



## **Tax News**

February 2019

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### What's new for filing 2018 tax returns

**Voluntary Contributions –** Taxpayers may contribute to the following new funds:

- Organ and Tissue Donor Registry Voluntary Tax Contribution Fund
- National Alliance on Mental Illness California Voluntary Tax Contribution Fund
- Schools Not Prisons Voluntary Tax Contribution Fund

California Earned Income Tax Credit (EITC) – For taxable years beginning on or after January 1, 2018, the age limit for an eligible individual without a qualifying child is revised to 18 years or older. Search our website for EITC or get form California Earned Income Tax Credit (FTB 3514) for more information.

**New Employment Credit** – The sunset date for the New Employment Credit is extended until taxable years beginning before January 1, 2026. Search our website for **NEC** or get form New Employment Credit (FTB 3554) for more information.

**California Competes Tax Credit** – The sunset date for the California Competes Tax Credit is extended until taxable years beginning before January 1, 2030. Visit the GO-Biz website at **business.ca.gov,** search our website for **ca competes,** or get form California Competes Tax Credit (<u>FTB 3531</u>) for more information.

Native American Earned Income Exemption – For taxable years beginning on or after January 1, 2018, federally recognized tribal members living in California Indian country who earn income from any federally recognized California Indian country are exempt from California taxation. This exemption applies only to earned income. Enrolled tribal members who receive per capita income must reside in their affiliated tribe's Indian country to qualify for tax-exempt status. Get the Instructions for Schedule CA (540) and Instructions for Enrolled Tribal Member Certification (FTB 3504), for more information.

Engineers, Land Surveyors, and Architectures – California extended the authorization for persons licensed to engage in the practice of engineering, land surveying or architecture to form limited liability partnerships until January 1, 2026.

New Partnership Audit Regime — For federal purposes, the Bipartisan Budget Act of 2015 replaced the Tax Equity and Fiscal Responsibility Act of 1982, creating a centralized partnership audit regime, and generally transferring the liability for the tax due to the partnership. All partnerships with tax years beginning after 2017 are subject to this new regime unless an eligible partnership elects out. For California purposes, taxable years beginning on or after January 1, 2018, partnerships are required to report each change or correction made by the IRS, FTB, for the reviewed year within 6 months after the date of each final federal determination, and will generally be liable for the tax due.

Schedule K-1 (1065-B) and its instructions — Public Law 114-74, Title XI, Section 1101(b) repealed the electing large partnership rules for partnership tax years beginning after 2017. As a result, Schedule K-1 (Form 1065-B) and its instructions will be obsoleted after 2017.

Federal Tax Reform – The Tax Cuts and Jobs Act (TCJA) signed into law on December 22, 2017, made changes to the Internal Revenue Code (IRC). In general, California Revenue and Taxation Code does not conform to the changes. California taxpayers continue to follow the IRC as of the specified date of January 1, 2015, with modifications. The IRS issued Notice 2019-11 to provide for a waiver of the estimated tax penalty for taxpayers whose 2018 federal income tax withholding and estimated tax payments fell short of their total tax liability for the year. This relief is designed to help taxpayers who were unable to properly adjust their withholding and estimated tax payments to reflect an array of changes under the TCJA, the far-reaching tax reform law enacted in December 2017. For California purposes, the TJCA had no general impact to the amount of state income tax an individual California state income taxpayer would owe. Thus, it is not necessary for California provide a similar waiver as described in IRS Notice 2019-11.

**Like-Kind Exchanges** – California **does not** conform to the amendments under the TCJA. The TCJA amended IRC Section 1031 limiting its application to real property that is not primarily held for sale. Additionally, under the TCJA, exchanges of personal property and intangible property do not qualify for non-recognition of gain or loss as like-kind exchanges. Get Instructions for Sales of Business Property (Schedule D-1) for more information.

**IRC Section 965 Deferred Foreign Income** – California does not conform. Under federal law, if a taxpayer owns (directly or indirectly) certain foreign corporations, they may now have to include certain deferred foreign income on their return.

Global Intangible Low-Taxed Income (GILTI) Under IRC Section 951A — California does not conform. Under federal law, if a taxpayer is a U.S. shareholder of a controlled foreign corporation, they must include their GILTI in their income.

New Deduction for Pass-Through Income – California does not conform to the TCJA additions of the IRC Section 199A, Qualified Business Income, for tax years beginning after December 31, 2017, and before January 1, 2026.

Qualified Opportunity Zone Funds — California does not conform to the deferral and exclusion of capital gains reinvested or invested in federal opportunity zone funds under IRC Sections 1400Z-1 and 1400Z-2, and has no similar provisions. The TCJA established Opportunity Zones. IRC Sections 1400Z-1 and 1400Z-2 provide a temporary deferral of inclusion of gross income for capital gains reinvested in a qualified opportunity fund, and exclude capital gains from the sale or exchange of an investment in such funds.

**Technical Terminations** – California law **does not** conform to the federal repeal of the technical terminations of a partnership. The TCJA repealed the IRC Section 708(b)(1)(B) rule providing for technical terminations of partnerships. For California purposes, 2 short period returns are still required.

**Depreciation Limitation** – California **does not** conform to the federal modification to depreciation limitations on luxury automobiles (IRC Section 280F).

**Net Operating Losses (NOLs)** – California law **does not** conform to the TCJA changes to the rules for NOLs. California taxpayers continue to compute NOLs in conformity to federal rules as of the specified date of January 1, 2015, with modifications.

Capital Assets — California does not conform to the amendment under the TCJA. The TCJA amended IRC Section 1221 excluding a patent, invention, model or design (whether or not patented), and a secret formula or process held by the taxpayer who created the property (and certain other taxpayers) from the definition of a capital asset. For California purposes, IRC Section 1221 as of January 1, 2015, applies.

# California Department of Tax and Fee Administration sponsored small business tax seminars will begin soon

Beginning this month, the California Department of Tax and Fee Administration (CDTFA) will begin sponsoring Small Business Tax Seminars that will be held throughout the state. These informative, half-day seminars will feature representatives and experts from some of California's state departments, such as CDTFA, Employment Development Department (EDD), Franchise Tax Board (FTB), and Governor's Office of Business and Economic Development (GOBiz). Additionally, representatives from IRS, Small Business Administration (SBA), and Small Business Development Centers (SBDC) may attend as well depending on availability.

Small business owners and tax professionals can learn up-to-date information about compliance issues, filing requirements, and changes in tax laws. Questions about specific tax related issues will be answered and contacts can be made with these agencies for future issues or concerns. Presentations may include avoiding common sales and use tax problems, employee versus independent contractor, common forms of business ownership, better business through keeping better records, and more.

These seminars are free and are an important asset in the state of California's education and outreach efforts. The CDTFA has made it easy to register and to find a small business seminar that is being held in a location near you. For a list of upcoming events and its location, go to the CDTFA <u>seminar webpage</u>. Here you can find a seminar that interests you, find important information about the event, and then, conveniently, register online. Take advantage of this great resource and register today.

# How to work with auditors before your power of attorney (POA) relationship is approved

When taxpayers receive an Initial Contact Letter (ICL) for an audit, they may retain an individual or entity to represent them in working with our Audit staff. A POA declaration will usually be required since most audit activities involve the representative acting on the taxpayer's behalf. POA declarations can be submitted by <a href="MyFTB or mail">MyFTB or mail</a>. Our current POA processing time is approximately 15 business days if manual intervention is not needed. It is helpful if the POA relationship is already approved in our system before the representative initially contacts our Audit staff.

A common reason for manual intervention is relationship verification. Protecting taxpayer's confidential information is our primary goal. For this reason, we verify all new POA relationships. If we are unable to verify the relationship during our initial processing, a letter is sent to the taxpayer requesting they contact us to authorize the relationship. A letter will also be sent to the representative informing them that the request is on hold and their client has 45 days to respond. Additionally, we will call the representative letting them know we have contacted their client as part of the relationship verification process and we ask them to have the taxpayer contact us by phone to authorize the relationship. When the taxpayer contacts us, we can immediately approve the POA. Additional discussion on relationship verification can be found in the <a href="September 2018 Tax News">September 2018 Tax News</a>, Relationship Verification for Power of Attorney (POA)/Tax Information Authorization (TIA) Relationship Requests.

After the POA is submitted, but before it is approved, the representative can still work with FTB Audit staff using implied consent (a discussion of implied consent can be found in <a href="February">February</a>
<a href="Pebruary">2017 Tax News</a>, Implied Consent.) Unfortunately, we are unable to provide any written communication (e.g. IDR) to the representative using implied consent. Our Audit staff will send or email the written correspondence directly to the taxpayer until the POA is approved, and the representative can then obtain the information from their client. Representatives are encouraged to check MyFTB for the status of their POA declarations.

## Victims of disasters receive more time to file and pay

Disaster loss rules apply to victims in Governor-declared or presidentially-declared disaster areas.

- We automatically follow federal postponement periods for any presidentially-declared disasters.
- California law generally follows federal law regarding the treatment of losses incurred as a result of a casualty or a disaster.
- Taxpayers may deduct a disaster loss for any loss sustained in California that is proclaimed by the Governor to be in a state of emergency.

The **affected taxpayers** impacted by Northern and Southern California wildfires in 2018 are granted an extension to file 2018 California tax returns and make payments until April 30, 2019.

The <u>IRS granted relief</u> to individuals and businesses in 3 counties for 2018: Butte, Los Angeles and Ventura. This applies to various tax filing and payment deadlines that occurred starting on November 8, 2018, including:

- Individual income tax returns normally due on April 15, 2019.
- Quarterly estimated tax payments due January 15, and April 15, 2019.

We will also follow these extended dates and will cancel interest and any late filing or late payment penalties that would otherwise apply.

Your clients may claim a disaster loss in 1 of 2 ways: In the tax year that the disaster occurred, when filing a 2018 tax return spring 2019; or by filing either an amended or original 2017 tax return. We can more quickly issue a refund for eligible claimed losses in the prior tax year.

For a complete list of all disasters declared by the Governor, see the "Qualified Disasters" chart on our <u>Disaster Loss webpage</u>. Get Disaster Loss - How to Claim a State Tax Deduction (<u>FTB Pub.</u> 1034) for more information and instructions.

For your clients claiming the disaster loss, you should write the name of the disaster in red ink at the top of the tax return to alert us to expedite the refund. If you are e-filing, follow the software instructions to enter disaster information.

Additional business tax relief for wildfire victims is available through the <u>California Department</u> of Tax and Fee Administration and the Employment Development Department.

## Interagency Intercept Collection Program – Update

We administer the Interagency Intercept Collection (IIC) program on behalf of the State Controller's Office. The IIC program intercepts (offsets) refunds when individuals and business entities owe delinquent debts to government agencies including the IRS and California colleges.

An **interagency intercept** occurs when our IIC program receives a request from one of the participating agencies to intercept tax refunds, lottery winnings, or unclaimed property payments from individuals or business entities who owe delinquent amounts. All refunds are subject to interception. We only intercept the amount owed. We intercept lottery winnings for all agencies except for the IRS.

If a participating agency requests we intercept someone's funds, we seize and send only the amount of the debt to the requesting agency.

Refunds from joint tax returns may be applied to the debts of the taxpayer, spouse or registered domestic partner. After all tax liabilities are paid we apply any remaining credit to voluntary contributions if requested; and then, the remainder will be refunded. The State Controller's Office will mail a check for the remaining amount.

If the taxpayer's debt was previously paid to the requestor and we also intercepted the taxpayer's refund, any overpayment will be refunded by the agency that received the funds. Please allow 3 to 4 months of processing time.

For details about the debt, taxpayers must call the agency listed on the intercept notice we sent. We do not have any information about the taxpayer's debt with the agency.

Please note we have changed our contact information:

Toll free number: 866.563.2375

Fax: 916.843.2460

Search our website for <u>interagency intercept collection</u> for more information about the IIC program.

#### Ask the Advocate



Susan Maples, CPA
Taxpayers' Rights Advocate
Follow me on Twitter at
twitter.com/FTBAdvocate

#### 2019 tax season is here

The holidays are a distant memory and for many of you, your schedule is now filled with client appointments, tax return preparation and longer days at the office. I hope tax season is off to a smooth start for you, since you are now preparing returns reflecting the significant changes in federal law and answering the many questions your clients have about the new law.

For many of you, this is the one time each year you have the opportunity to sit down and meet with their clients. For this reason, I'd like to mention a few things again this month that I wrote about last year to help ensure things go smoothly in 2019 for your clients. One of the simplest things you can do is to make sure we have current and correct contact information for your clients. We receive a large volume

of returned mail every year due to returns filed with an incorrect address. An accurate and current address speeds up the processing of some refunds and reduces the possibility of unnecessary notices and billing.

While most taxpayers now take advantage of direct deposit for their refunds, there are still times when a refund check is sent to an old address simply because the taxpayer didn't let you or FTB know they moved. We make every effort to get a refund to the correct taxpayer, but

having to resend a refund check or have the State Controller reissue one creates delays that likely could have been avoided.

Another one of the things I always talk about when I'm out speaking is signing up for a Tax Professional MyFTB account and adding your clients to your client list. There are many benefits to interacting with us through MyFTB and I hope you will consider opening your own MyFTB accounts (personal and tax professional) this year if you don't have one already. Each month in Tax News we have a MyFTB Corner with helpful tips, along with information about upcoming changes and enhancements to MyFTB.

We also want to continue to improve your experience with MyFTB. Based on comments received from active MyFTB tax professionals, we recently implemented a 1-step process for client account access. You can now add a client in MyFTB and request full online access to their information and filing history, if needed, at the same time. While the client will still have to approve this added level of access, this should help make the process of adding clients and getting the level of access you need a bit easier for you this busy tax season.

#### Chief Counsel Corner



Jozel Brunett Chief Counsel

### Office of Tax Appeals Decision - Appeal of Larsen

The Appeal of Larsen, 2018-OTA-073, July 25, 2018, is a recent nonprecedential decision of the Office of Tax Appeals (OTA). Nonprecedential decisions are controlling for the case before the OTA, but only precedential decisions are binding for any subsequent cases. (California Code of Regulations (CCR), title 18, Section 30502(b).)

The case stemmed from a filing enforcement action in which the FTB received information that Mr. Larsen, a resident of Idaho, had received a Form 1099-MISC reporting non-employee compensation from a company with a California address. As explained in last month's Chief Counsel Corner, it is FTB's position that the nature of these facts indicate Mr.

Larsen had California-sourced income under the market-based sourcing rules for sole proprietorships.

Mr. Larsen disputed the tax and penalties because he had not lived or worked in California during the year at issue. He did not, however, dispute that he was paid as an independent contractor by the company in question. Further he did not provide the FTB or the OTA with any information regarding his compensation, including a description of the services provided or a copy of a contract between the company and him. As explained last month, neither the residence of the taxpayer nor the place where the services were performed are dispositive in this type of case.

Under CCR Section 17951-4(c) and (c)(2) a nonresident's California source income from a sole proprietorship which carries on a unitary business, trade, or profession within and without the state is the amount of business income apportioned to this state. For sales of other than tangible property (services and intangible property), sales are apportioned using the market-based rules (MBR). (CCR Section 25136-2.) Under MBR, sales are considered California sales if the taxpayer's customer received the benefit of service in this state or if the taxpayer's customer used the intangible in this state. Since a customer received a benefit of service in this State, a nonresident may have California source income from California and may therefore have a filing requirement. For the purposes of CCR, title 18, Section 17951-4, unitary businesses are those businesses where there is an interrelationship between in-state and out-of-state activities that are constitutionally permitted to be treated as a discrete business enterprise.

The OTA analyzed whether Mr. Larsen's business was unitary and determined that the FTB had not met its initial burden of showing that Mr. Larsen was engaged in a unitary business.

Mr. Larsen performed the services entirely from Idaho, but the Form 1099-MISC suggests that a customer from California received those services from within California. The out-of-state activity (provision of service) and the in-state activity (receipt of the benefit of that service) are interdependent of each other showing a strong indication of a unitary business.

#### MyFTB Corner

How to retain full online account access to your client's account on MyFTB

Effective January 2, 2019, we updated our Power of Attorney Declaration (POA) (FTB 3520 PIT and BE) and Tax Information Authorization (TIA) (FTB 3534) forms and MyFTB, to allow you or the taxpayer to request full online account access at the same time you submit the POA declaration or TIA request. Below is important information to **retain** full online account access to your client's MyFTB account when you submit a new POA declaration or TIA request.

If I already have full online account access for my client, do I have to do anything if I file a *new* POA declaration or TIA request?

Yes. To **retain** full online account access to your client's MyFTB account, you must make the following selection for the POA declaration or TIA request you are submitting:

- Yes must be selected on the form.
- Full must be selected on MyFTB.

#### Important details:

- When we **approve** the POA declaration and there are multiple representatives listed on the declaration, the online account access level will apply to both:
  - o All tax professional representatives listed.

- o All existing POA and TIA relationships that you, or any tax professional representative listed, have with the client.
- When **no** or **limited** is selected on the POA declaration or TIA request, we will change the Online Account Access level from **full** to **limited** for all existing POA and TIA relationships that you have with your client. If there are multiple tax professional representatives listed on the declaration, we will change the online account access level from **full** to **limited** for all existing POA and TIA relationships that you, or any tax professional representative listed, have with the client.
- If we **reject** the POA declaration or TIA request, we will not process the online account access request. The online account access level for all existing POA or TIA relationships between the tax professional(s) and the client will not change.

#### All About Business

#### Reporting federal partnership audit adjustments to California

New to the California 2018 Partnership Return of Income (<u>FTB 565</u>) and Limited Liability Company Return of Income (<u>FTB 568</u>) is the addition of a Partnership Level Tax line - FTB 565, it's line 25 and FTB 568, it's line 5.

The sole purpose of the Partnership Level Tax line is to allow partnerships and Limited Liability Companies classified as a partnership to report to us each change or correction made by the IRS under the centralized partnership audit regime.

The addition of the Partnership Level Tax line for the 2018 forms is necessary since the federal change or correction must be reported to us for the tax year that was examined by filing an amended return. Whereas, for federal tax purposes, the change or correction is reported in the year the audit/examination is completed.

Each IRS change or correction should be reported to us within 6 months after the date of each final federal determination.

Refer to the <u>Bipartisan Budget Act of 2015</u> for more information on the centralized partnership audit regime at the federal level. Visit <u>California Revenue and Taxation Code Section 18622.5</u> for information on how the results of a partnership audit for federal purposes should be reported to California.

#### **Event Calendar**

As part of education and outreach to our tax professional community, we participate in many different presentations and fairs. We now provide a <u>calendar</u> that shows the events we attend, as well as other events happening with us, such as interested party and board meetings.