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California Tax Update

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New conformity bill

AB 154 (Ch. 15-359) updates the IRC conformity date to January 1, 2015, for taxable years beginning on or after January 1, 2015. Among other changes, the bill does the following:

- Increases the additional tax on nonqualified withdrawals from medical savings accounts (MSAs) from 10% to 12.5%;
- Retains the 7.5% threshold for medical expense deductions for California;
- Creates exceptions to the large corporate understatement penalty;
- Conforms to Foreign Account Tax Compliance Act (FATCA) information reporting for foreign financial assets, with modified penalty amounts;
- Excludes cell phones from listed property;
- Conforms to ABLE accounts; and
- Conforms to IRC §6164, related to extension of time for payment of current year taxes by corporations expecting NOL carrybacks.

Major nonconformity

Although AB 154 was labeled "conformity legislation," California continues to not conform to major federal provisions, including these, some of which continue to be extended by Congress:

- Changed federal tax return due date for 2017;
- Bonus deprecation;
- Increased IRC §179 deduction;
- 15-year depreciation on qualified leasehold, retail, and restaurant improvements;
- Expensing election for costs of film and television production;
- Real estate professional treatment;
- Small business stock gain exclusion;
- State and local sales tax deduction;
- Teacher's deduction for classroom supplies;
- Mortgage insurance premium deduction;
- Liberalized rules for qualified conservation contributions (corporation franchise/income);
- Enhanced deduction for contribution of food inventories; and
- Above-the-line deduction for qualified tuition expenses.

Not much conformity to federal extenders

On December 18, 2015, the President signed the Consolidated Appropriations Act of 2016 (H.R. 2029), which contained the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act). PATH makes permanent some provisions of the law that have been subject to several rounds of extenders. It also extends several provisions through 2019 and others through 2016. All these provisions are effective retroactive to 2015.

The Act also postpones the implementation of the "Cadillac tax," the 40% excise tax on employer health plans that are considered generous, until 2020, and makes it deductible.

The IRA-to-charity provision is the only major provision in the PATH Act that California conforms to.

New nonconformity

Seismic retrofitting

SB 84 (Ch. 15-25) enacted a new exclusion from gross income for residential property owners or occupants who receive assistance with earthquake loss mitigation expenses or related debt, applicable to taxable years beginning on or after July 1, 2015. (R&TC §§17138.3, 24308.7) SB 102 (Ch. 15-323) expanded the original legislation.

The exclusion applies to amounts received from the California Residential Mitigation Program or the California Earthquake Authority in the form of a:

- Loan forgiveness;
- Grant;
- Credit;
- Rebate;
- Voucher; or
- Other financial incentive.

Turf removal

Any rebate issued to an individual or business taxpayer for participating in a turf removal water conservation program is excluded from income for California purposes, applicable to taxable years beginning on or after January 1, 2014, and before January 1, 2019. (R&TC §§17138.2, 24308.2)

We are unaware of a federal provision that would allow this as an exclusion from income, and many municipalities, including Los Angeles DWP, have been issuing Forms 1099 reporting the rebate.

Due date changes

HR 3236, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, changes federal return due dates for years beginning after December 31, 2015, as follows:

- Partnership returns — March 15;
- C corporations — April 15;
- S corporation returns — remains March 15; and
- FBAR (FinCEN Form 114) — April 15.

The preceding dates are for calendar year entities. Fiscal years are adjusted.

There is a special provision for C corporations with a June 30 year end. These corporations may continue to file on September 15 until years beginning after December 31, 2025 (not a typo).

California does not currently conform. It will require legislation to pick up the new due dates.

New MyFTB

The FTB launched a new, enhanced MyFTB on January 4, 2016. To access the enhanced MyFTB, you must register (or re-register) your online account with the FTB. Here are a few notes about the registration process:

- You must re-register (even if you had a previous account);
- The FTB suggests using your PTIN, rather than your license number, to register;
- Each individual preparer must set up his or her own account. You may not register for an office;
- The registration process now includes a step to activate your tax preparer account, which requires an FTB-provided PIN; and
- After you register, a PIN number will be mailed to you in three to five days (but it could take up to 10 days).

Improvements to the new system include:

- The ability for tax professionals with a Power of Attorney (POA) to receive an e-mail alerting them to activity on the account;
- The ability to correspond with the FTB through online secure chat, and send a secure message;
- Copies of all correspondence, bills, and returns provided in the taxpayer's folder if there is a POA on file; and
- Election by the taxpayer to receive FTB correspondence by e-mail rather than by mail.

MyFTB Account contains:

- Indicators for mandatory e-payment;
- Estimated tax payments and state tax refund;
- Wage and withholding information; and
- Ability to change address.

Caution

When you input a client into your MyFTB account, the FTB mails a letter to the client alerting them that you now have the ability to see their tax information.

POA issues

The enhanced MyFTB allows taxpayers and tax preparers to submit their POA declaration online. The new system is designed to expedite the processing of POAs into MyFTB practitioner accounts. However, the changes have caused some confusion for FTB employees.

After hearing complaints that FTB employees, particularly in collection and filing enforcement areas, would not accept a faxed POA, and refused to talk to the tax professional, we contacted the FTB. We are pleased to report that they have found a resolution to this problem.

The problem stemmed from concerns about validating the POA and training issues.

The FTB is currently working to ensure their internal procedures are applied more consistently, and avoid some of the earlier issues that arose. We believe the new procedures will make working with the FTB easier than it was prior to the new POA processing. However, as with any major change, there will likely be hitches in the plan. Try to be patient with employees who are learning new procedures.

If you are working with FTB staff and concerns arise while validating the tax preparer–client relationship, you can always ask to speak to a lead or supervisor in order to resolve the issue.

If you still encounter problems, you may contact the FTB Taxpayers' Rights Advocate through their website, www.ftb.ca.gov/Contact_Us/tpa_problems.asp.

Or e-mail Spidell Publishing at editor@spidell.com.

Free webinar

We offer a **free** 1-hour webinar for more information on the new MyFTB. Go to www.caltax.com to register.

College Access Tax Credit

Taxpayers are eligible for a California personal and corporate tax credit for the 2014 through 2017 tax years for contributions made to the College Access Tax Credit Fund. The credit is available to taxpayers who make cash contributions to the fund and who receive a credit certification and allocation from the California Educational Facilities Authority (CEFA) in the State Treasurer's Office.

The credit is:

- 55% for contributions made in 2015; and
- 50% for contributions made in 2016 and 2017.

The taxpayer may take a federal charitable contribution deduction and the credit, rather than a charitable contribution deduction for California. Go to www.treasurer.ca.gov/cefa for more information.

SB 81 (Ch. 15-22) retroactively allows the credit to reduce the regular tax below tentative minimum tax and AMT. It also extended the credit through 2017.

California Earned Income Tax Credit (SB 80 (Ch. 15-21))

A new refundable state Earned Income Tax Credit (EITC) has been enacted beginning with the 2015 taxable year. The availability of the credit is dependent on the Legislature providing for the credit in the annual Budget Act. This year's Budget Act authorizes the credit for the 2015 tax year and sets the annual adjustment. (AB 93 (Ch. 15-10))

Key differences between the federal and state credits include:

- The state credit is determined by multiplying a modified federal credit amount by an "adjustment factor," which is set at "0" but may be increased by the Legislature in the Budget Act each year. For 2015, the adjustment factor is equal to 85%;
- To remain in effect, the Budget Act must also authorize resources for the FTB to oversee and audit returns on which the credit is claimed;
- "Earned income" for purposes of the state credit does not include self-employment income; and
- The credit is only available to individuals who have a qualifying principal place of abode in California for more than half the year.

Student loan forgiveness

SB 150 (Ch. 15-650) excludes from gross income student loan indebtedness used to attend a for-profit higher education company that is discharged on or after January 1, 2015, and before January 1, 2020, for an eligible individual who:

- Could not complete a program of study because the school closed;
- Successfully asserts that the school did something wrong, or failed to do something that it should have done;
- Has debt discharged that is associated with attending Corinthian Colleges on or before May 1, 2015; or
- The debt is discharged under the agreement between ECMC Group, Inc., Zenith Education Group, and the Consumer Financial Protection Bureau concerning the purchase of certain assets of Corinthian Colleges, Inc., dated February 2, 2015. (New R&TC §17144.7)

The IRS also provides loan discharge relief for Corinthian Colleges students. (Rev. Proc. 2015-57 (December 4, 2015))

Other California legislation of interest

AB 99 COD principal residence exclusion (VETOED)

In a surprise move, Governor Brown vetoed AB 99 (Perea), the bill that would have extended California's partial conformity to the COD principal residence exclusion through December 31, 2014. SB 907 (Galgiani) has been introduced. If passed by the Legislature and signed by the Governor, the exclusion would apply to years beginning before January 1, 2017.

Medical Marijuana Regulation and Safety Act — AB 243 (Ch. 15-688), AB 266 (Ch. 15-689), SB 643 (Ch. 15-719)

The Act requires all medical marijuana businesses, including cultivators, manufacturers, dispensaries, delivery services, etc., to obtain a state license(s), but only if they first receive a local permit, license, or other local authorization. Under the Act, medical marijuana businesses are no longer prohibited from making a profit. Currently, the owner may pay reasonable salaries, but these businesses are not allowed to make a profit. Current dispensaries may continue to operate as they do today until at least January 1, 2018, when the formal state licensing process is expected to begin. (B&PC §19320)

Cheerleaders are employees — AB 202 (Ch. 15-102)

Cheerleaders who cheer for professional sports teams must be treated as employees for tax, labor, and fair employee practice purposes, effective January 1, 2016.

Administrative dissolution of nonprofits — AB 557 (Ch. 15-363)

Provides for the administrative dissolution or surrender of a qualified nonprofit corporation under certain conditions if, as of January 1, 2016, or later, the nonprofit corporation's corporate powers are suspended or forfeited by the FTB for a period of not less than 48 continuous months. (Corp. Code §5008.9)

Paid sick leave — AB 1522 (Ch. 14-317)

Effective July 1, 2015, this bill requires all employers to provide paid sick leave to California employees who work at least 30 days from the commencement of employment. Employers who already have a paid sick leave or paid time off policy that meets this bill's minimum requirements do not have to provide additional paid sick leave. The mandate also does not apply to employees, including construction workers, covered by certain collective bargaining agreements, in-home supportive service workers, and certain flight deck and cabin crew employees of air carriers. AB 304 (Ch. 15-67) makes minor changes that simplify computation of paid sick leave for smaller businesses.

FTB Legal Ruling 2014-01 and Swart

In 2014, the FTB released a ruling that effectively imposes a California filing requirement and the $800 annual tax on each LLC in a tiered LLC, whether the member is a managing or nonmanaging member or inside or outside California. The ruling also requires a corporation that has an interest in an LLC doing business in California to file returns and pay the $800.

On November 20, 2014, the Fresno Superior Court ruled in the ***Swart*** case that an Iowa corporation whose only tie to California was a 0.2% interest in a California investment LLC was not doing business in California. (***Swart Enterprises Inc. v. Franchise Tax Board***, filed July 9, 2013, Fresno Superior Court, Case No. 13CECG02171)

The case is on appeal. So in the meantime, we suggest you file a protective claim. More information, including a chart summarizing who may want to file the claims and a sample protective claim letter, is available on our website at www.caltax.com/spidellweb/public/editorial/swartclaim.doc.

Real estate withholding errors

Last year, the FTB implemented a program to manually process tax returns claiming real estate withholding where the withholding had not been credited to their accounts. This seemed to reduce the number of notices. This filing season, you will be able to check the taxpayer's MyFTB account to see if real estate withholding is posted and head off problems in the future.

The FTB is pursuing a regulation change to allow them to change the wording on the forms so the FTB can more easily match withholding on revocable grantor trusts.

If you have a problem, contact the FTB Withhold at Source Unit at (888) 792-4900 or (916) 845-4900.

IRC §1031 exchange reporting requirement — AB 92 (Ch. 13-26)

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.

New notice

The FTB has changed the name of the Return Information Notice (RIN) to Notice of Tax Return Change (TRC). The notice is used when an error creates or increases a taxpayer's balance due. The explanatory paragraphs for many adjustments have been revised and additional new paragraphs specifically describe the adjustments.

New HOH filing schedule

The FTB has eliminated Form FTB 4803E, Head of Household Audit Letter, and replaced it with a new Form FTB 3532, Head of Household Filing Status Schedule. This new schedule must be filed with the tax return.

The new form is only one page, and has only five questions. E-filed 2015 returns that do not include the schedule will not be rejected by the FTB, but they may be selected for audit.

FTB mailing letters on deductions for employee business expenses

The FTB last month began mailing education letters to taxpayers who may have claimed unreimbursed employee business expenses as an itemized deduction on federal Schedule A. (FTB Public Service Bulletin No. 15-25) Although the education letter is not an audit, the FTB will likely follow up with audits of some taxpayers' employee business expenses.

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- ACA: Business and Individual Issues (Including Extenders Update) — Friday, February 12
- Social Security: Planning and Preparing to Collect — Friday, February 26
- Quarterly Tax Update — Tuesday, April 26, and additional dates
- Regulatory Review: Practicing Within the Law — Wednesday, April 27, and additional dates

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