident that is included in a group return filed in one of these states, unless any of these states allow a credit for taxes paid to California for the group. According to Schedule S instructions, the taxpayer must attach a composite schedule or statement explaining that he/she is included in a group return.

As a result of new validation rules, the FTB has begun adjusting or disallowing the OSTC because of incomplete or missing information on the Schedule S. Below are tips to avoid requests for additional information or an adjustment to a return during processing when claiming OSTC:

- Fill out each Schedule S completely and attach all applicable Schedule S forms.
- Do not lump all of the income or credits under "Various," "See attached," or under a particular state.
- For California residents belonging to a group, attach a composite schedule or statement that the taxpayer is in a group. Attach all applicable Schedule S forms.

Providing all complete Schedule S forms and a composite schedule or statement (if it applies) with the return will:

- Speed up the processing of the return.
- Avoid delay in any applicable refund.
- Avoid receiving a Notice of Tax Return Change.

The FTB reiterated this treatment of the OSTC for California taxpayers' share of income taxes paid to a reverse credit state in Technical Advice Memorandum 2017-01 and Technical Advice Memorandum 2017- 04.

OSTC Not Allowed Simply Because Other Nonresident State Taxes Income

Residents of California may claim the OSTC only if the income taxed by the other state has a source within the other state under California law (R&TC §18001(c)). That means that in certain circumstances, a California resident who pays tax to another state may be required to pay tax to both California and the other state.

> ***Example.*** Ben is a California resident who sold property in Hawaii on an installment plan. During 2021, Ben received $10,000 in interest payments and $5,000 in taxable principal payments. Ben has no other interest in Hawaii property or business. Ben must file a Hawaii return and pay tax on $15,000 (both the principal and interest payments). Ben must report both the principal and interest payments to California because residents are taxable on income from all sources.
>
> Ben will get a credit for the tax paid on the $5,000 principal payments, but he will not get a credit for the tax he pays Hawaii on the $10,000 interest payments because under California law the interest payments are not sourced to Hawaii under Cal. Code Reg. §17952.

New! OSTC Calculation Changed for Pass-Through Entity Tax Paid

For taxable years beginning on or after January 1, 2022, and before January 1, 2026, SB 851 (Portantino, Stats. 2022, Ch. 705) changes the calculation of the OSTC. Specifically, the bill allows a taxpayer to increase the "net tax payable", as that term is used in R&TC §18001 and §18002, by the amount of the allowed Pass-Through Entity (PTE) tax credit for the taxable year.

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Avoiding Double Taxation.

Without this relief, some taxpayers reduced California tax significantly, or entirely on income taxed in another state. As a result, these taxpayers found they were in fact being "double taxed" because they received a reduced or eliminated OSTC, but were still taxed in both California and the other state. This bill allows the taxpayer to calculate taxes paid for OSTC as if he/she had paid the taxes directly at the individual level.

TAXATION OF TRUSTS WITH OUT-OF-STATE TRUSTEES

A trust is a taxable entity separate and apart from its beneficiaries. In order for California to tax the income of a trust, one or more of three separate elements must be present:

1. the trust must have income from California sources;
2. a trustee of the trust must be a resident of California; or
3. a non-contingent beneficiary of the trust must be a resident of California.

Under both federal and California law, non-grantor trusts are taxable at the trust level on accumulated income. In general, trusts receive a deduction for amounts of income distributed to beneficiaries in the taxable year and, accordingly, the tax paid by a trust will be a tax on income that is accumulated by the trust.

All of a trust's California source income is taxable by California, regardless of where the trust is managed or where the beneficiaries reside. The remaining income of a trust (i.e., the non-California source income) will be taxable by California based on a residency theory if the trust has a California resident fiduciary or California resident non-contingent beneficiary. Essentially, if either all of the fiduciaries or all of the non-contingent beneficiaries of a trust are California residents, the trust's income will be wholly taxable by California. Where there are multiple fiduciaries or non-contingent beneficiaries with varying residencies, California taxes the trust income based on the proportion of its California resident and non-resident fiduciaries and California resident and non-resident, non-contingent beneficiaries.

In summary, a trust is taxable first on all of its California source income and is next taxed on a portion of its non-California source income that reflects the proportion of California-resident fiduciaries and non-contingent beneficiaries, and non-resident fiduciaries and non-contingent beneficiaries.

> **Example.** The Brosi Family Trust has at least one trustee that is a resident of California. Assuming the trust had no California source income and no California resident non-contingent beneficiaries, the trust would still be taxable on the portion of its non-California source income that reflects the proportion of California resident trustees (of which there is at least one) and non-resident trustees.

What Impact from the *Kaestner* Supreme Court Decision?

While it is still a "wait and see" environment, and we may see future litigation in California following the ***Kaestner*** decision, most do not believe there will be much impact. Reasons given include that the Supreme Court was carefully very limited in its decision against North Carolina, and that the California statute is based upon non-contingent beneficiaries.

California Source Income Taxable to Trust Regardless of Fiduciary Residency

The Paula Trust was established for the sole benefit of Paula Medeiros, a California resident. The Paula Trust has two co-trusteesCa California resident and a Maryland resident. In 2007 Paula Trust received

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reported income of $2,831,336 from an interest in a limited partnership doing business in the state - California source income.

The FTB assessed tax on the full amount of the California source income and the State Board supported that decision. The trust argued that California could only tax one-half of the income based upon the ratio of California fiduciaries to total fiduciaries. The trust subsequently filed suit in Superior Court and that court ruled in the trust's favor and ordered FTB to issue a refund.

The California Appellate Court overturned the lower court decision citing that the statute in California calls for apportioning of only non-source income, and that California source income is fully taxable by the state. (***Steuer et al. v. Franchise Tax Board***, Court of Appeal of California, First District, No. A154691, June 29, 2020)

DOMESTIC/FOREIGN BUSINESSES UNDER THE CORPORATE INCOME TAX

WHEN DOES AN OUT-OF-STATE CALIFORNIA BUSINESS NEED TO FILE A CALIFORNIA INCOME TAX RETURN?

Sole proprietors and business entities, not based in California, still may be subject to California taxation if they are doing business in California or have income from California sources.

California R&TC §23101 defines "doing business" as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. Unfortunately, this is often a facts and circumstance test. While we are able to discuss the facts and circumstances to consider in determining if an entity is doing business in California, taxpayers must ultimately decide if they are doing business in California.

R&TC §23101(b) does provide some "bright-line tests" for out-of-state business entities based on sales, property, and compensation. For tax years beginning on or after Jan. 1, 2011, an out-of-state business entity that is not doing business under R&TC §23101(a) may be considered doing business in California under R&TC §23101(b) if it has sales, property, or payroll compensation in California in excess of "bright-line" threshold amounts. Sales, property, and compensation of the taxpayer include the taxpayer's pro rata or distributive share from pass-through entities.

2022 Bright-Line Test Thresholds

For taxable year 2022, the relevant amounts for sales, property, and payroll that constitute "doing business" are $690,144, $69,015, and $69,015, respectively.

Public Law 86-272 and "Doing Business"

Public Law 86-272 (15 USC §381) prevents the state from asserting its right to impose a tax based on net income, such as the corporate income tax or franchise tax. Public Law 86-272 protection is available to out-of-state business entities that sell tangible personal property in this state and whose in-state activities are limited to the solicitation of orders for their goods. As a result, if a taxpayer is protected by Public Law 86-272, it will not be required to pay the franchise tax or the corporate income tax, as both are measured by net income.

However, even if protected by Public Law 86-272, an out-of-state entity is still obligated to file a tax return and pay taxes that are not measured upon net income, such as the minimum franchise tax, annual LLC tax, and the LLC fee, unless certain exceptions apply.

For further details in regards to what activities are protected by Public Law 86-272, see FTB 1050, Application and Interpretation of Public Law 86-272.

> **Example.** Tax, Inc., an out-of-state corporation that does not file a combined return, sells tangible goods over the Internet and qualifies for protection under Public Law 86-272. For the 2018 taxable year, Tax, Inc. has $1,000,000 of California sales but no property or payroll in California. Tax, Inc., though considered doing business in California because it has $1,000,000 in California sales, will not be subject to California's franchise tax as it is protected under Public Law 86-272. However, Tax, Inc. must still file a California return and pay the minimum franchise tax of $800.
>
> **Example.** Brosi, LLC, an out-of-state LLC, engaged in activities that are protected under Public Law 86-272 and is considered to be doing business in California for the tax year 2018. Brosi, LLC's total income from sources derived from or attributable to the state of California was $300,000.
>
> Therefore, Brosi, LLC must file a California tax return, pay the annual LLC tax of $800, and pay the LLC fee of $900. Public Law 86-272 does not protect qualified out-of-state business entities from the annual LLC tax or the LLC fee.

What Constitutes a Valid Filing?

What constitutes a valid "filing" if the business entity is filing solely for purposes of reporting the minimum/annual tax? In most cases this is a business entity that is relying on a federal provision, Public Law (PL) 86-272, that preempts states including California from taxing entities. Other times this question comes from a nonregistered foreign corporation, LLC, or limited partnership that owns an interest in another pass-through entity doing business in California.

Preparers often ask, "How can a taxpayer designate the return filing as only 'minimum tax' due and 'PL 86-272 protected' without it being considered an incomplete return for processing and/or filing enforcement purposes?" Or maybe the question is, "If a taxpayer meets the requirements of doing business under California R&TC §23101 but is protected by PL 86-272, what is the minimum amount of information required to be reported on the tax return for purposes of reporting and remitting $800 minimum tax due?"

A business entity is required to file the appropriate form (California Form 100, 568, or 565) if it is doing business within California and pay the appropriate tax and fee. Each business entity is required to fill out the necessary form including all pertinent schedules and tax forms as instructed.

Partnerships, LLCs, and S corporations are also required to fill out a California Schedule K-1 for each partner/member/shareholder. For purposes of reporting the information from Column (e) of the California Schedule K-1, the entity must complete Schedule R, to determine the entity's income from California sources.

If the activities of the business entity are protected under PL 86-272, taxpayers should provide that information on Schedule R. It is best to attach a statement explaining why the apportioning percentage and the business income are zero.

Teleworkers During COVID-19 "Stay at Home" Order (Executive Order N-33-20)

Will California treat a corporation that had no previous connections with California as doing business if it has an employee who is currently teleworking in California due to Executive Order N-33-20?

No. California will not treat an out-of-state corporation whose only connection to California is the presence of an employee who is currently teleworking in California due to Executive Order N-33-20 as being actively engaged in a transaction for the purposes of financial or pecuniary gain or profit. Also, California will not include the compensation attributable to an employee who is currently teleworking due to Executive Order N-33-20 in the minimum payroll threshold set forth in California R&TC §23101(b)(2)(4).

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Further, California will treat the presence of an employee who is currently teleworking in California due to the Governor's Executive Order as engaging in de minimis activities for purposes of P.L. 86-272 protection.

Rescission of Executive Order N-33-20

FTB has updated its website regarding whether an out of state corporation is considered to be "doing business" when it has employees teleworking from California. FTB has noted that with the rescission of Executive Order N-33-20, an out of state corporation may now be considered to be "doing business" in California, and may not be protected by Public Law 86-272, depending on the teleworking activities of the corporation's employee.

New! FTB Updates Advice in the Digital Age

When Congress adopted PL 86-272 in 1959 it specifically prohibited a state from imposing a net income tax on the income of a person derived within the state from interstate commerce if the only business activities within the state consisted of the solicitation of orders for sales of tangible personal property. The protections provided by PL 86-272 only apply to orders that are sent outside of the state for acceptance or rejection. If the orders are accepted, they must be filled by shipment or delivery from a point outside the state to maintain PL 86-272 immunity.

Further clarification has long been needed in this internet sales, telecommuting world. In February, 2022, FTB released Technical Advice Memorandum 2022-01 addressing PL 86-272 protections in today's environment. Among the clarifications:

1. The activities of an employee telecommuting from California on a regular basis that are not strictly solicitation of orders for sales of tangible personal property would cause a business to lose protection of PL 86-272. These are business activities in California as an employee works from within the state, and the activities are non-sales activities, therefore the protection of PL 86-272 is lost.

2. After sale of a product, a business is providing live chat and email through its website available to customers through computers or other electronic devices located in California. This post- sales activity is not solicitation or ancillary to solicitation as the sale has already taken place, disqualifying the business from PL 86-272 protection.

3. The business activity in California is making applications for credit cards available to California customers via the Internet through computers and other electronic devices located in California. This business activity exceeds solicitation as offering to provide credit to customers is an activity outside of seeking to make orders of tangible personal property in California – no PL 86-272 protection.

4. The business activity in California is the inserting of cookies into computers or other electronic devices of California customers. This activity exceeds solicitation as gathering information for purposes of adjusting production schedules and inventory amounts, developing new products, or identifying new items to offer for sale are not activities related to facilitating a sale of tangible personal property, thus disqualifying the business from PL 86-272 immunity.

5. Sales of digital video and music streaming are not sales of tangible personal property but rather are services and thus are not activities within the protection of PL 86- 272. Accordingly, a company has business activities in California by offering streaming services for sale to California customers, but this activity exceeds solicitation of orders of tangible personal property and defeats PL 86-272 immunity.

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“DOING BUSINESS” CASES AND RULINGS

“Bright-Line” Tests Apply to Interest in Pass-Through Entity

Aroya Investment I, LLC is a foreign LLC formed in Delaware and based in New York. For 2016, Aroya owned a 0.7830849 interest in 1155 Island LLC which owned, operated and managed property acquired from the Thomas Jefferson School of Law in San Diego, CA.

According to San Diego County tax assessment records, the total assessed value of the property Island owned was $64,239,943 for 2016-2017 and $65,524,741 for 2017-2018. Aroya’s interest in the California property exceeded $54,771, the 2016 “bright-line” test for “doing business” in California. FTB demanded an $800 annual tax.

While Aroya argued that the small, minority interest in the Island LLC excluded them from doing business in the state under the ***Swart*** decision, the OTA ruled that ***Swart*** did not apply because Aroya met the property “bright-line” test. (***Appeal of Aroya Investment I, LLC***, OTA No. 19074982, July 2020)

Having A California Employee Constituted “Doing Business” in State

In 2014, Propharma Sales LLC, a foreign LLC, paid $12,427 in wages to, and withheld taxes from, a California employee. When FTB received information from the EDD about the wages paid, it issued a demand for tax return and assessed the $800 annual tax.

Propharma’s argument was based on the fact that it used ADP to provide payroll services, and that shielded it from a California tax filing. Absent any rebuttal that Propharma had an employee in the state, OTA agreed with FTB that the LLC was doing business in California because it had a physical presence in the state. (***Appeal of Prophama Sales LLC,*** OTA No. 18010699, August 2020)

Management of LLC Constituted “Doing Business”

DPMG Juniper, LLC is a limited liability company (LLC) that was organized in Arizona on January 7, 2016. The articles of organization list only two members, J. Roberts and D. Gilbert, both having the same post office box mailing address in California. According to those articles, the LLC is managed by its two members. They argued the LLC wasn’t required to file in California because it conducted no business in the state.

Under R&TC §23101(a), “doing business” is defined as “actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.” In addition, for taxable years beginning on or after January 1, 2011, R&TC §23101(b)(1) provides that a corporation that is “commercially domiciled” in California also is doing business in California. “The essence of the concept of commercial domicile is that it is the place where the corporate management functions, the place where real control exists with respect to the business activities of the corporation.”

The appeal board ruled the LLC was required to file a California return and pay the minimum franchise tax of $800 (***Appeal of DPMG Juniper, LLC,*** OTA No. 2003514, March 2021).

APPORTIONMENT

California R&TC §25121 mandates that any taxpayer having income from business activity which is taxable both within and without this state shall allocate and apportion its net income.

Single Sales Factor Apportionment Formula Applies Beginning in 2013

Statewide Proposition 39, passed by voters in November 2012, in part enacts a single sales factor method of determining California taxable income for businesses. Starting in 2013, multistate businesses no longer

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are allowed to choose the method for determining their state taxable income that is most advantageous for them. Instead, most multistate businesses have to determine their California taxable income using the single sales factor method. Businesses that operate only in California are unaffected by this measure.

Proposition 39 also included rules regarding how all multistate businesses calculate the portion of some sales that are allocated to California for state tax purposes. These include a set of specific rules for certain large cable companies.

History of California's Apportionment

In 1966, California adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), with certain modifications, to determine how much of an apportioning taxpayer's total income, which is earned from activities both inside and outside of California, is attributed to California and subject to California tax. UDITPA uses an apportionment formula to determine the amount of "business" income attributable to California.

The original apportionment formula.

The UDITPA apportionment formula consists of property, payroll, and sales factors. Each of these factors is a fraction, the numerator of which is the value of the item in California and the denominator of which is the value of the item everywhere. The property factor includes tangible property owned or rented during the taxable year, the payroll factor includes all forms of compensation paid to employees, and the sales factor generally includes all gross receipts from the sale of tangible and intangible property.

The "double-weighted" sales formula.

Prior to 1993, California subscribed to the UDITPA formula, which ascribed equal weight to three factors: property, payroll, and sales (former §25128, as added by Stats. 1966, ch. 2, §7, p. 179). Then, in 1993, the Legislature amended §25128 to give double weight to the sales factor for most business activity, specifying that "notwithstanding §38006, all business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus *twice the sales factor*, and the denominator of which is four…" (Former §25128(a), italics added, as amended by Stats. 1993, ch. 946, §1, p. 5441).

$$\frac{\text{Average CA Propery}}{\text{Average Total Property Everywhere}} + \frac{\text{CA Payroll}}{\text{Total Payroll Everywhere}} + 2 \times \frac{\text{CA Sales}}{\text{Total SalesSales Everywhere}} = \text{CA Apportionment Percentage}$$

CA Apportionment Percentage H Total Business Income = CA Business Income

Exception for certain "qualified business activity."

An exception to this rule exists for taxpayers of an apportioning trade or business that derive more than 50% of its gross business receipts from conducting a "qualified business activity." These taxpayers are required to use a three-factor, single-weighted sales, apportionment formula. For this purpose, a qualified business activity is defined as an agricultural, extractive, savings and loan, and banking or financial business activity. In addition, current law requires that once a determination has been made that the apportioning trade or business is involved in a qualified business activity, all members of the apportioning trade

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or business use the same weighting, regardless of whether the particular entity was involved in a qualified business activity.

State law permits a departure from the standard apportionment provisions only in limited and specific cases and recognizes that the standard apportionment provisions are not appropriate when applied to certain industries and types of transactions, in which case special apportionment provisions exist for those situations.

Election to use a sales only formula.

Effective for tax years beginning on or after Jan. 1, 2011, through Dec. 31, 2012, R&TC §25128.5 allowed an apportioning trade or business to make an annual, irrevocable election to utilize a single factor, 100% sales (single sales factor) apportionment formula instead of the three-factor, double-weighted sales apportionment formula described above. Qualified business activities (described above) would be specifically prohibited from electing a single sales factor apportionment formula.

The election had to be on a timely filed original return in the manner and form prescribed by the FTB.

Applying the Single Sales Factor Apportionment Method to Services and Intangibles

For taxable years beginning on or after Jan. 1, 2013, all apportioning trades or businesses must assign sales of other than tangible personal property under the new market-based rules.

This affects the way services and intangibles are assigned for sales factor purposes. You no longer look to where the service is performed but rather you need to source the receipts the taxpayer received from services to the location where the customer received the benefit of the service. This will generally be the location of the taxpayer's market for the sales.

Intangibles are no longer assigned to California where the greater cost of performance occurred; instead, you need to assign receipts from sales of intangibles to California to the extent the property was used in California.

Where Did the Customer Receive the Benefit?

R&TC §25136 (which is the provision for determining if sales of other than tangible property are sourced to California) now states (formerly R&TC §25136(b)):

1. Sales from services are in this state to the extent the purchaser of the service received the benefit of the services in this state.

2. Sales from intangible property are in this state to the extent the property is used in this state. In the case of marketable securities, sales are in this state if the customer is in this state.

3. Sales from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state.

4. Sales from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state.

Regulation §25136-2 was adopted for taxable years beginning on or after Jan. 1, 2011, to provide guidance on how to assign sales using the new market-based rules (described under former R&TC §25136, subdivision (b)).

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Taxpayers who are required to follow special industry apportionment and allocation regulations (special industry taxpayers) under Regulation §25137 will follow the 25137 sales factor provisions incorporating the new 25136 rules and incorporating the exclusions in Regulation §25136-2(g)(3). Special industry taxpayers will not use the property and payroll factor rules, unless the trade or business is within one of the exceptions of R&TC §25128(b) described above.

You should also be aware that law changes that affect income sourced within California can also affect the taxation of estates and trusts (Regulation §17742).

FTB Issues Legal Ruling on Sales of Services, Revokes Prior Advice

In March 2022 FTB issued Legal Ruling 2022-01 further outlining sourcing of sales of services. The ruling addresses the relevant considerations and proper analysis to determine the assignment of gross receipts from the sales of services pursuant to R&TC §25136(a)(1) as supplemented by California Regulation §25136-2.

Specifically, to properly assign receipts from the sales of services under the cascading rules in Regulation §25136-2, we must first ascertain:

1. Who is the customer?
2. What is the service being provided?
3. What is the benefit of the service being received by the customer?
4. Where is the benefit of the service being received by the customer?

Cascading Rules

After the above issues have been determined, the cascading rules provide guidance on measuring the location of where the benefit was received. Application of the cascading rules is demonstrated in the Web Corp examples in Example 4 and Example 5 of Regulation §25136-2(c)(2)(E). In both examples, it has been determined that assignment should be based on click/view location. In the first Web Corp example, the taxpayer has sufficient information in its books and records to locate the actual click/view locations. However, in the second Web Corp example, the taxpayer does not have sufficient information in its books and records to locate the actual click/view locations and thus reasonable approximation of such locations is necessary.

Finally, the new legal ruling retroactively revokes Chief Counsel Ruling (CCR) 2015-03 and CCR 2017-

01. If a taxpayer relied on either of the revoked CCRs when determining its tax filing position, the Large Corporate Understatement Penalty (LCUP) will not be assessed against it, and an Accuracy Related Penalty (ARP) will also not apply, assuming the taxpayer filed a California return. However, if a taxpayer relied on the CCRs' analyses to determine it did not have a filing requirement, and consequently filed a late return, a delinquent penalty will apply. Furthermore, interest will be assessed on any underpayment amounts resulting from a taxpayer's reliance on the CCRs.

California Isn't the Only State Applying Market-Based Sourcing

As of January 2020, there are 31 states and the District of Columbia that use market-based sourcing for sales of other than tangible property. These are:

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Market-Based Sourcing States	
Alabama	Minnesota
Arizona	Missouri
California	Montana
Colorado	Nebraska
Connecticut	Nevada
District of Columbia	New Jersey
Georgia	New York
Illinois	Ohio
Indiana	Oklahoma
Iowa	Oregon
Kentucky	Pennsylvania
Louisiana	Rhode Island
Maine	Tennessee
Maryland	Utah
Massachusetts	Vermont
Michigan	Wisconsin

Tax preparer note. States using market-based sourcing have adopted their own regulations. Be sure to check the specific rules for your apportioning state(s).

Apportionment Isn't Just for Corporations

California Regulations §§17951 through 17954 require businesses to source business income in accordance with the provisions of the corporate apportionment rules (§25120 to 25139). These regulations also requires a partner's distributive share of partnership income derived from sources within California (with some modifications) be determined using corporate apportionment rules.

This means "an apportioning trade or business" regardless of the form of ownership (e.g., sole proprietorship, partnership, LLC, or corporation), that carries on within and out of California under Regulations §17951 through 17954, or the provisions of §25128.7[2] is required to apportion the nonresident's business income using the single sales factor.

The same would be true for a partner's distributive share. Whether the trade or business is the partnership's business (if not unitary with the trade or business of its partner), or the partnership interest when combined with the partner's trade or business (if the partnership's activities are unitary with the activities of its partner, notwithstanding ownership requirements), the business income of the trade or business would be apportioned using the single sales factor under the provisions of §25128.7 unless the trade or business meets one of the exceptions of §25128(b).

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APPORTIONMENT CASES AND RULINGS

Sole Proprietor Must Apportion Income

In 2016, A. Dakers, a Texas resident, operated a sole-proprietorship providing staffing services. One of is contracts was with Host Analytics, a Redwood City, CA company with additional business locations in

Nevada and India. For some reason, Mr. Dakers used a Los Angeles, CA address on the contract with Host Analytics.

For 2016 Host paid Mr. Dakers $28,000 in fees. After agreeing, based upon evidence provided, that Mr. Dakers was not a California resident for 2016, FTB demanded a nonresident return from Dakers reporting the full $28,000 as California source income.

OTA agreed with FTB's demand that Mr. Dakers had California source income derived from the contract with Host. However, OTA ruled that because Dakers provided staffing services to all of Host's locations, two of which were outside of California, OTA reduced the amount of source income to 1/3 (sales in California/sales everywhere). (***Appeal of A. Dakers,*** OTA No. 19034411, February 2020)

FTB Web Page for Single-Sales Factor

The FTB continues to update its web page dedicated to assignment of sales under the Single-Sales Factor apportionment method. The new Single-Sales Factor and Assignment of Sales (Sales Factor) site includes information on the following:

1. Who do the new laws affect?
2. Who has a filing requirement in California?
3. How is California income computed for taxpayers who do business inside and outside California?
4. Who must use the single-sales factor to apportion business income to California?
5. What are the rules for assigning sales to California?
6. What is market assignment?

The site contains many examples and calculations for the proper use of the single-sales factor.

LIMITED LIABILITY COMPANIES FOREIGN (OUT OF STATE) LLCs

R&TC §17941 requires LLCs "doing business" in the state, as defined by §23101, to pay the annual tax. If the member of an LLC is "doing business" in California, the LLC is "doing business" in California and subject to the annual tax. Likewise, if the LLC registers with the California SOS, it must file and pay the $800 annual tax.

So, what is "doing business?" R&TC §23101 defines "doing business" as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. This is a facts and circumstances test.

The California residence of the sole member of a single member LLC, without more, does not mean that the LLC is "doing business" in California. But if that sole member, in his or her capacity as member of that

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LLC, has actively engaged in any transaction in California for the purpose of financial or pecuniary gain or profit, the LLC is “doing business” in California.

What about Out-of-State Rental Property Owned by a Single Member California Resident?

If the property is ever rented or even advertised for rent, then the basis for “doing business” may exist C depending on whether the member actively engaged in a rent-related activity in California. But expenses associated with mere ownership of property, such as paying taxes, do not usually rise to the level of “doing business.”

Leave the State to Conduct Business?

The managing member of Village View, LLC was a resident of California. The LLC was organized in Oregon, and its sole activity during the year in question consisted of the ownership and operation of an apartment building in Oregon. The LLC employed a property manager in Oregon.

The FTB declared and the OTA agreed that Village View was doing business in California because it was commercially domiciled in the state, in that the principal place from which the trade or business was directed or managed was the location of the managing member C a California resident (***Appeal of Village View, LLC***, OTA No. 18011300, Feb. 8, 2019).

See Also:

Appeal of Legend Plus Enterprises, LLC, SBE (2011) Case No. 486026.

FTB Reaches Settlement in Class Action Lawsuit

Prior to 2007, R&TC §17942 imposed the LLC annual fee on the gross receipts of an LLC from all sources, inside and outside California. In the ***Northwest Energetic Services, LLC*** and ***Ventas Finance I, LLC*** the statute was ruled unconstitutional and subsequently replaced with law that only applies the annual fee to gross receipts within California. FTB began processing thousands of claims for refund.

In processing claims, FTB set aside any claims that it determined were from LLCs where gross receipts were entirely from California sources. Subsequently, a class action was formed to force the FTB to process and either approve or deny those claims.

The case entitled ***Franchise Tax Board Limited Liability Corporation Tax Refund Cases*** was certified as a class action on or about September 23, 2019. Discovery conducted in that litigation has revealed that there are claims for refund contained within the non-processed claims which may rightfully be entitled to refunds or partial refunds of fees paid by LLCs under the guidance of NES and Ventas. A Settlement has been reached to resolve the claims of such class members. The Settlement establishes a fund which will be used to provide payments to LLCs with valid claims for refund that are still pending.

The Settlement requires a Settlement Administrator to mail notice of the Settlement to all class members. All LLCs in the class were to be mailed notice of the Settlement and a claim form by the Settlement Administrator on or before May 6, 2022. If you believe you are in the class but did not receive the notice of settlement, or you have other questions, you may contact the Settlement Administrator by telephone at 1-888-874-5887 or by e-mail at www.FTBLLCTaxSettlement.com. **The deadline for filing a claim was extended to August 19, 2022.**

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CALIFORNIA LLCs

Who Can Be a California LLC?

Current state law allows domestic or foreign LLCs to engage in any lawful business except banking, insurance, or trust company business. Domestic and foreign LLCs also are not permitted to render any professional services unless expressly authorized by law.

"Professional services" is defined in the Moscone-Knox Professional Corporation Act (Corporation Act) as any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Business and Professions Code, the Chiropractic Act, or the Osteopathic Act. "Professional services" also means any type of professional services that may be lawfully rendered only pursuant to a license, certification, or registration authorized by the Yacht and Ship Brokers Act.

Until 2004, the SOS did not accept LLC applications from all businesses licensed under the Business and Professions Code. In 2004, SOS requested an Attorney General (AG) opinion asking if "a business that provides services requiring a license, certification, or registration pursuant to the Business and Professions Code [could] conduct its activities as [an LLC]." AG Opinion 04-103 concluded that a business could "conduct its activities as an LLC if the services rendered require only a nonprofessional, occupational license." In its opinion, the AG declined to determine if each licensed activity specified in the Business and Professions Code was a professional or a nonprofessional occupational activity. As a result of the AG's opinion, the SOS does not deny any application on the basis that the business is licensed under the Business and Professions Code.

Contractors. SB 392 (Florez, Stats. 2010, Ch. 698) authorized the Contractor State License Board to issue a contractor's license to an LLC under the Business and Professions Code.

The act modified §17002 of the Corporations Code to allow an LLC to render services that may be lawfully rendered only pursuant to a license, certificate, or registration authorized by the Business and Professions Code if the applicable provisions of the Business and Professions Code authorize an LLC to hold that license, certificate, or registration.

This act was effective on Jan. 1, 2011, and specifically required the Contractors' State License Board (CSLB) to begin processing applications for licensure for LLCs no later than Jan. 1, 2012.

Engineers and Land Surveyors. SB 1008 (Padilla, Stats. 2010, Ch. 634) adds LLPs to the list of approved organizations that can be formed by civil, electrical, or mechanical engineers and land surveyors. It allows engineers and land surveyors to organize and operate as LLPs effective Jan. 1, 2011. SB 284 (Cannella, Stats. 2015, Ch. 157) extends these provisions until Jan. 1, 2019.

Under the terms of the bill, however, the authority to allow engineers and land surveyors to create a new LLP or operate as an LLP would be repealed as of Jan. 1, 2019. But the bill does not include provisions that cancel any LLPs that were created or registered by civil, electrical, or mechanical engineers or land surveyors between Jan. 1, 2011, and Jan. 1, 2019. As a result, LLPs created or registered by civil, electrical, or mechanical engineers or land surveyors during that period would continue to be required to pay the $800 annual tax to Franchise Tax Board until the legal existence of the entity is extinguished.

Architects. AB 560 (Gorell, Stats. 2011, Ch. 291) extends the sunset date under which licensed architects are allowed to organize and operate as LLPs from Jan. 1, 2012, to Jan. 1, 2019.

Architects, Engineers, and Land Surveyors Extended

SB 920 (Canella, Stats. 2018, Ch. 150) extends the sunset date from Jan. 1, 2019, to Jan. 1, 2026, on provisions allowing architects, engineers, and land surveyors that meet specified liability insurance requirements to organize and operate as registered and foreign LLPs through that date. In addition, these provisions would be repealed on Jan. 1, 2026.

LLC ANNUAL TAX AND FEE

California imposes on all LLCs classified as partnerships or disregarded entities both an annual tax of $800 and an annual fee based on the LLC's total income.

The LLC annual tax is similar to the corporate minimum franchise tax as both taxes are imposed for the privilege and protections of doing business in California. The $800 LLC annual tax is due on Apr. 15 of each year for calendar-year LLCs and on the 15th day of the fourth month of the taxable year for fiscal- year LLCs.

The annual fee, however, is a graduated fee based on the LLC's total income from all sources derived from or attributable to this state plus the cost of goods sold under R&TC §17942. Presently, the FTB is reevaluating the computation of total income under R&TC §17942.

An LLC that elects to be treated as either a C or S corporation will determine its tax under California Bank and Corporation Tax Law, so it is subject to the $800 minimum franchise tax under R&TC '23153, or the franchise tax under R&TC §23151, or the corporation income tax under R&TC §23501.

DEPLOYED MILITARY GET A BREAK ON ANNUAL & MINIMUM FRANCHISE TAX

AB 308 (Muratsuchi, et al, Stats. 2019, Ch. 421) replaces the existing Jan. 1, 2018, inoperative date with Jan. 1, 2030, and re-establishes for taxable years beginning on or after Jan. 1, 2020, and before Jan. 1, 2030, an exemption from the annual tax or minimum franchise tax as applicable, for LLCs and corporations that are small businesses that meet all of the following:

- Is solely owned by a deployed member of the US Armed Forces,
- Is a small business, and
- Operates at a loss or ceases operation for the taxable year. The following definitions would apply for purposes of the exemption:
- "Deployed" means being called to active duty or active service during a period when a Presidential Executive Order specifies that the United States is engaged in combat or homeland defense. Deployed would specifically exclude temporary duty for the sole purpose of training or processing, or a permanent change of station.
- "Operates at a loss" means:
    - Expenses exceed receipts with respect to an LLC.
    - Negative net income as defined in R&TC section 24341 with respect to a corporation.
- "Small business" means an LLC or a corporation with total income from all sources derived from or attributable to California of $250,000 or less.

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LLC ANNUAL FEES CASES AND RULINGS

SMLLC Must File and Pay Tax and Fee Even If Owner Is Not Required to File

An SMLLC organized in California is classified as a disregarded entity for federal tax purposes. In a request for clarification to FTB, the LLC states that it owns raw land and vineyards in California, where it grows and sells grapes. It further states that it is "doing business" in California within the meaning of R&TC §23101. The LLC is wholly owned by a single-employer pension and retirement fund.

The IRS issued a determination letter stating that the retirement fund is a trust qualified and exempt from federal income taxes, under IRC §501(a) as a governmental benefit plan under §401(a).

In Chief Counsel Ruling 2015-02, the FTB determined that the LLC has a filing requirement in California and is subject to LLC annual tax and fee. However, the owner of the LLC (the retirement fund) does not have a filing requirement in California because of its federal tax-exempt status under IRC §501(a) as a governmental benefit plan under §401(a).

LLC Wins Refund of Some Years of Annual Tax

MJK Real Estate Fund II, LLC filed a claim for refund for tax years 2013 – 2017. The FTB denied the claim. On appeal the LLC presented evidence that it did not meet the "property" bright line test for doing business in the state for 2013 and 2014.

For 2015 and 2016 the evidence showed that property exceeded the bright line test thresholds, and no evidence was submitted for 2017. OTA granted refunds for 2013 and 2014 (***Appeal of MJK Real Estate Fund II, LLC,*** OTA No. 19044718, May 26, 2022).

OTHER RESIDENT/NONRESIDENT BUSINESS ITEMS FIRST YEAR FREE?

Each year, any C or S corporation doing business in California must file a state tax return and pay the greater of the $800 minimum tax (R&TC §23153) or the franchise tax (R&TC §23151). This is true even if the corporation is formed in a different state and has not qualified by registering with the California SOS.

Most entrepreneurs know that for their corporation's first tax year, the $800 minimum tax is waived and the smaller franchise tax, if any, is paid. This is only if their corporation qualified or incorporated with the SOS. This first-year relief is also available to LLCs if they elect to be treated as either a C or S corporation.

However, what many entrepreneurs may not know is that when a corporation does not qualify by registering with the SOS (referred to as a non-qualified corporation), it is not eligible for the first-year minimum tax waiver. This is often the case with corporations formed in a different state that are doing business in California.

> ***Example.*** ABC Corporation, formed in North Carolina on Nov. 1, 2010, began doing business in California in 2010 and had taxable income of $1,000 from this state. However, ABC Corporation did not register with the SOS until July 2011. Accordingly for 2010, ABC Corporation is a nonqualified corporation and must file a California corporate return and pay the $800 minimum tax.

The good news is that a nonqualified corporation may still be able to receive first-year relief. Back in 2002, the FTB issued TAM 20020138 that states, in part:

"[R&TC §23153(f)(1)] permits a nonqualified corporation the first-year exemption of minimum franchise tax if Y it commences doing business in California even though it thereafter qualifies with the Secretary of State within the SOL [statute of limitations]."

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So, back to the example, after ABC Corporation registers with the SOS in July 2011, it may then file a claim for refund of $711.60 for its 2010 return. The refund amount is the difference between the $800 minimum franchise tax and the franchise tax of $88.40 ($1,000 x 8.84%). Since the claim would be filed within the statute of limitations, the FTB would refund the $711.60 plus interest.

More good news is that this year, the FTB began allowing corporations to e-file the Form 100X Amended Corporation Franchise or Income Tax Return.

"First Year Free" for LLC

The budget trailer bill AB 85 (Budget, Stats. 2020, Ch. 8) provides a first-year exemption from the annual tax for Limited Partnerships (LPs), Limited Liability Companies (LLCs), and Limited Liability Partnerships (LLPs).

Effective for entities forming with the Secretary of State on or after January 1, 2021, and before January 1, 2024.

CONTRACT VOIDABILITY

Under existing federal law, business entities are not subject to contract voidability for failure to pay taxes, penalties, fees, or interest, or for failure to file required tax returns with the IRS. Nor does the IRS offer relief from contract voidability for any business entities.

Under existing state law, domestic or foreign registered (qualified) LLCs or domestic or foreign qualified corporations may be subject to suspension or forfeiture for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice. One consequence of suspension or forfeiture is being subject to contract voidability for the period in which the entity is suspended or forfeited.

Foreign nonqualified corporations may be subject to contract voidability in two ways depending on whether or not the corporation has an FTB-assigned account number. The two ways are as follows:

- **Foreign nonqualified corporations that do not have an FTB-assigned account number** because the FTB is unaware of the entities' business activities within the state, may be subject to contract voidability beginning on the first day of the taxable year for which the taxpayer has failed to file a required return.
- **Foreign nonqualified corporations that have an FTB-assigned account number** may be subject to contract voidability for failure to file a tax return or for failure to pay delinquent taxes, penalties, fees, or interest within 60 days of the FTB mailing a final notice before contract voidability.

Unlike foreign nonqualified corporations, foreign nonregistered (nonqualified) LLCs are not subject to contract voidability for failure to file tax returns or for failure to pay taxes, penalties, fees, or interest. Consequently, foreign nonqualified LLCs do not need to obtain relief from contract voidability.

All business entities that enter into a contract while subject to contract voidability may have the contract voided by another party to the contract. The third party may exercise the right to declare a contract void only in a lawsuit brought by either party with respect to the contract. A court shall not issue a final judgment rescinding the contract unless the taxpayer subject to contract voidability is provided a reasonable opportunity to cure the voidability. In no event shall a court order a contract rescinded without providing the taxpayer full restitution of the benefits provided by the taxpayer under the contract.

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Entities that are subject to contract voidability may elect to obtain relief from contract voidability. If obtained during the revivor process, the entity may choose relief for a portion of the time in which the entity was subject to contract voidability by choosing the starting tax year for which the relief period will begin. If an entity elects to obtain relief from contract voidability outside of the revivor process, the entity must choose relief for the entire period for which the entity was subject to contract voidability. Relief from contract voidability is granted at a cost of $100 a day for the period of relief granted. The amount cannot exceed the amount of tax due for the relief period. When a return is not due, the minimum franchise tax is considered the tax due for that period.

FTB Updates Revivor Web Page

Do you have clients with suspended or forfeited business entities? The FTB suspends or forfeits business entities when they fail to file a return or pay their tax liability (tax, penalties, interest, or fees). Suspended business entities lose their rights, powers, and privileges to conduct business in California.

The FTB has recently updated its Revive My Business web page. The updated web page provides easier access to revivor information for suspended/forfeited business entities.

The web page includes the following information:

1. Suspension causes and effects.
2. What is needed to revive a suspended entity.
3. How to revive an entity at an FTB field office.
4. How to qualify for a walk-through revivor at an FTB field office.
5. Explanation of contract voidability and how to purchase relief from it.

Schedule an Appointment for Walk-Through Revivor

In Public Service Bulletin 16-26, the FTB announced that effective July 1, 2016, all field offices will implement an appointment process for business entity customers. The process will provide the option to schedule an appointment for a walk-through revivor at any of the field offices.

Corporation Revival Validated Claim for Refund

On August 1, 2017, FTB suspended Cornerstone Compounding Pharmacy, Inc., a California corporation. On September 7, 2017, the corporation filed a 2014 California tax return (Form 100) for the tax year ending June 30, 2015. On November 7, 2018, it filed a 2014 amended tax return (Form 100X), which claimed a refund of $7,130.

On December 6, 2018, Cornerstone revived with the issuance by FTB of a Certificate of Revivor. On December 19, 2018, FTB issued a Refund Claim Denial notice, which denied the claim for refund because the corporation was suspended at the time the claim for refund was filed.

According to FTB Legal Ruling No. 184 from 1957, when the "period within which a claim may be filed expired … a subsequent revivor will not validate the filing." Specifically, it is stated in the Ruling that "a subsequent revivor does not validate the action unless the statute of limitations is still open when the certificate of revivor is issued," and that this "rule applies to the filing of a claim for refund." (Emphasis added.) Thus, the Ruling suggests that a subsequent revivor validates a claim for refund if the statute of limitations is still open when the corporation is revived. In the instant case, Cornerstone revived prior to the expiration of

the statute of limitations. Accordingly, OTA found the corporation's claim for refund is retroactively validated (***Appeal of Cornerstone Compounding Pharmacy, Inc.,*** OTA No. 19024279, April 2021).

DISSOLVING AN ENTITY

Does your client plan to dissolve, surrender, or cancel business operations in California? If so, your clients may be able to avoid the minimum franchise tax or annual tax.

To terminate their legal existence, business entities registered with the California SOS can dissolve, surrender, or cancel their businesses in California as follows:

- **Domestic corporations** (those originally incorporated in California) may legally dissolve.
- **Foreign corporations** (those originally incorporated outside California) may legally surrender.
- **Limited liability companies and partnerships** (both domestic and foreign) may legally cancel.
- Avoiding Subsequent Years Minimum Tax or Annual Tax

Entities may be able to avoid the minimum franchise tax or annual tax for current and subsequent years if all of the following requirements are met:

1. The entity filed its final franchise or annual tax return timely, including extension, for the preceding taxable year.
2. Conducted no business after the last day of the preceding year.
3. Filed the appropriate documents with SOS within 12 months of the filing date of its final tax return.

Steps to Dissolve, Surrender, or Cancel a Business Entity

1. File any delinquent tax returns.
2. File the final/current year tax return. On this tax return's first page, write FINAL at the top of the page and check the box labeled "Final Return."

Exception for a Nonprofit Tax-Exempt Church or Tax-Exempt Corporation

It does not have to file a final return if its three-year gross receipts average is under $25,000. But it must file a final return if it exceeds this average, if it's a private foundation, or if it has non-member or unrelated business income.

1. Pay all tax balances, including any penalties, fees, and interest.
2. File the appropriate dissolution, surrender, or cancellation forms with the SOS within 12 months of filing the business's final tax return. To get the correct forms, go to

sos.ca.gov

or call the SOS at (916) 657-5448

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Suspended or forfeited business - You must revive the business before you file dissolution, surrender, or cancellation forms with the SOS.

***Public benefit and religious corporations, and mutual benefit corporations holding charitable assets* -** You must obtain a dissolution waiver from the Office of the AG before filing dissolution forms with the SOS. For more information, go to:

ag.ca.gov/charities

or call the Office of the Attorney General at (916) 445-2021

ADMINISTRATIVE DISSOLUTION FOR CORPORATIONS AND LLCs

The FTB lacks statutory authority to administratively dissolve business entities that fail to complete the process required to legally dissolve; thus, these entities remain on the department's accounting system, continuing to accrue taxes, interest, and penalties. In general, if the FTB is unable to collect a debt from a taxpayer, current state law allows the FTB to extinguish the uncollected debt after 20 years. However, the entity will continue to exist and accrue taxes, interest, and penalties, until it is properly dissolved.

AB 2503 (Irwin, Stats. 2018, Ch. 679) provides two options for administrative dissolution of qualified entities when there is unpaid minimum franchise or annual tax.

Option 1: FTB-Initiated Administrative Dissolution (Involuntary)

This option would allow the FTB to administratively dissolve those domestic corporations and domestic LLCs that are suspended by the FTB, have ceased doing business, have been suspended for 60 or more consecutive months, and have paid all taxes and filed all returns due as of the date the entity ceased doing business.

Prior to the administrative dissolution under this option, the FTB would be required to provide written notice to the business entity of the pending administrative dissolution. The FTB would transmit to the Secretary of State (SOS) the names and SOS file numbers of domestic corporations and domestic LLCs subject to the administrative dissolution. Upon receipt of the transmission, the SOS would also be required to provide on its website a 60 calendar-day notice of a pending administrative dissolution by listing the corporation or LLC name, and the SOS's file number, as applicable.

The notified corporation or LLC would be allowed to file a written objection with the FTB to object to the administrative dissolution. If a timely written objection is received by the FTB, the domestic corporation or domestic LLC would have an additional 90 days to pay or otherwise satisfy all accrued taxes, penalties, and interest, file a current Statement of Information with the SOS, fulfill any other requirements to be eligible, and apply for revivor. The 90-day period may be extended for no more than one period of up to 90 days, by the FTB. If there is no written objection or the written objector fails to revive, the domestic corporation or domestic LLC would be administratively dissolved.

Upon administrative dissolution, the FTB would abate the domestic corporation's or domestic LLC's liabilities for qualified taxes, interest, and penalties.

The administrative dissolution of a corporation would not diminish or adversely affect the ability of the Attorney General to enforce liability as otherwise provided by law.

No administrative appeal, writ, or other judicial action may be taken based on the FTB's or the SOS's action, except if related to repayment of amounts erroneously received after administrative dissolution has occurred.

Upon administrative dissolution, the corporate rights, powers, and privileges of the corporation would cease.

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Option 2: Taxpayer-Initiated Administrative Dissolution (Voluntary)

This option would be available to domestic corporations and domestic LLCs that have never done business or have ceased doing business within California, have paid all taxes due for years when the business was in operation, and filed all required returns prior to the cessation of business operations.

Under this option, taxpayers applying for administrative dissolution would be required to do all of the following:

1. Request in writing from the FTB abatement of any unpaid qualified taxes, interest, and penalties.

2. File dissolution paperwork with the SOS prior to the abatement of unpaid qualified tax, interest, and penalties by the FTB.

3. Establish that it has ceased all business activity and has no remaining assets at the time of filing the request for abatement.

Forms for Voluntary Administrative Dissolution/Cancellation

The qualified domestic corporation may file a FTB 3715, Domestic Corporation Request for Voluntary Administrative Dissolution.

The qualified domestic limited liability company may file FTB 3716, Domestic Limited Liability Company Request for Voluntary Administrative Cancellation.

These forms are used to assist FTB to determine whether the qualified entity has established that it has ceased all business operations and has no remaining assets at the time of filing the request for abatement. The following items must be completed in order to be considered for Voluntary Administrative Dissolution/Cancellation:

- Submit a completed and signed request for a Voluntary Administrative Dissolution/Cancellation form; and
- All tax returns filed up to the date the entity ceased business; and
- All taxes, penalties, and interest paid up to the date the entity ceased doing business.

    Note: The FTB will review the entity's account and other available information to determine if all tax returns have been filed and all taxes, penalties, and interest have been paid up to the date the entity ceased doing business. It is not a requirement to have the above items completed in order to request a Voluntary Administrative Dissolution/Cancellation; however, it will be a requirement to be approved for Voluntary Administrative Dissolution/Cancellation. In addition, file a Certificate of Dissolution or Certificate of Cancellation with the California Secretary of State.

Mailing Instructions

Mail or Fax the completed and signed FTB 3715 (Corp) or FTB 3716 (LLC) to:

BUSINESS ENTITY CORRESPONDENCE FRANCHISE TAX BOARD

PO BOX 942857

SACRAMENTO CA 94257-4040

Fax (916) 855-5519

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2023 CALIFORNIA TAX UPDATE

AUDITS AND ADMINISTRATION

OFFICE OF TAX APPEALS

The OTA has been established in state government to serve as a fair and impartial adjudicatory appellate body and, beginning Jan. 1, 2018, began conducting appeals on taxes and fees that are not related to the constitutional authority of the Board, such as franchise and personal income tax (PIT) appeals, sales and use tax, and other special taxes and fees. Each appeal will be heard by a panel of three administrative law judges, who will issue written decisions for each appeal decided. The OTA is an independent body and will not report to the California Government Operations Agency.

Appeals are heard in Sacramento, Fresno, and Los Angeles.

Starting the Appeal Process

Taxpayers may file an appeal once the FTB or the CDTFA issues a Notice of Action or Appeals Bureau Decision with an "appeal-by" date. You must file a written appeal with the OTA by that time by mailing or faxing in the following:

- Your completed OTA Request for Appeal Form or a written request for an appeal with specific grounds or reasons supporting your position that you do not owe the tax or fee.
- A copy of the notice from either the FTB or the CDTFA
- Any documents such as bank statements or receipts that support your case.

Appeals Process Assistance

Taxpayers who have questions about the appeal process or would like additional information should contact the office and OTA staff will be happy to assist you. For specific questions about the process, OTA's Ombudsperson, Dana Holmes, may be reached at:

(916) 206-4355

or at dana.holmes@ota.ca.gov.

Financial Hardship

If your taxpayer is experiencing financial hardship, you have options that do not involve filing an appeal. Both the FTB and the CDTFA accept installment plans for taxpayers who need to pay tax obligations over time. Both tax agencies also have Offer-In-Compromise (OIC) programs, which allow taxpayers in certain circumstances to pay a reduced amount to the state.

Legal Assistance

Taxpayers who have filed appeals with the California Department of Tax and Fee Administration (CDTFA) are able to seek free legal assistance through the CDTFA's Tax Appeals Assistance Program, which is managed by the Taxpayers' Rights Advocate.

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HEARING BEFORE ONE JUDGE INSTEAD OF PANEL

SB 92 (Budget, Stats. 2019, Ch. 34) requires the OTA to establish a process under which, through 2030, a person filing an appeal may opt to appear before one administrative law judge, rather than a tax appeal panel. The process will be available for an individual taxpayer, when the total amount in dispute, including penalties and fees, is less than $5,000 with respect to personal income taxes, fees, or penalties. For an entity filing the appeal, it must have gross receipts of less than $20,000,000 with respect to taxes, fees, and penalties administered by the California Department of Tax and Fee Administration, and the total amount in dispute, including penalties and fees, is less than $50,000. The decision of one administrative law judge made pursuant to these provisions does not have precedential effect.

NEW FORM TO REQUEST APPEAL BEFORE OTA

FTB developed a new form, Request for Appeal Before the Office of Tax Appeals (FTB Form 1037), to assist taxpayers in filing appeals with the Office of Tax Appeals (OTA) from notices of action of FTB. Form 1037 mirrors OTA's Form L-01 – Request for Appeal. FTB developed this Form at OTA's request.

OTA's Rules for Tax Appeals, Section 30208 provides if an appeal does not contain all the information required under Section 30201 of OTA's Rules for Tax Appeals, OTA will notify the taxpayer that the information is insufficient and allow the taxpayer 30 days to perfect the appeal by providing the missing information. FTB Form 1037 will help taxpayers provide all the information required under Section 30201 to avoid this potential delay.

Although FTB hopes that Form 1037 will be helpful to streamline the appeal process, taxpayers are not required to use the form when filing an appeal with OTA.

TAX PROFESSIONALS

NOT A CRIME TO PERFORM WORK FOR CANNABIS ACTIVITY BUSINESS

AB 1525 (Jones-Sawyer, Stats. 2020 Ch. 270), provides that an individual or firm, that practices public accounting pursuant to Chapter 1 (commencing with§5000) of Division 3, does not commit a crime under California law solely for providing professional accounting services as specified to persons licensed to engage in commercial cannabis activity.

AUDITS

SCHEDULE A AND SCHEDULE C REVIEW LETTERS

Select taxpayers who reported large Schedule A itemized deductions or large Schedule C expenses will continue to receive "Review Your State Tax Return" letters.

Last year, the FTB began an outreach effort by sending letters to taxpayers who reported Schedule A itemized deductions or Schedule C expenses on their 2019 tax returns that were "significantly higher than expected." FTB is continuing this outreach effort in May 2023 by sending review letters to taxpayers who reported these deductions or expenses on their 2020 income tax returns.

The purpose of the review letter is to encourage taxpayers to review their 2020 tax return, and current tax year returns, for any discrepancies. The letters inform taxpayers of the type of deductions commonly

overstated, where to find more information regarding what is deductible, and to file an amended tax return if necessary. If no changes are needed to the items reported, then no action or response is necessary.

These review letters do not constitute an audit.

The tax returns remain subject to audit until the expiration of the statute of limitations. The taxpayer should maintain documentation to substantiate their itemized deductions or to substantiate their expenses are in line with their business activity.

These outreach efforts are part of FTB's overall strategies to encourage voluntary compliance which includes providing taxpayers with the information they need to meet their filing requirements.

TOP AUDIT TARGETS

The following is a list of the top audit areas at this time.

GAINS AND LOSSES FROM PROPERTY DISPOSITIONS

The FTB verifies whether gains and losses were reported correctly for a variety of audit issues, including sales of stock, business property, casualty losses, and amounts flowing through from pass-through entities. In an audit of this type, be sure to provide supporting documents for all basis calculations (not just the broker's 1099-B). In addition, be prepared to support and substantiate capital loss carryovers.

RESIDENCY AND SOURCING OF INCOME

One of the FTB's top audit issues continues to be residency and sourcing of income. According to the Residency and Sourcing Technical Manual, FTB uses various criteria to select potential residency cases. It identifies most residency cases by the taxpayer filing Form 540NR. Residency cases also originate from the following areas:

- Claims for refund.
- Discovery projects.
- Other program and departmental referrals.
- Informant cases.
- Special Investigation referrals.
- Filing enforcement referrals.
- Law enforcement and other agency referrals.
- Revenue Agent Reports (RARs).

FTB identifies most sourcing cases when the taxpayer reports a change of residency status on Form 540NR. Sourcing cases also originate from the following areas:

- Claims for refund.
- Discovery projects.
- Other program and departmental referrals.

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PASS-THROUGH ENTITY AUDIT AREAS

Partnership/LLC Property Dispositions

Issues involving property dispositions reported by partnerships and LLCs include like-kind exchanges (IRC §1031), foreclosures of real estate, and cancellation of debt income.

Termination of Partnership/LLC

Issues include partnership and LLC liquidations reported by both partnerships and partners.

Transfer of Partnership Interest

Issues include disposition of partnership and LLC interests by the partners/members of partnerships and LLCs. The FTB continues to identify taxpayers who transfer partnership interests between related entities to create a higher basis.

FTB also looks for sourcing of gains/losses from sale of partnership interests by nonresident individuals.

Shareholder/Partner/Owner's Basis in a Pass-Through Entity

The FTB verifies shareholder's basis to determine the correct flow-through income, losses, deductions, and credits. It uses the correct basis to determine taxability of distributions, debt repayments, and dispositions.

S Corporation Liquidations

Common S corporation liquidation issues include the following:

- S corporation taxpayers that do not accelerate the recognition of installment gain for California purposes in the final year;
- S corporation shareholders that do not report the gain recognized under IRC §331(a); and
- Nonresident shareholders that do not report their share of the gain that was recognized by the S corporation on the sale of intangible assets.

CREDITS

Corporation Credits

The FTB verifies that credits, such as Enterprise Zone and Research and Development Credits, are reported correctly. In addition, it verifies that the assignment of credits is properly reported by the assignor and the assignee.

Expired Credits

Some of the expired credits the FTB disallows include the Ridesharing, Recycling Equipment, Solar Energy, Political Contribution, Employer Ridesharing, and Water Conservation credits.

CORPORATION AUDIT AREAS

Cost of Performance and Sourcing of Intangible Sales

For tax years beginning before Jan. 1, 2011, sales from intangible sales and services are assigned based on the cost of performance. The complex rules of identifying income-producing activities and documentation

necessary to do a cost-of-performance analysis may result in incorrect assignment of sales from intangibles and services. For tax years beginning on or after Jan. 1, 2011, taxpayers who elect a single sales factor for apportioning business income to California will use market rules for assigning sales from intangibles and services instead of cost-of-performance rules.

Sales Factor and Gross Receipts

The FTB continues to see items in the sales factor denominator that do not meet the definition of "gross receipts" or that result in distortion.

COLLECTIONS ELECTRONIC WITHHOLDING ORDERS

Effective January 1, 2021, FTB is allowed electronic delivery of continuous orders to withhold (COTW), earnings withholding orders for taxes (EWOTs), and earnings withholding orders (EWOs), and related notices or documents. Authorized by AB 3372 (AR&T, Stats. 2020, Ch. 297), FTB will now be able to deliver such notices electronically in addition to or instead of current personal or first-class mail delivery.

REQUEST A 30-DAY DELAY

Beginning June 20, 2017, PIT taxpayers who receive an Income Tax Due Notice or Final Notice Before Levy and Lien can use a self-service option through the FTB's interactive voice response (IVR) system to request a one-time, 30-calendar-day delay to pay their bill balance in full. Interest and penalties apply until the balance is paid in full.

The self-service option can be utilized by calling:

(800) 689-4776

and is available 24 hours a day, 7 days a week.

Thirty-Day Delay Also Available Through MyFTB

Representatives who have a valid power of attorney (POA) on file may request a one-time, 30-day delay online through MyFTB.

When a taxpayer requests an IVR bill payment delay, their eligibility will be verified up front. They may be eligible if

- They recently received an Income Tax Due Notice or Final Notice Before Levy and Lien dated within the last 45 days;
- They have not received a delay in the last 90 days;
- They do not have an Earnings Withholding Order, Continuous Order to Withhold, or Order to Withhold in place; and
- They do not have an existing installment agreement (IA).

Ineligible taxpayers will only have the option to make a payment, go to the main menu to "self-help," or during normal business hours, request to be transferred to a customer service representative.

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INSTALLMENT AGREEMENTS

To start the IA process, an individual must first fill out a simple form to request an IA. **FTB Form 3567, Installment Agreement Request**, can be completed online or mailed to the FTB. An IA can also be applied for by calling the FTB at

(800) 689-4776

The FTB normally grants an agreement without requiring financial information if an individual taxpayer

- Owes a balance of $25,000 or less;
- Agrees to pay the full amount in 60 months or less; and
- Has filed all required PIT returns.

For the client who does not meet the above parameters, once he or she has applied for an IA, the FTB will either approve or deny the agreement. In some cases, the FTB will request additional financial information from your client. The decision to approve the agreement is based on ability to pay and compliance history. When applying for the IA, the client should provide complete information, including bank information for an automatic debit. Failure to provide complete information will delay the process and possibly cause the FTB to deny the application.

If the application is completed online, the status can be checked by using the client's Social Security number and confirmation number found on the IA confirmation page. If the application was mailed or requested by phone, the FTB will send a written notification within 30 days. If you do not hear from the FTB after 30 days, call the above phone number during business hours. During this time, you should advise your client to begin making payments as proposed in the agreement application. If the IA is approved, this amount will be due on a specific day each month for the duration of the agreement. Missing a payment or having a payment dishonored may result in the IA being revoked or cancelled.

If your client is a business entity, the entity may also qualify for an IA. Business entity must call:

(888) 635-0494

FTB May Let You Skip an IA Payment

On its Help with Payment Plans page, the FTB outlines the procedures for taxpayers to make a request to skip an IA payment. Eligible taxpayers can make the request online.

A taxpayer may be eligible to skip an IA payment if the following criteria is met:

- The taxpayer is in an existing, active IA.
- The taxpayer has less than two previous skipped payments.
- The taxpayer submits his or her request more than five days but less than 30 days from the next payment due date.

The IA balance will continue to accrue interest and applicable penalties. The FTB will extend the original IA repayment period until the taxpayer pays the IA balance in full. In all other respects, the taxpayer will be subject to the original terms and conditions of the IA.

Log in to MyFTB and select "Skip Installment Agreement Payment" from the "Services" drop-down menu.

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STATUTE OF LIMITATIONS

The general time limit for a taxpayer to file a **claim for credit or refund** of California state income and franchise taxes is provided by R&TC §19306. Section 19306 states that no credit or refund shall be allowed after four years from the original due date of the return, four years from the date the return was filed (if filed within the extension period), or one year from the date of the overpayment, whichever is later, unless a claim is filed by the taxpayer prior to the expiration of that period.

The general time limit for the FTB to **assess** additional California state income and franchise taxes is provided by R&TC §19057. The law generally requires the FTB to mail a proposed deficiency assessment to the taxpayer within four years after the filing date of the taxpayer's return. Returns filed before the original due date of a PIT return (Apr. 15 of the year after the tax year) are considered as filed on the original due date.

Tax Returns Filed Late or Not at All

For tax years 1992 and after, the FTB must assess tax within four years from the original Apr. 15 due date of the return if the taxpayer filed the return on or before that date. If the taxpayer did not file the return on or before the original Apr. 15 due date, the FTB has four years from the date the return was filed to assess tax.

If the taxpayer did not file a tax return, or files a false or fraudulent tax return, there is no time limit for the FTB to assess tax. The FTB will estimate net income from any available information and assess tax based on that estimate.

Assessments may be allowed after the general time limit in special circumstances, such as if the IRS made federal adjustments, or if the taxpayer failed to report 25% or more of the gross income required to be reported on a tax return.

Statute Following IRS Audit

If the IRS audits your client, he or she has a requirement to notify the FTB of the outcome. Once the IRS completes an examination of the tax return and issues a revenue agent report, you or your client should notify the FTB within six months of the final federal determination.

Notification Requirements

You or your client are required to notify the FTB if the IRS adjusts or corrects gross income or deductions. Your notification should include any IRS assessed penalties, adjustments, or corrections resulting from math errors, tax credit adjustments, other tax adjustments, or supplemental income even if the IRS did not examine these adjustments.

The final federal determination is the date each IRS examination adjustment or resolution is assessed, as described in IRC §6203. If the FTB receives the federal changes within the six-month period, it has two years from the date it receives a report of the federal changes to apply the federal changes to the California tax return. Notification of a change or correction by the taxpayer or IRS must be sufficiently detailed to allow computation of the resulting California tax change.

If you or the IRS notify the FTB more than six months after the date of the final federal determination, the FTB considers the notification untimely. In that case, it has four years from the date it receives "sufficiently-detailed" information to apply the federal changes to the California return. "Sufficiently-detailed" information is defined as enough information to allow the FTB to compute the resulting California tax return change.

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If your client receives an assessment from the FTB because the IRS has notified it of the federal adjustment, you may call the practitioner hotline, or your client may call the general line, to find out the date of notification for purposes of the two year or four year statute of limitations.

If FTB Is Not Notified by the Taxpayer or the IRS

If neither the taxpayer nor the IRS provides the FTB timely notification of the federal changes, the statute of limitations for assessment remains open, and therefore, the FTB may issue an assessment at any time. Interest accrues from the original tax year due date until the tax liabilities and penalties are paid in full.

When FTB is properly notified, it may be able to resolve the case without the need to request more information. Notification also ensures prompt assessment of any additional tax, which may reduce the amount of interest charged.

Statute Did Not Run out Because Taxpayers Failed to Notify FTB

Joseph and Patricia West filed a joint 2005 California Resident Income Tax Return on Oct. 15, 2006. On Apr. 4, 2013, the FTB learned that the IRS disallowed $71,891 of the $112,594 mortgage interest claimed as a deduction on the Wests' Schedule A due to limitations under IRC §163(h) and that the IRS had imposed a federal accuracy related penalty (ARP). The Wests did not report the federal adjustment to the FTB.

On Oct. 16, 2013, the FTB issued an NPA that conformed to the federal adjustment by adding $71,891 to the Wests' 2005 California taxable income. The NPA set forth an additional tax of $6,686 and an ARP of $1,337, plus applicable interest.

Although the Wests appealed, the State Board agreed that the FTB was not barred under the statute following an IRS determination (***Appeal of Joseph and Patricia West***, SBE No. 923264, June, 2017).

OFFERS IN COMPROMISE

The Offer in Compromise (OIC) Program offers taxpayers who do not have, and will not have in the foreseeable future, the money, assets, or means to pay their tax liability in full. It allows a taxpayer to offer a lesser amount for complete satisfaction of a nondisputed final tax liability. The FTB's OIC program is authorized by R&TC §19443.

The FTB requires taxpayers to prove that the amount offered is the most it could expect to receive based on their present assets and income. In addition, the FTB determines whether taxpayers have reasonable prospects of acquiring additional income or assets that would allow them to satisfy a greater amount of the liability than the offered amount within a reasonable period (depending on other factors, five years is usually considered a reasonable period). Furthermore, the FTB must determine that acceptance of the offer is in the best interest of the state.

You may use the following publications to assist your clients in applying for an OIC:

4905 PIT Booklet, Offer in Compromise for Individuals

4905 BE Booklet, Offer in Compromise for Business

Entities DE 999CA, Multi-Agency Form for Offer in Compromise

You may call the OIC staff directly at

(916) 845-4787

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CDTFA Offers Online Tool for OIC Eligibility

In October 2019, the California Department of Tax and Fee Administration (CDTFA) released an online screening tool to help people determine if they are eligible to apply for an Offer-in-Compromise (OIC).

The CDTFA's OIC program is for taxpayers that do not have, and will not have in the foreseeable future, the income, assets, or means to pay a tax liability in full. Taxpayers may be eligible for the program if they:

- Have a final tax or fee liability
- Are no longer associated with the business that incurred the liability or a similar type of business
- Do not dispute the amount of tax or fee owed
- Cannot pay the full amount owed in a reasonable amount of time

The new eligibility screening tool can help taxpayers quickly determine if they are eligible to apply for an OIC by entering financial information to calculate a preliminary offer amount. Taxpayers can use the preliminary offer amount when they submit an application for an OIC.

INNOCENT SPOUSE

When a taxpayer files a joint liability tax return with his or her spouse, the individuals are each responsible for paying the entire liability due. However, if an individual meets certain criteria, he or she may qualify for relief from having to pay all or part of the liability.

To obtain relief from the obligation to pay the tax due from a joint personal tax return, complete the following steps:

1. Ask the court to issue an order granting relief, if the taxpayer is divorcing his or her spouse.
2. Ask the FTB to determine if the taxpayer qualifies for innocent spouse relief.

Relief by Court Order

A taxpayer may qualify for relief by court order if the following conditions are met:

- He or she is obtaining a divorce from a spouse, and the court issues an order relieving the individual of the unpaid tax due from a joint liability.
- He or she is in the process of divorcing and joint gross income exceeds $150,000 or the taxpayer owes more than $7,500 for the year he or she is seeking relief. Send the FTB a letter requesting a Tax Revision Clearance Certificate. Make sure your letter includes name, address, telephone number, and Social Security number. After the court issues its order, provide the FTB with a copy of the court order, and it will determine the amount of relief.

Innocent Spouse Relief

A taxpayer may qualify for innocent spouse relief if the following conditions are met:

- He or she has an unpaid tax that was reported on a joint California income tax return, and the taxpayer had no reason to know that the tax shown on the return was not paid when the return was filed, or

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- He or she owes a joint liability for underreported income or erroneous deductions that are attributable to the spouse, and the taxpayer had no reason to know of those items when he or she signed the return.

To request relief, complete form FTB 705 and send it with a statement of the reasons why the taxpayer thinks he or she qualifies for relief. The statement should include name, address, telephone number, Social Security number, and the tax years or years for which you are asking for relief.

If the IRS allowed innocent spouse relief for the same tax years that the taxpayer is asking the FTB for relief, please make sure that you provide the FTB with the IRS information when you make your request. To submit a request for innocent spouse relief, contact the FTB at the following address:

Innocent Spouse Unit

Franchise Tax Board A-452

PO Box 2966

Rancho Cordova, CA 95741-2966

California Innocent Spouse Relief Conforms to Federal Relief Provisions

SB 1065 (Walters, Stats. 2010, Ch 318), enacted Sep. 27, 2010, provides the following:

- Reenacts and makes permanent the statutory requirement that the FTB grant innocent spouse relief when the IRS has granted relief under the same facts and circumstances.
- Allows a taxpayer to appeal the FTB's determination on an "equitable relief" request for innocent spouse relief.
- Removes the obsolete transition rule that refers to a four-year period for submitting a request for innocent spouse relief.

The provisions of SB 1065 are effective Jan. 1, 2011, and specifically apply to the following:

1. Requests for state relief that are based on an IRS request for similar relief made on or after Jan. 1, 2009, and

2. Requests for equitable relief received by the FTB on or after Jan. 1, 2011.

PENALTIES

REASONABLE CAUSE FOR PENALTY ABATEMENT

Penalty abatement requests are considered based on the individual facts and circumstances surrounding each case. Taxpayers most often request waivers of penalties based upon reasonable cause for the following penalties:

- Late payment of tax;
- Failure to file a return;

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- ARP;
- Failure to furnish information; and
- File after notice of demand.

Late Payment of Tax

In order to establish reasonable cause for the *late payment of tax*, the taxpayer must show that his failure to pay the proper amount of tax by the original due date occurred despite the exercise of ordinary business care and prudence (*Appeal of Roger W. Sleight* (83-SBE-244), Oct. 26, 1983).

In a recent decision, the Board determined that a taxpayer did not show reasonable cause in a case where the taxpayer paid his tax late because of a dispute he had with his partnership over the amount of income reported on a Schedule K-1. The Board ruled the taxpayer had not explained with adequate precision the nature and extent of the steps that he allegedly took to gather the information he considered necessary to confirm the correctness of the income reported on the K-1. The Board also reasoned that the taxpayer failed to obtain by independent inquiry the information he needed from the partnership to calculate accurately the tax that he owed before the due date of his return. As a result, the Board concluded that the taxpayer failed to exercise ordinary business care and prudence when he paid his tax after the due date.

Failure to File a Return

In order to establish reasonable cause for *failing to file a return* on or before the due date, the taxpayer must show that his failure was due to reasonable cause and not due to willful neglect. To establish reasonable cause, the taxpayer "must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances" (*Appeal of Howard G. and Mary Tons* (79-SBE-027), Jan. 9, 1979). The burden is on taxpayers to prove that reasonable cause exists to support abatement of the penalty for filing a late tax return.

Accuracy Related Penalty

The FTB may impose the ARP on any portion of an underpayment of tax that should be shown on the return (R&TC §19164). The penalty is equal to 20% (or 40% for amnesty eligible year) of the underpayment of tax. R&TC §19164 imposes a 20% ARP on any portion of an underpayment attributable to one or more of the following:

- Negligence or disregard of rules or regulations;
- Substantial understatement of income tax;
- Substantial valuation misstatement; and
- Substantial overstatement of pension liabilities.

A 40% penalty may be assessed for gross valuation misstatements.

The reasonable cause and good faith defense applies to negligence or disregard of rules or regulations, substantial understatement of income tax, substantial valuation misstatement, and gross valuation misstatement. However, under certain circumstances the defense does not apply to an underpayment attributable to a substantial or gross valuation understatement regarding charitable deduction property.

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IRC ‘6664(c)(1) provides that no penalty under IRC §6662 will be imposed if the taxpayer can show that there was reasonable cause and that the taxpayer acted in good faith with respect to the underpayment. Treas. Reg. §1.6664-4 provides guidance on what constitutes reasonable cause and good faith and whether those standards are met for purposes of eliminating the ARP. The determination of reasonable cause is made on a case-by-case basis, taking into account all facts and circumstances.

Failure to Furnish Information or File after Notice and Demand

Failure to furnish information or file after notice and demand penalty can only be abated by showing reasonable cause and not willful neglect. To establish reasonable cause, a taxpayer must show that the failure to reply to the notice and demand or request for information occurred despite the exercise of ordinary business care and prudence such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances.

OTA Issues Precedential Opinion on Demand Penalty Regulation Inconsistency

R&TC §19133 provides that FTB may impose a penalty when a taxpayer fails to file a return or provide information upon FTB’s notice and demand to do so. To provide taxpayers clarity as to when this penalty would be imposed, FTB promulgated Cal. Code of Regs., title 18, §19133 (the Demand Regulation), which indicates that, for personal income taxpayers, FTB will only impose a penalty for failure to file a return upon demand if:

1. the taxpayer fails to respond to a current demand, and
2. at any time during the preceding four tax years, FTB issued a Notice of Proposed Assessment (NPA) following the taxpayer’s failure to timely respond to a request or demand.

In prior OTA non-precedential opinions applying the Demand Regulation to current appeals, there was a split by OTA Administrative Law Judges (ALJs) in the interpretation of the second prong of the Demand Regulation. This interpretation turned on the meaning of the words “during the four-taxable-year period preceding the taxable year for which the current Demand for Tax Return is issued” in the regulatory language.

FTB’s interpretation of the regulatory language means that FTB imposes the penalty when a taxpayer received a prior NPA following a request or demand for a tax return for any of the four years preceding the tax year at issue. In several non-precedential OTA opinions, some ALJs interpreted the language to mean that an NPA following a request or demand for tax return had to have been issued by FTB during the four years preceding the tax year at issue. FTB took the position that interpreting the language in the regulation in this alternative manner was inconsistent with the regulation; therefore, the language of the regulation was ambiguous and the principles of administrative deference should apply.

In Jones, a similar fact pattern emerged. There the appellant appealed the imposition of the Demand Penalty imposed for the 2016 tax year. The prior request or demand and NPA for the 2015 tax year were not issued until 2017 - the tax year after the 2016 tax year at issue in the appeal. Using the alternative interpretation found in several non-precedential OTA opinions, the penalty would have been determined to have been improperly imposed because the prior NPA following the request or demand was not issued in the four years preceding the tax year at issue, but rather in the year after the tax year at issue.

However, the panel in Jones determined that the penalty was properly imposed because the determining factor is the tax year of the failure to file rather than the timing of the request or demand and NPA. The

opinion noted that this interpretation is supported by the intent of Regulation §19133, which is to impose the Demand Penalty "only upon individual taxpayers who are repeat nonfilers; that is, those taxpayers who received an NPA for previously failing to timely file within any one of the preceding four taxable years." (***Appeal of R. Jones***, OTA No. 20015731, March 2021)

<table>
<tr><th colspan="2">Examples</th></tr>
<tr><th>Reasonable Cause</th><th>Not Reasonable Cause</th></tr>
<tr><td rowspan="2">Credible and competent proof of illness or other personal difficulty completely prevented taxpayer from complying.</td><td>Ignorance of the law.</td></tr>
<tr><td>Reliance on agent to respond on taxpayer's behalf.</td></tr>
<tr><td rowspan="2">Relied on tax professional with competency in the subject of tax law, and tax professional's advice is based on taxpayer's full disclosure of relevant facts and documents.</td><td>Lost, lacking, inaccurate, or difficult to obtain information.</td></tr>
<tr><td>Complexity of tax law.</td></tr>
<tr><td rowspan="2">Proof that the notice and demand/request for information was not mailed to taxpayer's last known address.</td><td>Pressures of business affairs or work.</td></tr>
<tr><td>Claim that taxpayer did not receive notice.</td></tr>
</table>

NEW FIRST-TIME ABATEMENT PROGRAM

For taxable years beginning on and after January 1, 2022, AB 194 (Budget, Stats. 2022, Ch. 55) requires the Franchise Tax Board, upon request by an individual taxpayer, to grant a one-time abatement of a failure-to-file or failure-to-pay timeliness penalty. was not previously required to file a California personal income tax return or has not previously been granted abatement under the bill's provisions. To receive abatement, the taxpayer:

- has not previously been required to file a California personal income tax return or has not previously been granted abatement under the bill's provisions.
- Has to have filed all required returns as of the date of the request for abatement,
- Has to have paid, or is in a current arrangement to pay, all tax currently due.

TWO REASONABLE CAUSE ABATEMENT REQUEST FORMS

In September 2014, the FTB rolled out two forms with instructions regarding reasonable cause and statute of limitations:

FTB 2917, Reasonable Cause B Individual and Fiduciary Claim for Refund; and

FTB 2924, Reasonable Cause B Business Entity Claim for Refund.

The FTB standardized the layout of the forms to make it easier for taxpayers to provide all the information the FTB needs in order to carry out the following:

- Evaluate a reasonable cause abatement request;
- Prevent unneeded correspondence; and
- Scan and route incoming forms to speed claims processing.

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Although the FTB recommends using these two forms for a quicker response, it continues to accept and process hand-written reasonable cause abatement requests.

MISCELLANEOUS PENALTY CASES

Blame the Tax Software? Not Reasonable Cause

R. and C. Mauritzson were Idaho residents in 2017. They received a K-1 from RM Enterprises, LLC for their share of income including the sale of California real property. When, at FTB's request, they filed a California non-resident return over a year past the due date, FTB imposed a late-filing penalty in the amount of $1,614.25 plus interest.

The Mauritzson's argued that the penalty should be abated because they relied on their tax software which did not warn them of their California filing requirement. The appeal board denied the penalty relief citing several federal Tax Court decisions that reliance on tax software did not constitute reasonable cause (***Appeal of R. and C. Mauritzson,*** OTA No. 20015672, April 2021).

Late K-1 Can Create Reasonable Cause

Richard Reed and his wife were Hawaii residents during 2016. Richard held a 10% interest in an LLC that was taxed as a partnership, and prior to 2016 the LLC had no California assets. Despite 23 emails from March 2017 through February 2018, the LLC failed to provide Richard with a 2016 K-1 until February 27, 2018, and it filed a California Form 568 for 2016 on March 1, 2018. FTB imposed a late-filing penalty for the Reeds' 2016 California tax return.

OTA noted that reasonable cause may be found when a taxpayer is unable to acquire the information necessary to make a reasonably accurate estimate of a tax liability after prudent efforts to acquire such information. Richard had shown that he exercised ordinary business care and prudence by his persistent efforts to acquire the information necessary to determine whether he had a California filing requirement, despite the nonresponsive nature of the LLC and its accountant. Therefore, OTA found that the Reeds had shown that they acted in a manner matching that of an ordinarily intelligent and prudent businessperson given the situation in which they were placed, and the penalty was abated for reasonable cause. (***Appeal of Richard Reed***, OTA No. 19034478, November 2019).

E-file But Verify - or No Reasonable Cause

Witman Enterprises, LLC is taxed as a partnership. Its tax preparer attempted to electronically file its 2016 return on April 6, 2017, but FTB rejected the transmission. Approximately two years later, Witman filed its 2016 return on March 12, 2019, in response to FTB Form 765, which FTB accepted. FTB subsequently assessed a late filing penalty

Witman contends the late-filing penalty should be abated or assessed to its tax preparer because it relied on its tax preparer who represented to Witman that its 2016 return had been filed. However, Witman did not substantiate what efforts, if any, it took to verify that its 2016 return had been filed timely. Although it relied on the representation of its tax preparer that a 2016 return was filed, the tax preparer failed to complete the transmission attempted on April 6, 2017.

Consequently, OTA found that the LLC has not established reasonable cause for the late filing of its 2016 return because reliance on its tax preparer does not constitute reasonable cause. (***Appeal of Witman Enterprises, LLC,*** OTA No. 19105349, August 2020).

NEW! FTB CHARGED TO HELP INCREASE EITC CLAIMS

The legislature doesn't think there are enough California EITC (CalEITC) claims. It enacted legislation to consider an alternative option to the traditional tax return in order to reduce barriers and increase the number of CalEITC claims among eligible individuals and families.

SB 1409 (Caballero, Stats. 2020, Ch. 114) requires the FTB to analyze and develop a plan to increase the number of claims of the CalEITC allowed pursuant to R&TC §17052 and the federal Earned Income Tax Credit (EITC), including alternative filing systems. The analysis would be required to include, but is not limited to, the following:

- An overview of the changes needed to the income tax system that would reduce any barriers to tax filing for nonBfilers of tax returns who are eligible for the CalEITC; and
- An outline of the necessary changes needed to increase collaboration and coordination among state agencies to reach the greatest number of individuals eligible for the CalEITC.

The FTB would be required to engage any state agency task force or group that exists to reduce poverty and other stakeholders that work to reduce poverty. The FTB would be required to report to the Legislature on or before January 1, 2022, on its analysis and plan required by this section.

VOLUNTARY DISCLOSURE PROGRAM EXPANDED

California allows an applicant requesting a "voluntary disclosure agreement" (VDA) to remain anonymous until the signed voluntary disclosure program (VDP) is returned to the FTB. Existing law allows qualifying entities, certain LLCs, qualified trusts, qualified shareholders, qualified members of LLCs, and qualified beneficiaries of qualified trusts to participate in the VDP. These entities are defined as follows:

- A "qualified entity" includes any corporation, including an S corporation, an LLC not classified as a corporation, and a qualified trust that has never filed a California income or franchise tax or LLC return and that voluntarily applies for a VDA prior to any contact from the FTB regarding income, franchise, or LLC tax liability.
- A "qualified shareholder" is a nonresident shareholder of an S corporation on the signing date of the VDA and for which the S corporation has disclosed all material facts pertaining to the shareholder's liability.
- A "qualified member" is an individual who is a nonresident on the signing date or a corporation or LLC that is not organized in California nor qualified or registered with the office of the Secretary of State (SOS). A qualified member in all cases is a member of an LLC that has applied for a VDA and disclosed all material facts pertaining to the member's liability.
- A "qualified trust" is a trust that meets both of the following requirements:
    - The administration of the trust has never been performed in California, except for inconsequential in state administrative services; and

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- For the six taxable years immediately preceding the signing date of the VDA, the trust has had no California resident beneficiaries, except for a California beneficiary whose interest in that trust during such period was always contingent.
- If the trust has made any distribution to a California resident beneficiary at any time during the six taxable years before the signing date of the VDA, that beneficiary's trust interest is non-contingent.

- A "qualified beneficiary" is an individual who is a beneficiary of a qualified trust and is a nonresident on the signing date of the VDA and for each of the prior six taxable years.

Under the VDP, the following penalties may be waived:

- Failure to make and file a tax return.
- Failure to pay any amount due by the date prescribed for payment.
- Underpayment of estimated tax.
- SOS-imposed penalties, pursuant to Corporations Code '6810 and '8810(a).
- Failure to furnish information or maintain records, as provided in R&TC '19141.5.
- Underpayment of tax.
- Late filing of partnership tax returns, except for LLCs classified as partnerships.
- Failure to file information tax returns.
- Relief from contract voidability.

To satisfy the terms of the VDA, approved applicants must return a signed VDA to the FTB, make all payments, and submit all returns to the FTB within 30 days from the signing date of the VDA. The FTB may grant an extension for filing tax returns and paying amounts due to 120 days from the signing date of the VDA, or the latest extended due date of the tax return for a tax year where relief is granted, whichever is later. Failure to adhere to the terms of the VDA renders the VDA null and void.

Additional Penalty Relief

AB 1719 (R&TC Comm., Stats. 2017, Ch. 176) modifies the VDP's provisions to allow penalty relief for S corporations or LLCs classified as a partnership for late filing penalties for VDAs entered into on or after Jan. 1, 2017.

Additional Entities Eligible

SB 813 (Finance, Stats. 2017, Ch. 288) further modifies the VDP's provisions to allow the following:

- Eligibility for out-of-state partnerships with nonresident partners of GPs, LPs, and LLPs; and
- Eligibility for out-of-state trusts with California resident beneficiaries to participate in the VDP.

Additionally, the bill duplicates the penalty relief for S corporations or LLCs classified as a partnership for failure to file a timely return, as enacted by AB 1719**.**

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CONTACTING THE TAXPAYERS’ RIGHTS ADVOCATE

You may contact the Taxpayers’ Rights Advocate if you have an ongoing state income tax problem that you have been unable to resolve through normal channels. Representatives in Executive and Advocate Services (EAS) coordinate resolution of taxpayer complaints and problems. Depending on your issue, EAS may either help you get in contact with the appropriate business area or ask you to provide a written request for assistance.

Angela Jones

Taxpayers’ Rights Advocate

(916) 843-6022

Angela.Jones@ftb.ca.gov

Or visit the Taxpayers’ Rights Advocate page on the FTB’s website.

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2023 CALIFORNIA TAX UPDATE
PAYROLL, SALES & PROPERTY TAXES

PAYROLL TAXES

SDI, UI, AND ETT RATES FOR 2023

State Disability Insurance (SDI)

The Employment Development Department (EDD) announced the SDI rate and wage limits for 2023.

Year	SDI Rate	Maximum Wage Base	Maximum Payment
2022	1.1%	$145,600	$1,601.60
2023	**0.9%**	**$153,164**	**$1,378.48**
2024	1.1%	No Maximum	No Maximum

Tax planning note. California Employee SDI Wage Cap Removed Beginning January 1, 2024. Senate Bill (SB) 951, signed into law in September 2022, removed the Taxable Wage Ceiling as of 2024. Employees whose 2024 wages exceed $153,164 in 2024, will see their employee payroll taxes increase by 1.1% of the amount over $153,164. The elimination of the wage cap will substantially increase SDI contributions by higher income employees.

Unemployment Insurance (UI)

The UI rate schedule in effect for 2023 is Schedule "F+." This is Schedule F plus a 15% emergency surcharge, rounded to the nearest tenth. Schedule F+ provides for UI tax rates from 1.5% to 6.2 %. The taxable wage limit is $7,000 per employee.

New employers: The UI tax rate is 3.4% for up to three years. If the taxpayer purchased an established business, he/she has the option of acquiring the previous owner's UI tax rate.

Note. The Voluntary UI program is not in effect for 2023 or 2024.

Employment Training Tax (ETT)

The ETT rate for 2023 is 0.1%. The UI and ETT taxable wage limit remains at $7,000 per employee per calendar year. The ETT rate for 2024 will remain the same.

UI, ETT, and SDI tax rates are combined on a single rate notice, Notice of Contribution Rates and Statement of UI Reserve Account (DE 2088). The DE 2088 will be mailed in December, with a mailing date of Dec. 30. Employers will have 60 days from the Dec. 30 mailing date to protest any item on the DE 2088 except SDI and ETT, which are specifically set by law.

WORKER CLASSIFICATION CALIFORNIA STYLE

Generally, whether a worker is an employee or an independent contractor can be determined through the application of the factors contained in common law or employment and statutory provisions of the California Unemployment Insurance Code.

Under California tax law, there is no statutory definition of an "independent contractor," therefore, the determination of whether a worker is an employee, or an independent contractor, relies on federal income

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tax law, judicial tests and administrative guidelines. There is a rebuttable presumption under Labor Code 3357 that a worker is an employee.

However, in order to rebut the presumption, a number of factors must be considered, none of which is controlling by itself.

The *Borello* Standards

The California Supreme Court in the case of ***S.G. Borello & Sons, Inc. v Department of Industrial Relations*** ((1989) 48 Cal.3d 341) (Borello) adopted the "economic realities" test. In applying this test, a significant factor to be considered is whether the person to whom service is rendered has the right to control the manner and means of the work performed.

Additional factors that may be considered under this test include:

1. Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
2. Whether or not the work is a part of the regular business of the principal or alleged employer;
3. Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
4. The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers;
5. Whether the service rendered requires a special skill;
6. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
7. The alleged employee's opportunity for profit or loss depending on his or her managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job; and
11. Whether or not the parties believe they are creating an employer-employee relationship may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

However, as stated above, all of the factors must be considered in light of the facts and circumstances surrounding the worker's relationship with its employer and no one factor is given more weight than another.

California Supreme Court Makes Up a New Test

In a rather alarming decision in April, 2018, the California Supreme Court found in favor of a delivery service's drivers as employees for purposes of the state's Industrial Welfare Commission (IWC) wage orders. In doing so, the Court chose to disregard the long-used 11-factor common law test from ***Borello*** and limit the factors to determine the "suffer or permit to work" standard.

It concluded it is appropriate, and most consistent with the history and purpose of the suffer or permit to work standard in California's wage orders, to interpret that standard as:

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- placing the burden on the hiring entity to establish that the worker is an independent contractor who was not intended to be included within the wage order's coverage; and
- requiring the hiring entity, in order to meet this burden, to establish each of the three factors embodied in the "ABC test" C namely:
    - that the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; and
    - that the worker performs work that is outside the usual course of the hiring entity's business; and
    - that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

While this is not a brand-new standard, in that several other states have been using the ABC Test (Illinois and Massachusetts for example), it is the first time it has been applied in California (***Dynamex Operations West, Inc v. Superior Court of Los Angeles***, No. S222732, Apr. 30, 2018).

The Legislature Jumps on the Bandwagon

In enacting AB 5 (Gonzalez, Stats. 2019, Ch. 296) state legislators decided to codify a portion of the ***Dynamex*** case that presumes a worker is an employee unless a hiring entity satisfies the factors of the "ABC" test in order to determine the status of a worker as an employee or independent contractor for selected provisions of the Labor Code and Unemployment Insurance Code.

The bill is effective January 1, 2020, and operative as of that date. And the law expressly states that no provision of the bill shall permit an employer to reclassify an individual who was an employee on January 1, 2019, to an independent contractor due to enactment of this bill.

Presumptive Employee Status Unless All Factors are Satisfied

According to AB 5, under the Labor Code, Unemployment Insurance Code, and for the purpose of wage orders of the Industrial Welfare Commission, except for specified statutory exemptions, a person providing labor or services for remuneration shall be considered an employee unless the hiring entity demonstrates that all three of the conditions are satisfied.

Any exceptions to the terms "employee," "employer," "employ," or independent contractor as defined in the Labor Code, Unemployment Insurance Code, or an applicable order of the Industrial Welfare Commission remain in effect.

For purposes of this bill, an individual is defined as an individual providing services through a sole proprietorship or other business entity. The individual must:

- Maintain a business location separate from the hiring entity. An individual is not prohibited from choosing to perform services at the location of the hiring entity.
- Have a business license in addition to any required professional licenses or permits for the individual to practice in their profession if work is performed more than six months after the effective date of this provision.
- Have the ability to set or negotiate their own rates for the services performed.
- Have the ability to set their own hours outside of project completion dates and reasonable business hours.

- Be customarily engaged in the same type of worked performed under contract with another hiring agency or holds themselves out to other potential customers as available to perform the same type of work.
- Customarily and regularly exercise independent judgment in the performance of the services.

How Good is Your Lobbyist? Certain Professions Excluded

AB 5 provides that the ABC test outlined in ***Dynamex*** will not apply to specified occupations and instead

Borello will apply. The professions subject to the ***Borello*** test include:

- A person or organization licensed by the Department of Insurance.
- A physician, surgeon, dentist, podiatrist, psychologist or veterinarian licensed by the State of California pursuant to the Business and Professions Code, performing professional or medical services provided to or by a health care entity, except for employment settings currently or potentially governed by collective bargain agreements for these licensees.
- A practicing lawyer, architect, engineer, private investigator, or accountant who holds an active license from California.
- A securities broker-dealer or investment adviser or their agents and representatives registered with the Securities and Exchange Commissions, the Financial Industry Regulatory Authority or licensed by the State of California.
- A direct sales salesperson.
- A commercial fisherman working on an American vessel, as defined, through December 31, 2022.
- A commercial fisherman working on an American vessel is eligible for unemployment insurance benefits if they met the definition of "employment" under the Unemployment Insurance Code.
- The Employment Development Department shall issue an annual report to the Legislature on or before March 1, 2021 and each March 1 thereafter.
- This subdivision shall become inoperative on January 1, 2023, unless extended by the Legislature.
- Professional services, performed under contract by an individual, in the following professions:
- Marketing, under specified conditions.
- Administrator of human resources, under specified conditions.
- Travel agent services.
- Graphic design.
- Grant Writer.
- Fine Artist.
- Enrolled agent services.
- Payment processing agent through an independent sales organization.
- Services provided by a still photographer or photojournalist who does not license content submissions to the putative employer more than 35 times per year. A photographer or artist is not prevented from displaying their work product for sale.
- Services provided by a freelance writer, editor, or newspaper cartoonist who does not provide content submissions to the putative employer more than 35 times per year.

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- Services provided by a licensed esthetician, licensed electrologist, licensed manicurist, licensed barber, or licensed cosmetologist if the individual sets their own rates, processes their own payments, is paid directly by the client, sets their own hours and has discretion to decide which clients to provide services to, has their own book of business and maintains their own business license. If the individual is performing services at the hiring entity location, then the individual issues a 1099 form to the salon or business owner from which they rent their space. The provision specific to licensed manicurist becomes inoperative on January 1, 2022.

AB 5 also provides that the ABC Test outlined in the holding in ***Dynamex*** will not apply to the following professions:

- A real estate licensee licensed by the state of California. If the section of the BPC that governs employee or independent contractor is not applicable then the determination is governed by the following:
- Unemployment Insurance Code;
- For purposes of workers compensation §3200 et seq; and
- For all other purposes, in the Labor Code by ***Borello***.
- A repossession agency.

Other Special Rules Apply to Certain Business Relationships

AB 5 also provides rules for:

- Bona fide business to business contracting relationships (see clarification from AB 2257 below)
- Individuals performing construction work - contractor or subcontractor

  Reminder: in California a subcontractor can only be considered to be an independent contractor of the contractor if the sub holds a valid contractor's license.

- Construction trucking services
- Referral agencies and
- Motor clubs

Legislature Modifies Exemptions for Certain Services & Provides New Exemptions

As if it wasn't confusing enough. AB 2257 (Gonzalez, Stats. 2020, Ch. 38) has already made modifications and created new exemptions for specific occupations, and if beneficial, these can be retroactive to January 1, 2020.

Bona Fide Business-to-Business Contracting Relationship

AB 2257 clarifies that when two bona fide businesses are contracting with one another, the determination of whether an individual working for a business service provider is an employee is governed by the test set forth in ***Borello*** if certain criteria are met.

The determination of whether an individual worker who is not acting as a sole proprietor or formed as a business entity, is an employee or independent contractor is governed by the "ABC" test.

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Relationship between Referral Agency and a Service Provider

If a sole proprietor, or business entity formed as a partnership, limited liability company (LLC), limited liability partnership (LLP), or corporation (service provider) provides services through a referral agency, the determination of whether the service provider is an employee or independent contractor of the referral agency is generally governed by ***Borello*** if the referral agency meets certain conditions.

AB 2257 also expands and defines the type of services qualifying under this exemption to include but not limited to **tutors, youth sports coaching, interpreting services, consulting and animal services**.

Contract for Professional Services

For a contract for professional services, the determination of whether the individual is an employee or independent contractor is governed by ***Borello*** if the hiring entity demonstrates certain factors are met.

AB 2257 also added the following occupations to the professional services exemption: **advisor, producer, narrator, cartographer, a specialized performer hired by a performing arts company to teach a master class for no more than one week, appraiser, registered professional foresters, and a home inspector**.

Relationship Between Two Individuals/Single-Engagement Event

The relationship between two individuals where each is acting as a sole proprietor or separate business entity, formed as a partnership, a LLC, a LLP, or a corporation, pursuant to a contract to provide services at the location of a single engagement event is governed by ***Borello*** if certain conditions are met.

AB 2257 also defines single engagement event as a stand-alone non-recurring event in a single location, or a series of events in the same location no more than once a week.

The bill clarifies that qualifying services for this exemption do not include those services provided in an industry designated by the Division of Occupational Safety and Health or the Department of Industrial Relations as a high hazard industry, or janitorial, delivery, courier, transportation, trucking, agricultural labor, retail, logging, in-home care, on construction services other than minor home repair.

Individual Performance Artist

The determination of employee or independent contractor status is governed by ***Borello*** for individual performance artist performing material that is their original work, creative in character, and the result of which depends on the individual's imagination, invention or talent if certain requirements are met.

AB 2257 defines individual performance artists to include, but not limited to improvisation, stage magic, performing comedy, illusion, mime, spoken word, storytelling or puppetry.

Individuals participating in a theatrical production, musician or musical are subject to the "ABC" test.

Data Aggregator

The holding in ***Dynamex*** does not apply to the relationship between a data aggregator and the individual providing feedback to the data aggregator and instead, the holding in ***Borello*** applies if certain conditions are met.

AB 2257 also defines a data aggregator as a business, research institution, or organization that requests and gathers feedback on user interface, products, services, people, concepts, ideas, offerings or experiences.

Other Occupations

AB 2257 was amended to exempt additional occupations which includes:

- A manufactured housing salesperson;

- A newspaper distributor working under contract with a newspaper publisher and a newspaper carrier (This subdivision becomes inoperative on January 1, 2022 unless extended by the Legislature);
- An individual engaged by an international exchange visitor program that has obtained and maintains full official designation by the United States Department of State; and
- A competition judge with a specialized skill set or expertise that exercises discretion and independent judgment in determining the outcome or enforcing rules of a competition. This includes but is not limited to an amateur umpire or referee.

What If the Worker is Now an Employee for California, But a Federal Independent Contractor?

Neither the FTB nor the EDD have yet provided any kind of real guidance in this area. While it is possible for a worker now classified as an employee for California purposes to continue to be treated as an independent contractor for federal law, such a position is fraught with benefits and dangers for both the company and the worker. Some of these include:

- **Social Security taxes.** Companies can save on employer FICA, shifting the full burden to a federally claimed independent contractor.
- **Health insurance premiums**. Even a large employer can exclude independent contractors under its ACA mandated plan, but the worker must have minimum essential coverage under new California law.
- **Retirement savings**. Independent contractors generally cannot participate in company sponsored 401(k) plans. Thus the worker also loses any company matching contributions. But what happens under California tax if the independent contractor funds SEP or other self- employed pension plan?
- **Out-of-pocket expenses**. In light of TCJA 2017 and employee can no longer deduct unreimbursed expenses on his/her federal tax return, but an independent contractor reports expenses on Schedule C.

These are just a few of the potential discussion areas awaiting further clarification in California.

APP-BASED WORKERS

The California Attorney General and several city attorneys had sued Uber and Lyft on behalf of the People, arguing that the companies improperly classified their drivers as independent contractors rather than employees in violation of state law. The main allegation in the case was that Uber and Lyft misclassified drivers, which:

- deprived the drivers of benefits to which they were entitled;
- gave the companies an unfair advantage against competitors; and
- cost the state significant sums in lost payroll tax revenues and workers' compensation insurance premiums.

In August 2020 a trial court issued an injunctive order restraining the companies from continuing this practice. The companies appealed, and the court of appeal stayed the order during the pendency of the appeal. But, the court of appeal said the trial court acted within its discretion and affirmed the order. The stay is set to expire in late November 2020. (***The People v. Uber Technologies, Inc., et al.***, Court of Appeal of California, First District, Nos. A160701, A160706, October 22, 2020)

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California Proposition 22

Meanwhile, on the November 3 ballot, Proposition 22 classifies app-based drivers as "independent contractors," instead of "employees," and provides independent-contractor drivers other compensation, unless certain criteria are met.

Specifically, the proposition contains the following conditions:

- **Makes Drivers Independent Contractors**. This measure makes app-based rideshare and delivery drivers independent contractors. The new state law that limits the ability of companies to hire independent contractors would not apply to drivers.
- **Gives Drivers Certain Benefits**. This measure requires rideshare and delivery companies to provide certain benefits:
- **Earnings Minimum**. This measure requires companies to pay 120 percent of the local minimum wage for each hour a driver spends driving, but not time spent waiting.
- **Health Insurance Stipend**. For drivers who normally work more than 15 hours per week (not including waiting time), this measure requires that companies help pay for health insurance.
- **Pay For Costs When a Driver Gets Hurt on the Job**. This measure requires that companies pay medical costs and replace some lost income when a driver is injured while driving or waiting.
- **Rest Policy**. This measure prohibits drivers from working more than 12 hours in a 24-hour period for a single rideshare or delivery company.
- **Other Requirements**. This measure prohibits workplace discrimination and requires that companies: (1) develop sexual harassment policies, (2) conduct criminal background checks, and (3) mandate safety training for drivers.
- **Limits Local Government Ability to Set Additional Rules**. This measure limits the ability of cities and counties to place additional rules on rideshare and delivery companies.

Superior Court Says Proposition 22 is Unconstitutional

In August 2021 the California Superior Court deemed Proposition 22 unconstitutional in that it limits the legislature's powers to include app-based drivers in the worker's compensation program. The state Constitution grants the legislature unlimited power in this area. In addition, the Court found that while the people of the state have the right to enact laws through the initiative process, a provision in Proposition 22 that restricts legislative amendments was also found to be unconstitutional (***Castellanos et al., v. State of California et al.,*** Superior Court, Alameda County, No. RG21088725, August 20, 2021).

The case is currently pending in the California Court of Appeals.

FAQs on AB 5 and Worker Classification

FTB launched an entire page of FAQs regarding the enactment of AB 5 in 2019.

FTB Addresses Issues of Different State vs. Federal Classification

Among the areas addressed by the FTB, some of the toughest are questions about reporting income, worker benefits and pensions. For example:

Q. If the worker is issued a W-2 reporting earnings because the worker is an employee under California law, and a Form 1099-K or 1099-MISC reporting the same earnings because the worker is an independent

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contractor under federal law, should the payor file a Form 1099-K or 1099-MISC showing zero income to the Franchise Tax Board?

A. The payor is not required to file the Form 1099-K or 1099-MISC with California and would file the form with the Internal Revenue Service. The payor would be required to report information on the Form 1099-K or 1099-MISC in accordance with the federal Form 1099 filing requirements.

Q. Will California follow the federal pension plan qualification rules through automatic conformity regardless of its determination if a worker is an employee or independent contractor?

A. §401 through §424 of the Internal Revenue Code provide rules regarding deferred compensation plans, including the qualification rules regarding employer provided pension plans. California, pursuant to §17501 of the R&TC, automatically conforms to §401 through §424 of the IRC and any modifications to those code sections. Thus, California would follow the federal determination if a pension plan is a qualified plan. Therefore, if a pension plan is a qualified plan under the IRC, the pension plan would be considered a qualified plan for the purposes of the R&TC.

These, and all of the FAQs are downloadable in pdf format in the worker classification and AB 5 FAQs section of the FTB's website.

OTHER EDD NEWS

CA EDD Form DE-4, Employee's Withholding Allowance Certificate (CA DOES NOT CONFORM to Federal W-4)

Beginning January 1, 2020, California's Form DE-4, Employee's Withholding Allowance Certificate, was required for wages paid to new employees or for employees wishing to adjust their CA income tax withholding (PIT). Substantial changes to the IRS Form W-4, Employee's Withholding Certificate, do not allow employees to designate their withholding allowances therefore it no longer qualifies to be used for California personal income tax (PIT) withholding purposes.

New employees and employees wishing to adjust their CA income tax withholding (PIT) will now fill out a federal Form W-4 ***and*** a California Form DE-4. If an employee's withholding allowances for California PIT are unknown, the employer must use "Single" "Zero" (S-0) for California PIT withholding purposes.

EDD Wants to Help Cannabis Industry

The EDD is trying to help business owners in the cannabis industry comply with California's payroll tax laws and avoid unforeseen tax liabilities. California businesses that hire employees to perform services are required by law to withhold, report, and pay payroll taxes to the EDD. Cannabis businesses include but are not limited to, distributors, transporters, and dispensaries, and would include employees such as managers, plant caretakers, budtenders, security guards, salespersons, and delivery persons.

DE 643 **Cannabis Industry Businesses** explains state employment payroll tax reporting as it applies to the cannabis industry.

FAQs - Cannabis Industry Payroll Tax Reporting provides online answers to frequently asked questions regarding state payroll compliance for the cannabis industry.

President/CEO Loses Credit for Income Tax Withholding

Solvis Staffing Services, Inc. (Solvis) employed R. Carr as its president/CEO from the early part of 2016, through February 14, 2017, when he resigned. Solvis was in the business of supplying temporary staffing

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to third-party employers. Mr. Carr's primary responsibilities were to grow the business, obtain workers' compensation insurance for Solvis's temporary workers, and pay unemployment and payroll taxes associated with Solvis's temporary workers.

For 2016 and 2017, Carr claimed state income tax refunds of $16,164 and $19,542 from withholding from Solvis. However, in processing the returns, FTB notified Carr that it could find no record of the withholding claimed on his returns. While Carr provided FTB with copies of Forms DE 9C Quarterly Wage and Withholding Reports, he never provided proof of payment of the withholding and FTB refused to process the requested refunds.

On appeal, OTA noted that in general, for rank-and-file employees, income tax withholdings can be substantiated by third-party employer reporting and/or payments made to the EDD. But when, as here, the taxpayer is the president/CEO of a company and/or otherwise in control of the company's payroll tax reporting and payment obligations, a further evidentiary showing is required to prove that actual withholding at the source occurred (***Appeal of R. Carr,*** OTA No. 19064927, March 29, 2022).

REAL ESTATE WITHHOLDING

Real estate withholding is a prepayment of income tax due from the selling of California land or anything on it (real property).

Examples of real property:

- Vacant land
- Buildings
- Homes

Withholding is required on sales or transfers of:

- Real property (including exchanges).
- Interest in land owned by someone else (Easements).

Exemptions

No withholding is required if the CA real property is:

- $100,000 or less
- In foreclosure
- Seller is a bank acting as a trustee

See **Form 593**, Part III for a complete list of full exemptions, and Part IV for full or partial exemptions. To file an exemption, submit **Form 593** to escrow agent before closing.

Common Errors Made on Form 593 – Real Estate Withholding Statement

If you are a remitter who submits real estate withholding forms and payments to the FTB, use these tips to ensure proper submission and to avoid errors that could result in the assessment of penalties and interest.

Issue	Resolution
Forms with incorrect tax year are submitted	Submit the form for the tax year the sales transaction took place. For example, if the transaction occurred on October 1, 2021, submit the 2021 Form 593.
Modifications are made to the form	Do not modify forms
Incorrect or obsolete forms are submitted	As of 2020, do not submit: Form 593-C, Real Estate Withholding Certificate Form 593-E, Real Estate Withholding - Computation of Estimated Gain or Loss From 593-I, Real Estate Withholding Installment Sale Acknowledgment
The Amended box is checked in error	Review the form thoroughly to ensure this box is not improperly checked.
The Perjury Statement isn't complete	Seller must complete the Perjury Statement, when applicable
The form is not signed	Seller must always sign the form. Buyer must sign only when the transaction is an installment sale.
Part VII of form isn't complete	Ensure all applicable parts are complete.
Line 36 (Amount Withheld from Seller/Transferor) isn't complete	Ensure all applicable parts are complete

Withholding Requirement for §1031 **Exchange Accommodators Modified**

A qualified intermediary (QI) must withhold and remit state tax when either of the following occur:

- The transferor receives "boot" in excess of $1,500, including cash, excess debt relief, or non- like-kind property from the sale. The QI must withhold 3 1/3 percent (.0333) of the boot. If an election is made to use the alternative withholding calculation method (completed on Form 593) then the QI must withhold the amount determined through the election.
- The exchange fails, does not occur, or does not meet the IRC §1031 requirements, regardless of the transferor's certification that the transaction is a like-kind exchange, unless another exemption applies. If the exchange fails and no other exemptions applies, the QI must withhold 3 1/3 percent (.0333) of the sales price unless an election is made to use the alternative withholding calculation method.

Under current state law, the QI must remit the full withholding amount even if the QI does not receive sufficient funds from escrow. Otherwise, the QI may be subject to a penalty for failure to remit the full amount of withholding, discussed below.

AB 1582 (R&T Comm., Stats. 2021, Ch. 66) amends the real estate withholding provisions by limiting a QI's withholding obligation to available funds in those situations where the QI does not receive sufficient funds from escrow or the QI disbursed funds for the purpose of completing an exchange under IRC section 1031.

The FTB has been authorized to prescribe regulations to implement this change, including clarifying when a disbursement is for the purpose of completing an IRC section 1031 exchange.

SALES AND USE TAXES

SMALL BUSINESS HIRING CREDIT CAN BE APPLIED TO SALE TAX

In AB 150 (Budget, Stats. 2021, Ch. 82) the Small Business Hiring Credit (Main Street Small Business Tax Credit II) against California sales tax was expanded as part of the 2021 – 2022 budget package.

Applying the Credit

The small business hiring tax credit is not refundable and is usable against either:

- personal income or corporate income in the 2021 tax year; or
- sales and use taxes between January 1, 2022 and April 30, 2027.

Election to Apply Credit Against Sales and Use Taxes is Irrevocable

A qualified small business employer with an active seller's permit or active certificate of registration may make an irrevocable election to apply the credit against qualified sales and use taxes in lieu of claiming the credit against personal or corporate income taxes. The election cannot be amended by the employer or converted entity.

A qualified small business employer that has received a tentative credit reservation for the small business hiring tax credit and that made an irrevocable election to apply the credit against qualified sales and use taxes imposed on the employer is allowed to apply the credit as follows:

- for monthly filers, the credit will apply to amounts due and payable for the month of March 2022, and due on April 30, 2022;
- for quarterly filers, the credit will apply to amounts due and payable for the quarter that starts on January 1, 2022, ends on March 31, 2022, and is due on April 30, 2022, including required prepayments for the quarter; and
- for annual filers, fiscal year filers, or a qualified small business employer or converted entity on any other reporting basis, the credit will apply to amounts due and payable on the first return due on or after April 30, 2022.

NEW COLLECTION REQUIREMENTS DUE TO THE WAYFAIR DECISION

In 2019, California passed AB 147 (Burke, Stats. 2019, Ch. 5). AB 147 amended R&TC §6203 to require retailers located outside of California (remote sellers, including foreign sellers located outside of the United States) to register with the California Department of Tax and Fee Administration (CDTFA) and collect California use tax if, during the preceding or current calendar year, the total combined sales of tangible personal property for delivery in California by the retailer and all persons related to the retailer exceed $500,000.

> ***Important Note:*** In general, the requirements to register and collect California use tax prior to AB 147 remain in effect. That is, retailers with a physical presence in California are still generally required to be registered with the CDTFA. Examples of a physical presence in this state include, but are not limited to:

- Maintaining inventory or office locations in California.
- Having representatives in California for purposes of taking orders, making sales or deliveries, or installing or assembling tangible personal property.
- Leasing equipment, including a computer server in California.

AB 147 also amended R&TC §7262 to require all retailers, whether located inside or outside of California, to collect district use tax on all sales made for delivery in any district that imposes a district tax if, during

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the preceding or current calendar year, the total combined sales of tangible personal property in California or for delivery in California by the retailer and all persons related to the retailer exceed $500,000. This new collection requirement is operative April 25, 2019.

What Started All This? The US Supreme Court Decision in *South Dakota v. Wayfair Inc.*

South Dakota, like many states, taxes the retail sales of goods and services in the State. Sellers are required to collect and remit the tax to the State, but if they do not then in-state consumers are responsible for paying a use tax at the same rate. Under ***National Bellas Hess, Inc. v. Department of Revenue of Ill***., (386 U. S. 753), and ***Quill Corp. v. North Dakota***, (504 U. S. 298), states may not require a business that has no physical presence in the State to collect its sales tax.

South Dakota Responds to Low Compliance Rates

Consumer compliance rates are notoriously low, and it is estimated that ***Bellas Hess*** and ***Quill*** cause South Dakota to lose between $48 and $58 million annually. Concerned about the erosion of its sales tax base and corresponding loss of critical funding for state and local services, the South Dakota Legislature enacted a law requiring out-of-state sellers to collect and remit sales tax "as if the seller had a physical presence in the State." The Act covers only sellers that, on an annual basis, deliver more than $100,000 of goods or services into the State or engage in 200 or more separate transactions for the delivery of goods or services into the State.

Top Online Retailers Rebel

Several top online retailers with no employees or real estate in South Dakota, who each met the Act's minimum sales or transactions requirement, did not collect the State's sales tax. South Dakota filed suit in state court, seeking a declaration that the Act's requirements are valid and applicable to those retailers and an injunction requiring them to register for licenses to collect and remit the sales tax. The retailers sought summary judgment, arguing that the Act is unconstitutional. The trial court granted their motion. The State Supreme Court affirmed on the ground that ***Quill*** is controlling precedent.

US Supreme Court Overturns the State Courts

In a 5-4 split, the US Supreme Court held that the physical presence rule of ***Quill*** is unsound and incorrect, and that both ***Quill*** and ***Bellas Hess*** are outdated methods of determining nexus. In their absence, the Court ruled that South Dakota's statute establishes sufficient nexus. The Act applies only to sellers who engage in a significant quantity of business in the State, and respondents are large, national companies that undoubtedly maintain an extensive virtual presence (***South Dakota v. Wayfair, Inc., et al***, US No. 17-494, Jun 21, 2018).

More Legislation Regarding Marketplace Facilitators

Beginning October 1, 2019, more new California law generally provides that a marketplace facilitator is responsible for collecting and paying the tax on retail sales made through their marketplace for delivery to California customers. A marketplace includes a physical or online place where marketplace sellers sell or offer for sale tangible merchandise for delivery in California. A marketplace facilitator is generally the operator of the marketplace. This new law is referred to as the **Marketplace Facilitator Act**, added by AB 147 and amended by SB 92 (Budget, Stats. 2019, Ch. 34).

The following are the general definitions for terms used in the Marketplace Facilitator Act:

Marketplace: a physical or electronic place where a marketplace seller sells or offers for sale tangible merchandise for delivery in this state.

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Marketplace facilitator: in general, a person who contracts with marketplace sellers to facilitate the sale of the marketplace sellers' products through a marketplace operated by the person or a related person when other statutory requirements are met.

Marketplace seller: a person who has an agreement with a marketplace facilitator and makes retail sales of tangible merchandise through a marketplace owned, operated, or controlled by a marketplace facilitator.

Delivery network company: a business entity that maintains an internet website or mobile application used to facilitate delivery services for the sale of local products to customers within a 75 mile range from the local merchant. A delivery network company, as defined in the Marketplace Facilitator Act, is not a marketplace facilitator unless it elects to be a marketplace facilitator.

General Registration Requirements

A person, including a marketplace facilitator or a marketplace seller that is actively engaged in selling tangible personal property in this state is required to register with the CDTFA for a seller's permit. Additionally, a person who is engaged in business in this state under R&TC §6203 because they have a sufficient physical presence in California or economic nexus with California is required to register with the CDTFA for a Certificate of Registration B Use Tax, collect use tax from their purchasers, and file regular sales and use tax returns.

Marketplace Facilitators' Requirements

Beginning October 1, 2019, a marketplace facilitator is considered the seller and retailer for each sale facilitated through its marketplace, for example, an Internet shopping website, to determine whether the marketplace facilitator is required to register with the CDTFA for a seller's permit or Certificate of Registration B Use Tax.

Marketplace Sellers' Requirements

If you are a marketplace seller, beginning October 1, 2019, you will no longer be considered the retailer of your sales of tangible merchandise facilitated through a marketplace, as defined by statute, provided the marketplace facilitator is registered or required to be registered for a seller's permit or Certificate of Registration B Use Tax.

Regulations Issued Under Marketplace Facilitators Act

In June 2020, CDTFA adopted Reg. 1684.5, a sales and use tax regulation that implements the Marketplace Facilitator Act. The regulation, for marketplace facilitators and marketplace sellers:

- clarifies registration requirements with the California Department of Tax and Fee Administration for a seller's permit or Certificate of Registration-Use Tax; and
- between marketplace facilitators and marketplace sellers, identifies the retailer responsible for paying sales tax or collecting and remitting use tax on marketplace sales.

Marketplace Facilitators Required to Collect Certain Fees

AB 1402 (Levine, Stats. 2021, Ch. 421) extends the requirements of a marketplace facilitator relating to registration pursuant to the Sales and Use Tax Law to a law that imposes a fee administered pursuant to the Fee Collection Procedures Law. The bill treats a marketplace facilitator that is registered or required to register with the department under the Fee Collection Procedures Law, and who facilitates a retail sale of tangible personal property by a marketplace seller, as the retailer or dealer or both for purposes of collecting

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and remitting fees imposed upon the consumer in relation to that retail sale. The bill would further require a marketplace seller to register with the department for purposes of taxes or fees administered pursuant to the Fee Collection Procedures Law for sales made on its own behalf and not facilitated by a registered marketplace facilitator.

Sales Tax Economic Nexus following the *Wayfair* Decision

In addition to California, many other states have now passed legislation adopting a similar statute. Below, to help you advise your California businesses selling online, is a chart of those states.

State Sales Tax Economic Nexus Chart			
State	**Economic Nexus**	**State**	**Economic Nexus**
Alabama	$250,000	Mississippi	$250,000
Alaska (city of Nome)	$100,000!	Nebraska	$100,000*
Arizona	$150,000 (2019)	Nevada	$100,000*
Arkansas	$100,000*	New Jersey	$100,000*
California	$500,000	New Mexico	$100,000
Colorado	$100,000	New York	$500,000!
Connecticut	$100,000#	North Carolina	$100,000*
District of Columbia	$100,000*	North Dakota	$100,000
Florida	$100,000*	Ohio	$100,000*
Georgia	$100,000*	Oklahoma	$100,000
Hawaii	$100,000*	Pennsylvania	$100,000
Idaho	$100,000	Rhode Island	$100,000*
Illinois	$100,000*	South Carolina	$100,000
Indiana	$100,000*	South Dakota	$100,000*
Iowa	$100,000*	Tennessee	$500,000
Kansas	no thresholds	Texas	$500,000
Kentucky	$100,000*	Utah	$100,000*
Louisiana (by 7/1/20)	$100,000*	Vermont	$100,000*
Maine	$100,000*	Virginia	$100,000*
Maryland	$100,000*	Washington	$100,000*
Massachusetts	$100,000	West Virginia	$100,000*
Michigan	$100,000*	Wisconsin	$100,000*
Minnesota	$100,000*	Wyoming	$100,000*

** State economic nexus if sales meet or exceed dollar threshold or 200 separate transactions.*
! State economic nexus if sales meet or exceed dollar threshold and 100 transactions.
 # State economic nexus if sales meet or exceed dollar threshold and 200 separate transactions.

TAXPAYERS MUST CERTIFY ZERO REPORTING ON INCOME TAX RETURN

The California Department of Tax & Fee Administration (CDTFA) is responsible for collecting sales and use tax. California use tax is imposed on any person who purchases tangible personal property for use,

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consumption, or storage in this state where the purchase is not subject to California sales tax. Generally, use tax is owed when the purchase is made outside of California, and the property is used in California. A typical purchase subject to California use tax is a purchase shipped from an out-of-state retailer to a California consumer. The use tax rate is the same as the sales tax rate that varies depending on the county and city within California in which the taxpayer resides.

Taxpayers may report and pay use tax directly to the CDTFA or report and pay use tax on their California income tax return.

Individual taxpayers that have made one or more single non-business purchases of individual items of tangible personal property, each with a sales price of less than $1,000, can report the use tax liability by using a use tax table shown in the instructions for the individual tax return or they can report the actual use tax due. In addition, utilization of the use tax table precludes the CDTFA from making any determinations for understatements of use tax against any person with qualified purchases who utilizes the use tax table in accordance with the accompanying instructions.

Payments Applied to Use Tax First

The amount of payments or credits reported on an income tax return of a person who reports use tax, is applied first to the use tax liability reported on the tax return and then to the income taxes, penalties, or interest.

When Reporting Zero, Taxpayer Must Certify

AB 1593 (Ridley-Thomas, Stats. 2017, Ch. 563) makes changes to income tax returns and instructions beginning Jan. 1, 2018, to require:

- That a taxpayer enter a number on the use tax line of personal income tax (PIT) returns.
- That a taxpayer who entered a zero on the use tax line check one of two boxes to validate that the taxpayer has either remitted the use tax due for the taxable year to the CDTFA or that the taxpayer owes no use tax.

“Acceptable Tax Return” Means Original Return

AB 1717 (R&TC Comm., Stats. 2017, Ch. 175) defines an acceptable tax return to mean an original return, clarifying that use tax can be reported on an original return regardless of the date the original return is filed.

CANNABIS INDUSTRY

Growing and selling cannabis is illegal under federal law. Cannabis remains classified as a Schedule I substance under the Controlled Substances Act. California was the first state to establish a medical marijuana program, enacted by Proposition 215 in 1996 and Senate Bill 420 in 2003. Prop. 215 (also known as the Compassionate Use Act) was approved by initiative with a 55% majority, allowing people with cancer, AIDS, and other chronic illnesses the right to grow or obtain marijuana for medical purposes when recommended by a doctor. SB 420, or the Medical Marijuana Protection Act, was signed into law by Governor Gray Davis and established an identification card system for medical marijuana patients.

In November 2016, the people of the state of California passed Proposition 64, Adult Use of Marijuana Act. Under the new law, adults 21 and over may purchase, possess, and consume up to 1 oz. of marijuana in their private residence or in an establishment licensed for marijuana consumption. Adults also will be

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allowed to grow up to six marijuana plants and keep the herb that is produced, as long as it is done in a secure space not visible to the public.

While most criminal sanctions for marijuana were lifted immediately after the general election, the regulation of businesses, production facilities, and marijuana consumption establishments will be phased in over time. Licenses are scheduled to be granted in January 2018.

Bureau of Cannabis Control

The Bureau of Cannabis Control is the lead agency in developing regulations for medical and adult-use cannabis in California. The Bureau is responsible for licensing retailers, distributors, testing labs, and micro-businesses.

Growers and Sellers of Cannabis Must Register and File Returns with the CDTFA

If a person sells cannabis, the law requires him or her to register with the CDTFA for a seller's permit. This includes growers and dispensaries. One can register for a seller's permit on CDTFA's website using its online registration system or in person at one of the Board of Equalization's (BOE's) field offices. There is no cost to obtain a seller's permit.

Once registered, sellers must also file sales and use tax returns and pay any tax due. If one does not file timely returns, he or she may be subject to penalties and interest. Sales and use tax returns are filed using CDTFA's online filing services.

Even if all cannabis sales are nontaxable (for instance, sales for resale), returns must still be filed.

Certain Sales of Medical Marijuana Are Exempt from Sales and Use Tax

Retail sales of medicinal cannabis to persons who have a valid Medical Marijuana Identification Card (MMIC) issued by the California Department of Public Health (CDPH) and a valid government-issued identification card (ID) are exempt from sales and use tax.

To obtain the sales and use tax exemption, qualified patients or their primary caregivers must show their valid MMIC and valid ID to the retailer at the time of purchase. The card must be issued by the CDPH; other marijuana or cannabis cards or recommendations from physicians are not sufficient to qualify for the sales and use tax exemption.

To claim exempt sales, a seller must maintain specific information for his or her records. For information on recordkeeping requirements, see CDTFA's online Tax Guide for Cannabis Businesses.

Cannabis Taxes Effective Jan. 1, 2018

Under the provisions of Proposition 64, distributors of cannabis and cannabis products must also register with the CDTFA for a cannabis tax permit to report and pay the two new cannabis taxes to the CDTFA. The cannabis tax permit is in addition to a seller's permit.

Beginning Jan. 1, 2018, two new cannabis taxes are in effect:

- A 15% excise tax is imposed upon purchasers of cannabis and cannabis products. Retailers are required to collect the excise tax from the purchaser and pay it to the cannabis distributor.
- A tax on the cultivation of cannabis that enters the commercial market is imposed upon cultivators. Cultivators are required to pay the cultivation tax to either a distributor or a manufacturer depending upon the nature of the transaction. The 2022 cultivation tax rates are:

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- $10.08 per dry-weight ounce of cannabis flowers, and
- $3.00 per dry-weight ounce of cannabis leaves.
- $1.41 per ounce fresh cannabis plant All cannabis businesses making sales are required to:
  - Register online with the CDTFA for a seller's permit.
  - File sales and use tax returns electronically and pay any sales and use tax to the CDTFA. Even if none of the sales are subject to sales tax, you are still required to file a return and report your activities on your return to the CDTFA.

Certain Streamlined Procedures Apply to Collection and Remittance of Cannabis Taxes

SB 94 (Budget, Stats. 2017, Ch. 27) amended several provisions in the cannabis tax law as enacted by Proposition 64. SB 94 provides that:

- Distributors must collect the cannabis excise tax from retailers and the cultivation tax from cultivators or manufacturers.
- Distributors must report and pay the cannabis excise tax and the cultivation tax to the CDTFA.

Marijuana Dispensaries Are Allowed to Remit Taxes Other than by EFT

AB 1741 (Bonta, Stats. 2018, Ch. 228) extends to recreational cannabis dispensaries the provisions AB 821 (Gipson, Stats. 2016, Ch 811) allows marijuana dispensaries to remit sales and use taxes by means other than an EFT until Jan. 1, 2022.

Under existing law, California's sales tax is paid by retailers engaged in business in the state and applies to all retail transactions involving sales of tangible personal property except those the law specifically exempts or excludes. Retail sales of marijuana are subject to the tax to the same extent as any other retail sale of tangible personal property in this state.

Taxpayers with monthly tax liabilities that average $10,000 or more must remit their tax payments via an EFT under BOE-prescribed procedures. Failure to remit the funds under those procedures subjects taxpayers to specified penalties.

The new legislation is designed to encourage compliance in the cannabis industry by enabling dispensaries to pay their tax liability using cash without incurring a mandatory penalty.

For more information on requirements for California's Cannabis Industry, see the CDTFA's Tax Guide for Cannabis Businesses.

New! Cannabis Budget Trailer Bill Amends Several Provisions

AB 195 (Budget, Stats. 2022, Ch. 55) made several changes to sales and use tax and excise taxes for the Cannabis industry. Chiefly, the bill:

- suspends the California cannabis cultivation tax, maintains a 15% cannabis excise tax until June 30, 2025, and moves the collection of the excise tax from the distributor to the point-of-sale;
- codifies a sales and use tax exemption for medicinal cannabis or cannabis products sold at retail to qualified patients or their primary caregivers provided proper identification is provided to the retailer at the time of purchase;

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- requires, by July 1, 2025, the California Department of Tax and Fee Administration (CDTFA) to adjust the excise tax every two years by a rate, not to exceed 19%, that would generate an amount of revenue equivalent to what would have been collected from the cultivation tax;
- allows equity retailers who have received an equity fee waiver from the Department of Cannabis Control to retain 20% of the excise tax they collect; and
- authorizes the CDTFA to revoke an operator's tax permit if the operator fails to comply with the cannabis tax provisions, and makes illicit cannabis operators liable for the cultivation and excise tax they would have had to pay if they were operating in the legal market

The bill also provided a number of new enforcement procedures.

CDTFA Publishes Cannabis Special Notice

In response to the many changes contained in AB 195, in September, **2022** the CDTFA published a Special Notice online to remind cannabis distributors and retailers of new responsibilities effective January 1, 2023.

TAX REBATES AND CREDITS FOR PLUG-IN ELECTRIC VEHICLES

The Clean Vehicle Rebate Project (CVRP) California created by AB 118 (Nunez, Stats. 2007, Ch. 750) established rebates available for the purchase or lease of a qualified plug-in electric vehicle as of Mar. 15, 2010. Purchasers of these vehicles may also be eligible for a federal tax incentive through the American Recovery and Reinvestment Act. Rebates are available up to $5,000 for zero-emission light-duty vehicles and plug-in hybrid vehicles and up to $20,000 for zero-emission commercial vehicles. However, none of these rebate credits reduce the amount on which sales or use tax is due.

> ***Example:*** The retail selling price of a zero-emission commercial vehicle is $45,000 and the sale qualifies for a $15,000 rebate. The sales or use tax due would be computed on the $45,000 retail selling price.

Waitlist for Applications Started and Ended in 2021

Funding for the CVRP program was exhausted for standard and increased rebates. Effective April 23, 2021 a waitlist went into effect. Additional funding was approved and the waitlist ended as of September 15, 2021 For more information about the CVRP, visit the Clean Vehicle Rebate Project.

New! Sales and Use Tax Exemption for Designated Plug-In Hybrid or Zero-Emission Vehicles

SB 1382 (Gonzalez, Stats. 2022, Ch. 375) provides, effective January 1, 2023 until January 1, 2028, an exemption from sales and use taxes with respect to the sale in this state of, and the storage, use, or other consumption in this state of, a qualified plug-in hybrid or zero-emission vehicle. The bill provides that this exemption does not apply to specified state sales and use taxes from which the proceeds are deposited into the Local Revenue Fund, the Local Revenue Fund 2011, or the Local Public Safety Fund.

SALES TAX CASES AND RULINGS

Lumber Products Assessment Not Applicable to Non-Taxable Sales

California imposes the Lumber Products Assessment (LPA) on a person who purchases a lumber product or an engineered wood product for storage, use, or other consumption in California measured by the sales price of the product. A retailer is required to collect the LPA from the purchaser. The LPA is reported with

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the Sales and Use Tax Return (SUTR) and the pertinent terms have the same meaning as those same terms are defined under the Sales and Use Tax Law. A retailer includes every seller who makes any retail sale or sales of tangible personal property. A retail sale includes a sale for any purpose other than resale in the regular course of business in the form of tangible personal property.

Natural Wood Products, Inc. established that it sold products to customers who claimed tax-paid purchases that were resold. These were nontaxable sales for the taxpayer and therefore not subject to the LPA (***Appeal of Natural Wood Products, Inc.,*** OTA No. 18011952, April, 2021).

Mandatory Gratuities Subject to Sales Tax

D Griffith owns and operates Griff's BBQ & Grill in Copperopolis, CA. The menu included a statement that a gratuity of 18 percent would be added for parties of eight or more. CDTFA concluded that the recorded "Auto Gratuity" amounts, which totaled $40,669 for the audit period, represented mandatory gratuities that were subject to tax.

On appeal, Mr. Griffith contended that employees and servers have the option to charge a different gratuity and, in fact, did so. 44 transactions had a non18 percent gratuity that an employee or server apparently added prior to presenting the guest check to a customer. These gratuities are presumed to be mandatory per Regulation §1603(g)(2)(B) ("[A]ny amount added by the retailer is presumed to be mandatory.") With respect to these 44 transactions, Mr. Griffith did not provided evidence of any of the following:

1. an employee or server first conferred with the customer after service of the meal and received approval to add the tip;

2. an employee or server provided the customer with the option to write in the tip; or

3. customers specifically requested and authorized adding the non18 percent gratuity to the amount billed in these 44 transactions.

Accordingly, absent evidence to the contrary, OTA found that the gratuities in these 44 transactions are mandatory and are therefore taxable (***Appeal of D. Griffith,*** OTA No. 19125549, April, 2021).

Insufficient Proof That Vessel Kept Out of State for Sales Tax Exclusion

On June 20, 2002, R. Battistoni purchased a Hatteras 46-foot sport fishing vessel (the vessel) for $125,000. The sale was completed when the seller delivered the vessel to him in the Pacific Ocean outside of California territorial waters. Between June 20, 2002, and September 17, 2002, Mr. Battistoni used the vessel both within and outside of California territorial waters, including several overnight fishing excursions to the area outside of California's territorial waters. On September 17, 2002, he and some friends took the vessel outside of California territorial waters for fishing, following which the vessel traveled to Ensenada, Mexico. Battistoni arranged to rent a slip for the vessel beginning on September 20, 2002, for approximately $360 per month. The slip was located at Ensenada Cruiseport Village in Ensenada, Mexico (the Mexico marina). Nevertheless, OTA found that Mr. Battistoni did not provide sufficient proof to show that the vessel was used, stored, or both outside of California for half or more of the test period. Therefore, sales tax was owed. (***Appeal of R. Battistoni***, OTA No. 20035913, May, 2021).

CDTFA TAXPAYERS' RIGHTS ADVOCATE

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"MANSION TAX" TAKES EFFECT APRIL 1, 2023, IN LOS ANGELES

The midterm elections weren't only about the control of the House of Representatives and the Senate. In the City of Los Angeles, homelessness was on the ballot. Overcome with the growing numbers of people living on the streets, Los Angeles City voters backed a measure to fund affordable housing and tenant assistance programs. The new programs will be funded through an additional one-time tax on sales and transfers of real property exceeding certain thresholds.

Starting April 1, 2023, the tax rate on such sales and transfers will be:

- 4% of the consideration or value when the property transferred exceeds $5 million but is less than $10 million, and
- 5.5% when the property transferred is $10 million or more.

> **Example**. A $5 million sale would be subject to a $200,000 city tax, and a $10 million sale would be subject to a $550,000 city tax.

Homelessness and Housing Solutions Tax. The Homelessness and Housing Solutions Tax, although commonly referred to as the "mansion tax", is not limited to single family homes. The sale of multifamily properties and commercial buildings will be subject to the tax. And it is not just sales, but also the value of property disposed of in a tax deferred exchange that would be subject to the tax.

Long story short – the so-called mansion tax will drive a dramatic increase in the transfer taxes applicable to both residential and commercial property sales in the city of Los Angeles. That said, what related effects might the new tax have?

Keep in mind the following:

- Sellers will be incentivized to sell such property before April 1 to avoid the city tax.
- Inventory of high-end properties will likely climb, perhaps resulting in a buyer's market. After the effective date, sellers will net the same if they sell for $5.2 million or $4,999,000.
- Developers are going to look for other luxury communities to avoid a tax that could cost the developer a big chunk of their profit.
- And, most critically, what other cities in California will fund their efforts to address homelessness and affordable housing with a similar city (or county) tax?

Documentary Transfer v. Mansion Tax. It is important to note that the new tax would be on top of the existing documentary transfer tax imposed on property sales in the city of Los Angeles, which is at a combined city and county rate of 0.56%. And while the current documentary transfer tax is calculated by excluding the value or liens or encumbrances on the property at the time of sale, the new mansion tax appears to be imposed on the gross value of the property, which would include the value of such liens and encumbrances. And although certain exceptions do apply to the new tax, what remains unclear at this time, however, is whether the separate exceptions under the California state transfer tax statute regarding foreclosures, for example, would be applicable to the new tax.

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Although uncertainties on the new tax remain, we are likely to see applicable rules clarifying or perhaps even limiting the tax in the near future. Under Measure ULA, the ordinance containing the tax, the "Director of Finance is authorized and empowered, consistent with applicable law and the purposes of this article, to issue any rules and regulations reasonably necessary to enforce and administer this article, including but not limited to regulations further defining the term "realty sold" in Section 21.9.2 of this article and establishing procedures for administering exemptions to the tax imposed under this article."

DISABLED VETERANS' EXEMPTION INCREASES FOR 2022

R&TC §205.5, subdivisions (g) and (h) provide that the exemption amounts and the household income limit for the disabled veterans' exemption shall be compounded annually by an inflation factor.

Applying this factor, the 2022 exemption amounts are $149,993/$224,991. The 2022 household income limit is $67,355.

Definition of Veteran Revised

SB 1458 (Bates, Stats. 2016, Ch. 871) expands disabled veterans' exemption eligibility by changing the requirement that a veteran's character of discharge from military service be under "honorable" conditions to a lower threshold of under "other than dishonorable" conditions. The bill also extends the use of roll corrections to process disabled veteran-related refunds to eight years.

OTHER PROPERTY TAX ITEMS

Relief for Taxpayers Affected by Fires and Erosion

If your property has been damaged by the recent fires, and erosion, you may be eligible for property tax relief. In many cases, the damaged property can be reappraised in its current condition, with some taxes refunded to the property owner. Once rebuilt, the property's pre-damaged value will be restored.

To qualify for property tax relief, you must file a claim with your county assessors' office within 12 months from the date of damage or destruction. The loss estimate must be at least $10,000 of current market value to qualify.

Owners of eligible property may also apply for deferral of the next property tax installment on the regular secured roll or tax payments on the supplemental roll, without penalties or interest. The disaster must be the result of a Governor-proclaimed state of emergency. When a timely claim for deferral is filed, the next property tax installment payment is deferred without penalty or interest until the county assessor has reassessed the property and a corrected tax bill has been sent to the property owner.

For further information on property tax disaster relief, please see BOE's Disaster Relief web page with helpful information including Frequently Asked Questions (FAQs).

Base Year Value Transfers for Governor Proclaimed Disaster

Existing law allows three different types of base year value transfers for property owners whose real property was substantially damaged or destroyed by a disaster for which the Governor proclaimed a state of emergency. Each of these provisions was enacted by Constitutional amendment and implemented by statute.

R&TC §69 (Proposition 50).

R&TC §69 allows an owner of real property, whose property had been substantially damaged or destroyed in a disaster, to transfer the base year value of the damaged property to a comparable replacement

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property acquired or newly constructed in the same county (intracounty). This base year value transfer is available for any type of real property, as long as the damaged property and the replacement property are of the same property type.

R&TC §69.3 (Proposition 171).

R&TC §69.3 allows a homeowner whose principal place of residence is damaged or destroyed in a disaster to transfer the base year value of the pre-damaged residence to a replacement property acquired or constructed in another county (intercounty).

Article XIII A, §2.1 of the California Constitution (Proposition 19).

Operative as of April 1, 2021, §2.1(b) of article XIII A allows an owner of a primary residence who is a victim of a wildfire or natural disaster to transfer the taxable value of their primary residence (original primary residence) to a replacement primary residence that is purchased or newly constructed as that person's principal residence within two years of the sale of the original primary residence, regardless of the location or value.

2020 CALIFORNIA BALLOT PROPOSITION 19

Passed in November 2020, Proposition 19 allows homeowners who are over 55, disabled, or wildfire/disaster victims to transfer primary residence's tax base to replacement residence. The proposition also made changes to the taxation of family-property transfers and establishes a fire protection services fund.

Prior law for over age 55, disabled or victim of disaster.

In some cases, special rules allow existing homeowners to move to a different home without paying higher property taxes. These special rules apply to homeowners who are over 55 or severely disabled or whose property has been impacted by a natural disaster or contamination. We refer to these people as "eligible homeowners." An eligible homeowner can move within the same county and keep paying the same amount of property taxes if their new home is not more expensive than their existing home. Also, certain counties allow these rules to apply when an eligible homeowner moves to their county from another county. Homeowners who are over 55 or severely disabled generally can use these special rules only once in their lifetime. This limit does apply to properties impacted by a natural disaster or contamination.

Prior law for inherited properties.

Special rules also allow properties to pass between parents and children without an increase in the property tax bill. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. We call properties passed between parents and children or grandparents and grandchildren "inherited property." The rules apply to a parent's or grandparent's home and a limited amount of other types of property, up to $1 million.

Provisions of Proposition 19.

The measure makes changes to the special rules for eligible homeowners and inherited properties.

- **Expanded Special Rules for Eligible Homeowners**. Starting April 1, 2021, the measure expands the special rules for eligible homeowners. Specifically, the measure:
- **Allows Moves Anywhere in the State**. Eligible homeowners could keep their lower property tax bill when moving to another home anywhere in the state.

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- **Allows the Purchase of a More Expensive Home**. Eligible homeowners could use the special rules to move to a more expensive home. Their property tax bill would still go up but not by as much as it would be for other homebuyers.
- **Increases Number of Times a Homeowner Can Use the Special Rules**. Homeowners who are over 55 or severely disabled could use the special rules three times in their lifetime.
- **Narrows the Special Rules for Inherited Properties**. Starting February 16, 2021, the measure narrows the special rules for inherited properties. Specifically, the measure:
- **Ends Special Rules for Properties Not Used as a Home or for Farming**. The special rules would apply only to two kinds of inherited property. First, the rules would apply to properties used as a primary home by the child or grandchild. Second, the rules would apply to farms. Properties used for other purposes could no longer use the special rules.
- **Requires Tax Bill to Go Up for High Value Inherited Homes and Farms**. The property tax bill for an inherited home or farm would go up if the price the property could be sold for exceeds the property's taxable value by more than $1 million (adjusted for inflation every two years). In this case, the tax bill would go up but not as much as it would if the property were sold to someone else.

Board of Equalization Issues Guidance

On February 16, 2021, the Board of Equalization issued a letter to county assessors with a series of Questions and Answers regarding inter-generational transfers under Proposition 19. In addition, it has posted FAQs regarding Proposition 19 to its website.

New! **Provisions Enacted to Ease Implementation of Proposition 19**

SB 539 (Hartzberg, Stats. 2021, Ch. 427) add two new sections to California property tax law to assist in the implementation of Proposition 19. Among other provisions, the two new R&TC sections:

- clarify that escape assessments will not be issued after a subsequent eligible transferee no longer qualifies for the exemption;
- provide that each legal parcel that makes up a family farm is deemed by itself to be a family farm, except for a legal parcel containing a family home, which may qualify separately for the exclusion;
- clarify that the limit of three on the number of base year value transfers does not apply to claimants who are victims of a wildfire or natural disaster;
- state that in cases where the original property has been substantially damaged or destroyed by wildfire or natural disaster and the owner does not rebuild on the original property, the taxable value will be determined as of the date immediately prior to the wildfire or natural disaster;
- delete the requirement that each property tax bill envelope sent to a taxpayer to include an electronic address in no less than 12-point type to the county assessor's website to file a claim for a Proposition 19 base year value transfer; and
- make technical and conforming changes.

BOARD OF EQUALIZATION TAXPAYERS' RIGHTS ADVOCATE

Lisa Thompson is the current BOE Taxpayers' Rights Advocate. Contact her at:

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