



California Tax Update

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Propositions

Proposition 55 extends for an additional 12 years the “temporary” 1% to 3% surtax imposed on incomes above \$250,000 that voters approved when they passed Proposition 30 in 2012.

Proposition 64 legalizes recreational marijuana for use by adults age 21 or older. In addition:

- Excise taxes of 15% will be imposed on retail sales of recreational marijuana, as well as state cultivation taxes of \$9.25 per ounce of flowers and \$2.75 per ounce of leaves;
- The sale of cannabis for medical purposes is not subject to sales and use tax if the purchaser has a state card;
- Non-medical marijuana can only be sold by state-licensed businesses, and the state has until January 1, 2018, to begin issuing licenses for recreational retailers. So, for now, it is not legal to sell recreational marijuana; and
- The proposition also allows for the local regulation and taxation of marijuana, and allows for resentencing and expungement of records for prior marijuana convictions.

Proposition 67 implements SB 270 (Ch. 14-850), which prohibits grocery and other stores from providing customers with single-use plastic or paper carryout bags and requires these stores to charge at least 10 cents for any other carryout bag provided for customers at checkout.

Conformity

California conforms to:

- Porter Ranch gas leak relief payments;
- Repair regulations;
- IHSS payments; and
- The rollover of airline payments to an IRA from bankrupt airlines.

California does not conform to:

- The Olympic medal exclusion;
- Extenders – except IRA to charity; or
- The new HRA law – but this has a limited impact on California because the law generally only deals with the penalty.

Estimated tax due dates

California conforms to the federal estimated tax due dates. Due dates for LLC fee and tax are:

- For 2016, the final fee payment is due March 15;
- For 2017, the LLC annual tax (including SMLLCs) is due April 18, 2017;
- For 2017, the LLC estimated fee is due June 15, 2017; and
- For 2017, the final fee is due March 15, 2018 (the due date of the LLC return).

MyFTB Update

Reset your MyFTB password

You must renew every 12 months. The FTB will send reminder e-mail. After 12 months, you will be forced to reset your password the next time you log in.

Renew MyFTB clients

You must renew MyFTB clients every 13 months.

- Click the Renew button in Client List;
- You must confirm that you have authorization to access the client's information; and
- A notice will pop up informing you that another 10-business-day letter will be mailed to the client.

The screenshot shows the MyFTB Client List interface. At the top, there is a navigation bar with links for Home, Client Notices, Services, and Profile. The main content area is titled "Client List" and includes a "New" section about the Easy Client Renew option. Below this, there are buttons for "Add Individual Client", "Add Business Client", and "File a Power of Attorney". A "Client List Options" section allows filtering by "Client Type" (Individual, Business, Estate/Trust) and "Client Access" (Access Type: All). A "Search" button is also present. The search results show a table of individual clients, with one client named Jane Doe highlighted. A red arrow points to the "Individual" radio button in the "Client Type" section, and another red arrow points to the "Doe" link in the "Last Name" column of the search results table.

Client List Options

Client Type: Individual Business Estate/Trust

Client Access:

Access Type:

Search Results - Individual Clients

Clear Filter

Last Name	First Name	SSN/ITIN	Expiration Date	Access Type	Status	Actions
Doe	Jane	0000		tax prepar		
Doe	Jane	XXX-XX-0000	07/21/2017	Tax Preparer	Active	Renew Remove

(1 of 1) 1 20

POA issues

There are four methods to register your POA:

- **Option 1:** Submit the POA via the POA wizard. The taxpayer will receive confirmation via their MyFTB account and will certify the POA is correct by responding via their MyFTB. The turnaround is 30 days, but there is no confirming letter.
- **Option 2:** Go through the POA wizard on MyFTB and upload a properly signed POA. The turnaround is 30 days, plus the time for the confirming letter.
- **Option 3:** File a paper POA with an exception to online filing. The turnaround time is 45 days, plus the time for the confirming letter. This option is not recommended by Spidell.
- **Option 4:** File a paper POA without an exception. The turnaround time is 90 days or more, plus time for the confirming letter. Do not use this option.

What to do while waiting for POA processing

While the POA is being processed, an FTB representative will help you if you have the notice and prior year tax return in front of you. You can:

- Stop/postpone a wage garnishment (**Note:** The taxpayer must ratify an installment agreement.);
- Get information on an assessment or NPA;
- Handle an audit while the POA is being processed; and
- Solve a filing enforcement issue:
 - Either have demand to file removed; or
 - Get information needed to file.

You may not:

- Finalize an installment agreement;
- Change the taxpayer's address or contact information; or
- File an online protest on behalf of a taxpayer.

Fraud issues

We have recently been informed that some taxpayers are receiving notices indicating that they have been added to a practitioner account that they did not authorize. If this happens to you, or your clients, immediately contact the FTB Tax Practitioner Hotline at (916) 845-7057 and request that they remove the taxpayer from the unauthorized account.

Last Year's Withholding Notices and Problems

Last year, the FTB increased the mailing of its Form 4734D, Request to Confirm Tax Return Filing, due to increased fraud. Also, the FTB's validation ability went a bit awry, resulting in many incorrect Notices of Tax Return Changes (NTRC).

In the past, if an employer failed to send one quarter of data — most commonly the fourth quarter — the FTB and the IRS system would estimate the withholding based on the information from the other three quarters. However, this year, if the employer sent the fourth quarter data late or if another quarter was missing, the system automatically sent a bill.

In response to Spidell's requests, this year the FTB has stated that they will:

- Institute an enterprise call center escalation for additional help;
- Modify their process to be similar to prior procedures (they may still disallow refunds); and
- Work with the EDD to improve the exchange of information.

Other interesting California updates

Swart

In a much anticipated decision, a California court of appeal upheld the lower court's ruling that an out-of-state corporation (Swart Enterprises, Inc.) whose only connection to California was its 0.2% ownership interest in a California investment fund LLC was not "doing business" in California. Therefore, the taxpayer was granted a refund of the \$800 annual tax, interest, and penalties. (*Swart Enterprises, Inc. v. California Franchise Tax Board* (January 12, 2016) California Court of Appeal, Fifth District, Case No. F070922)

The FTB has not yet announced whether they will appeal the decision.

- If the FTB appeals, you must file the 2016 return and file another protective claim; and
- If the FTB does not appeal, will need guidance as to whether to file and make another protective claim.

Spidell's California Taxletter® contains complete information on the court's ruling. Instructions on how to proceed will be addressed in the newsletter as soon as the information is available.

Muni bond interest case

Taxpayers have filed in Superior Court to overturn California's law that allows no municipal bond exclusion if the fund invests less than 50% in U.S. Government or California municipal bonds. (*Ronald D. and Pamela S. Mass* (July 20, 2016) Los Angeles Superior Court, Case No. BC627648)

Real estate dealers and LLC fee

In FTB Legal Ruling 2016-01, the FTB stated that, for purposes of the LLC fee, if property is held for investment purposes, the property's adjusted basis is not included in the taxpayer's gross income. However, if the property is sold in the taxpayer's ordinary course of business, the adjusted basis must be added back to the taxpayer's gross income for purposes of calculating the taxpayer's LLC fee.

Identity theft phone number

The FTB has set up a new hotline number to report identity theft. The new phone number is (916) 845-7088. The identity theft fax number remains the same for submission of identity theft correspondence and forms, such as Form FTB 3552, Identity Theft Affidavit. The fax number is (916) 843-0561.

Sale of nonresident's California partnership interest

Former long-term California residents became residents of Washington state just two months before receiving an initial payment on the \$40 million paid for the sale of the husband's California partnership interest. Because the sale of the husband's partnership interest was a sale of an intangible, it was sourced to their new state of residence and not taxable by California. (*Appeal of Bills* (April 28, 2016) Cal. St. Bd. of Equal., Case Nos. 610028, 782397)

Taxpayer returns to California too soon

The Board ruled that a taxpayer who left California and became a nonresident in 2006, but who returned on May 12, 2008, became a resident and then sold stock on May 16, 2008, resulting in a gain of more than \$6 million on the sale of stock taxable to California.

Taxpayer wins sale of residence gain audit

The State Board of Equalization recently allowed actor Rob Lowe and his wife, Sheryl Berkoff, to include millions of dollars of improvement costs in the basis of their home, even though the Lowes conceded they had no records to substantiate the costs. (*Appeal of Lowe and Berkoff* (August 25, 2015) Cal. St. Bd. of Equal., Case No. 571973)

Taxpayer loses bid to be removed from the Top 500 Tax Debtor list

Ernest Franceschi, a California attorney, was barred from bringing a privacy action in state court challenging the FTB's authority to include him on its Top 500 delinquent taxpayer list. (*Franceschi v. Franchise Tax Board* (July 8, 2016) California Court of Appeal, Second Appellate District, Case No. BS154331). He was also subject to the \$5,000 frivolous claim penalty under R&TC §19714.

IRC §1031 exchange reminders

Taxpayers who exchange California property for out-of-state property in an IRC §1031 exchange will be required to file an annual information return (or presumably a tax return) with the FTB each year until the deferred California gain is recognized and reported to California. The new law applies to exchanges of property that occur in taxable years beginning after 2013. This applies to property relinquished in 2014.

Use Form FTB 3840, California Like-Kind Exchanges. The form may be filed with the California return or by itself if there is no California filing requirement. If filed with the return, the form may be e-filed.

Top 5 FTB audit targets

1. **Capital gains and losses:** Audits check 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 passthrough entities;
 2. **Like kind exchanges:** Issues include erroneous boot calculations, improper property identifications, and failure to meet other deferral requirements;
 3. **Head of household filing status:** Common errors include the qualifying individual's income exceeding the gross income test, and taxpayers who do not meet the requirements to be considered unmarried or considered not an RDP;
 4. **Employee business expenses:** The FTB may ask taxpayers claiming unreimbursed employee business expenses to provide documentation to substantiate their employer's reimbursement policy to determine whether the expenses are allowable; and
 5. **Shareholder/partner/owner's basis in a passthrough entity:** Audits check the correct reporting of flow-through items and amounts reported on the sales of interests in passthrough entities.
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- Health insurance: Update for HRAs, 2% shareholders, and more – Friday, February 17
- FBAR: Filing Issues and Asking for Forgiveness – Friday, March 17
- Spidell's Quarterly Tax Update™ – Tuesday, April 25
- Regulatory Review: Practicing Within the Law – Wednesday, April 26
- Fundamentals of Fraud Prevention and Detection – Thursday, May 11
- Primer on International Business Taxation – Thursday, May 18
- SSARS Update – Wednesday, May 24
- 2017 4-Hour CPA Ethics – Wednesday, June 21
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- Solar Energy Credits
- California Taxation of New Residents and Nonresidents
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- IRAs: ROBS, UBI, and Other Complexities

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