

Table of Contents

Changes to Carryovers of Repealed Enterprise Zone Credits	2
2013 State Income Tax Rate Schedules Adjusted	2
New Electronic Levy Program	3
Form 540A Elimination	4
FTB en Español – Extension Filing	4
Ask the Advocate	
California’s New Reporting Requirements for Certain 1031 Exchanges	5
Event Calendar	6
EDR in the News	
FTB Moving to Digital Office.....	6
Inside FTB	
Find Out What Your Taxes Pay For	7
Big Business	
Business Income: Where Are We Today?.....	7

Changes to Carryovers of Repealed Enterprise Zone Credits

Assembly Bill 93, signed into law on July 11, 2013, repeals all enterprise zones on January 1, 2014. Another major change limits any credit carryovers for qualified employers, including entity flow-through owners, to 10 years for taxable years beginning on or after January 1, 2014. Qualifying and vouchered employees hired prior to January 1, 2014, will continue to generate credits for any remaining portion of the 60-month period from the commencement of employment.

Likewise, any unused enterprise zone sales and use tax credit remaining for carryover to taxable years beginning on or after January 1, 2014, may now only be carried forward 10 subsequent years.

As always, the credit carryover is subject to the business income limitation. Specifically, the credit carryover may only be used against the net tax that would have been imposed on the income attributable to activities within the respective former enterprise zone.

In the coming weeks, information and frequently asked questions about the new California Competes Tax Credit and the New Employment Credit, created by Assembly Bill 93 and modified by Senate Bill 90, and the repeal of the enterprise zones will be available at ftb.ca.gov.

2013 State Income Tax Rate Schedules Adjusted

We released the 2013 state tax brackets. Brackets are “indexed” each year by adjusting them to reflect changes in the California Consumer Price Index (CPI).

Filing requirement thresholds, the standard deduction, and certain credits were adjusted along with income tax brackets. We based these adjustments on the inflation rate of 1.7 percent, as measured by the California CPI for all urban consumers from June 2012 to June 2013. Last year California had an inflation rate that measured 1.9 percent.

Below are some of the changes to various items:

	2013 Amounts	2012 Amounts
Standard deduction for single or married filing separate taxpayers	\$3,906	\$3,841
Standard deduction for joint, surviving spouse, or head of household taxpayers	\$7,812	\$7,682
Personal exemption	\$106	\$104

credit amount for single, separate, and head of household taxpayers		
Personal exemption credit amount for joint filers or surviving spouses	\$212	\$208
Dependent exemption credit	\$326	\$321
Renter's Credit is available for single filers with adjusted gross incomes	\$36,955 or less	\$36,337 or less
Renter's Credit is available for joint filers with adjusted gross incomes	\$73,910 or less	\$72,674 or less

In addition, we provide minimum filing requirement thresholds to ensure that most people who will not owe taxes are not required to file a state tax return. We adjust these tables each year to include the added senior exemption and the dependent exemption credits. For example, most single people under 65 years old with no dependents would not need to file a tax return until they have adjusted gross income of \$12,562 or more. Adjusted gross income is total income increased or reduced by specific adjustments, before taking the standard or itemized deduction.

Other tax credits affected by indexing include the Joint Custody Head of Household Credit/ Dependent Parent Credit and Qualified Senior Head of Household Credit.

More information about the 2013 tax rates and exemptions will be available soon at ftb.ca.gov.

New Electronic Levy Program

In the past, we issued all levies on financial institutions by paper notices. On July 3, 2013, we implemented our electronic order-to-withhold (eLevy) program. Financial institution participation in the eLevy program is voluntary. We are specifically focusing our efforts on enrolling the top ten financial institutions in California to participate to the eLevy program.

Several benefits we realize from using electronic bank levies include:

- Reduced paper usage.
- Decreased postage expenses.
- Increased overall operational efficiency.

Financial institutions participating in the eLevy process realize the following benefits:

- FTB's secure electronic transmission facilitates receipt of the levy within the financial institution and ensures taxpayer privacy.
- The program eliminates any possibility of misdirected or misrouted levies/
- The program reduces staff resource time for processing levies, creating costs savings.

Form 540A Elimination

Effective 2013 taxable year, we eliminated Form 540A, California Resident Income Tax Return. We eliminated the form because:

- Less than two percent of taxpayers file Form 540A and usage of this form continues to decrease each year.
- In 2004, tax preparation software stopped generating Form 540A.
- Form 540A was available only in paper format either in the tax booklet or printed from our website.

Taxpayers who previously filed Form 540A will need to use Form 540 2EZ or Form 540 to file their 2013 tax returns. We will provide an education and outreach program to taxpayers and tax professionals.

FTB en Español – Extension Filing

Fall is right around the corner! October 15, 2013, is the deadline for taxpayers to timely file their 2012 state personal income tax returns to avoid late filing penalties.

We offer tools and information for taxpayers and tax preparer's to make filing easy and convenient. We improved our services in Spanish so taxpayers can:

- See if they [need to file a tax return](#)
- [Check their refund](#) status.
- Request an installment agreement by telephone or [download](#) and fill out forms in Spanish.
- See if they qualify for the [Head of Household](#) filing status.

- Obtain answers to frequently asked questions.
- Obtain forms and publications in Spanish.

Don't forget the Federal Earned Income Tax Credit (EITC). Taxpayers earning less than \$50,270 in 2012 can qualify for a "refundable" credit that can total up to \$5,891. Taxpayers can see if they qualify for the credit by visiting the Internal Revenue Service website. California has no comparable state credit.

Ask the Advocate



California's New Reporting Requirements for Certain 1031 Exchanges

A number of practitioners have contacted us about Assembly Bill 92 which became law on June 27, 2013. Specifically, I have heard concerns about the new requirements under Revenue and Taxation Code sections 18032 and 24953. Each section states if a gain or loss from the exchange of property in this state is deferred under Section 1031 of the Internal Revenue Code (IRC), and the property acquired in that exchange is located outside of California, the taxpayer shall file an information return with the Franchise Tax Board for the taxable year of the exchange and for each subsequent taxable year in which the gain or loss from that exchange has not been recognized. If the required reporting is not done, then the deferred gain is accelerated, regardless of whether the replacement property has been sold. This new law applies to exchanges of property that occur in taxable years beginning on or after January 1, 2014. I have received questions as to whether or not this applies to California residents, if it applies to both individuals and business, and of course will a draft copy of the information return form be available soon?

Currently, we have begun planning the format for reporting exchange transactions that occur in 2014 which require disclosure. We anticipate that an implementation team will issue instructions in the spring to answer your questions in time for the first information returns, which will be due in the 2015 filing season. For taxpayers that fail to comply with the reporting requirement and fail to file a return, the FTB could make an estimate of the net income from the exchange and may issue an assessment including tax, interest, and penalties due in the same manner as assessments that are proposed for the failure to file a return.

Look for a future article this spring in Tax News on this issue.

Steve Sims, EA
Taxpayers' Rights Advocate

Follow me on Twitter at twitter.com/FTBAdvocate.

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 [combined-calendar](#) to show the events we are attending, as well as other events happening with us, such as interested party and board meetings.



Enterprise. Data. Revenue!

EDR in the News

FTB Moving to Digital Office

Did you know we are transitioning into a digital office? Thanks to EDR, we are in the process of imaging approximately 10 million pieces of correspondence, four million Personal Income Tax (PIT) returns, nearly one million Business Entity returns, and over eight million checks annually. Why is that important to you? We will load the imaged data. Beginning in the fall of 2014, you will be able to access the data in MyFTB Account (Taxpayer Folder).

Our first digital office milestone was reached when we successfully implemented [EDR Release 2.0](#) on June 30, 2013. With EDR, we automated processing for a small test group of correspondence and our staff now has electronic access to more data. We use the new EDR processes and procedures to automatically prepare, scan, and electronically route nonremit Personal Income Tax (PIT) Return Information Notice (RIN) correspondence. We electronically route RIN correspondence to the appropriate work areas for staff to access, view, and process.

In addition to the new correspondence process, we made some tax return, payment, and contact information for 35 million PIT taxpayers viewable for our staff. After full implementation, we anticipate that electronic handling of our correspondence and quick staff access to taxpayer information will increase our response times and improve our customer service.

Coming in Release 2.1, planned for December 2013, we will broaden the Release 2.0 pilot to include more staff and more types of correspondence. By next summer, we will

begin to image and process all of our correspondence electronically and continue to load this additional data and make it available on MyFTB Account.

These improvements will move us to a digital office and provide our taxpayers and tax professionals more self-service options.

Inside FTB

Find Out What Your Taxes Pay For

Do you wonder what your taxes are paying for? We have a chart to give you a sense of how state government spends tax dollars. To find out how your tax dollars contributed to the operations of the government, create your own [tax receipt](#).

Big Business

Business Income: Where Are We Today?

Over the past three years, California made several law changes that may affect your apportioning business clients that do business both in and out of California. Over the next few months, we will publish articles that focus on the changes and the effects for both individual and business entity taxpayers.

By now you are probably aware of the following changes:

- The definition of doing business in California changed. (R&TC Section 23101)
- There is a new definition of “gross receipts.” (R&TC Section 25120)
- You need to follow the new rule for assignment of sales to a state based on the nexus of any member of a unitary group (commonly referred to as the Finnigan rule). (R&TC Section 25135)
- That there are new rules for the assignment of sales of other than tangible personal property (commonly referred to as market rules or market-based rules). (R&TC Section 25136)
- Section 25136 regulations were amended, effective March 27, 2012, to add regulation 25136-2 providing guidance relating to the market-based rules of sales of services and intangible property.
- All trade or business income now must be apportioned to California based on sales (single sales factor), unless the apportioning trade or business

predominantly engaged in qualified business activities described in R&TC Section 25128(b).

Also, new rules for the assignment of sales of other than tangible personal property, R&TC Section 25136 market-based rules, are no longer elective, effective for taxable years beginning on or after January 1, 2013.¹ All apportioning trade or businesses must assign sales of other than tangible personal property under the new market-based rules.²

Your clients or colleagues may be asking, “What does this mean? How does this work? Where are we today?” While we cannot cover all the questions being raised as a result of these changes, we provided the following information to assist you:

What did not change?

1. If the business, trade, or profession is conducted wholly within California the entire net income will be sourced to California, and, unless otherwise provided, is taxable by California.
2. If the business, trade or profession is conducted partly within California and elsewhere, you need to determine if the taxpayer has one line of business (unitary) that will then need to allocate and apportion (R&TC Section 25121) **or** two (or more) separate and distinct lines of business.
3. If the business, trade, or profession has two (or more) separate and distinct lines of business, you will need to reconsider Items 1 and 2 again for each line of business.
4. When Public Law 86-272 applies, it only protects an out-of-state business from an income-based tax, not California’s minimum franchise tax, annual tax, or the LLC fee.
5. You still need to determine if there is business or nonbusiness income, property, and/or compensation.
6. Nonbusiness income is allocated (R&TC Section 25123), and is not included in the taxpayer’s apportionment factors sales, property, or payroll. (R&TC Sections 25120, 25129, and 25132) This means nonbusiness income, property, and payroll are not to be considered when applying the new “Doing Business” thresholds.
7. There are two tests used to determine if income is business:
 - a. The Transactional test.
 - b. The Functional test.

¹ This change was the result of the Proposition 39

² R&TC Section 25136.1 (new law) provides special sales factor rules for certain cable system operations, but even these taxpayers must use the new market rules.

8. Corporations³ are taxable pursuant to Part 11, Individual, Trust, and Estates, Limited Partnerships. Limited Liability Companies are taxable pursuant to Part 10. Administrative provisions can be found within Part 10.2 of the California Revenue and Taxation Code.

Keep in mind, there are different rules that should be considered based on the type of taxable entity. For example, on a sale of a partnership, an individual taxpayer, taxable under Part 10, will generally source the gain to their state of residence, unless their partnership interest has acquired a business status in California (R&TC Section 17952).

A taxpayer taxable as a corporation⁴ may have to pay California taxes on a gain from the sales of a partnership interest even if the taxpayer is a passive investor and the partnership interest was a nonbusiness asset. R&TC Section 25125(d) generally requires the nonbusiness gain or loss from the sale of a partnership interest to be allocated based on the ratio of the partnership's tangible property in state to everywhere at the time of sale. This rule applies unless more than 50 percent of the value of the partnership's assets consists of intangibles. If the partnership meets the more than 50-percent test, the gain from the sale will need to be allocated based on the partnership's sales factor for the year preceding the sale.

When considering how to report the sale of a partnership interest by an S corporation and how to report the flow-through to the shareholders, you may need to source the sale differently for corporation tax purposes than you do for the shareholders. Regulation 17951-4(f) states the source of an S corporation's items of nonbusiness income for purposes of tax on the S corporation will have no relevance in determining the source of the item for purposes of taxing a nonresident shareholder.

You should also be aware that when it comes to determining the LLC fee⁵, you will need to follow the rules for assigning sales under Sections 25135 (i.e. tangible personal property) and 25136 (i.e. market-based rules for services and intangibles). Regulation 17951-4(c), (d), and (g) rules do not apply.⁶

³ This includes check-the-box eligible entities that elect to be taxed as a corporation (C or S).

⁴ This would include C corporations, S corporations and any "eligible entities" that has made a federal election to be taxed as a corporation or S corporation (see our July Tax News discussion on **What is the Difference Between an S Corporation and a Limited Liability Company (LLC)? Part 2** for more information on "eligible entities.")

⁵ Imposed under Section 17942

⁶ See Regulation 17951-4(e).