



# Tax News

August 2020

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## Contents

State’s Top 500 Tax Delinquencies Total \$151 Million.....	2
Mandatory e-Payment requirements have now been in place for 10 years .....	2
Business Expenses publication (FTB 984) coming soon .....	3
Reminder: We are taking appointments at our field offices.....	3
California Competes Tax Credit – Application period began July 27, 2020.....	4
Delinquency Control program will reduce the amount of notices sent to business entities.....	5
Property managers and California withholding .....	5
Offsets, what are they and have they resumed? .....	8
California State Board of Equalization holds its Annual Taxpayers’ Bill of Rights Hearing August 18, 2020.....	10
IRS subscription services .....	10
Ask the Advocate.....	11
New guidelines and contact information for Advocate Assistance .....	11
Chief Counsel Corner.....	12
1031 transactions: The importance of determining which party conducted the sale .....	12
Event Calendar .....	14

## State's Top 500 Tax Delinquencies Total \$151 Million

View the latest [Top 500 Delinquent Taxpayers list](#), which includes individuals and businesses that collectively owe the state more than \$151 million in state income tax.

## Mandatory e-Payment requirements have now been in place for 10 years

For tax years beginning on or after January 1, 2009, an individual is required to make all future payments electronically if they have:

- A total tax liability greater than \$80,000
- Estimated tax or extension payments that exceeds \$20,000

This is regardless of type, amount, or tax year.

Once taxpayers meet the mandatory e-Pay requirement, they must make all payments electronically or they will be assessed a penalty of 1% of the amount paid. There is a reasonable cause exception to the penalty and under certain circumstances, a taxpayer may be granted a waiver of the mandatory e-Pay requirement.

### Exception to the penalty

Revenue and Taxation Code section 19011.5(c) provides that the mandatory e-Pay penalty may only be abated if the taxpayer shows that his or her failure to pay electronically was due to reasonable cause and not the result of willful neglect. Being unaware of the mandatory e-Pay requirement or arguing that it is the taxpayer's first failure does not establish reasonable cause because taxpayers are responsible for knowing and complying with the law. This is true even if a taxpayer's tax software or preparer does not advise the taxpayer to pay electronically.

### General mandatory e-Pay waiver

Taxpayers can request a general waiver from mandatory e-Pay if one or more of the following is true:

- They have not made an estimated tax or extension payment in excess of \$20,000 for the previous income year.
- The tax liability they reported for the previous income year did not exceed \$80,000.
- The amount they paid is not representative of their total tax liability.
- They had a one-time event, such as lottery winnings or inheritance.

If a waiver is granted and the taxpayer subsequently meets the mandatory e-pay requirements, they must resume making electronic payments.

To request a general waiver, download and complete Mandatory e-Pay Election to Discontinue or Waiver Request ([FTB Form 4107](#)). Visit [Mandatory e-Pay for individuals](#) webpage for more information.

## Combined 1<sup>st</sup> and 2<sup>nd</sup> quarter 2020 estimated tax payments due to COVID-19

If your combined estimated tax or extension payment is more than \$20,000, you will be required to make all future payments to us electronically. You may request a waiver of this mandatory e-Pay requirement by completing FTB Form 4107. Refer to the General Mandatory e-Pay Waiver section above for more information.

## Business Expenses publication (FTB 984) coming soon



Business Expenses ([FTB 984](#)) has recently been revised. While it still keeps most of the important and valuable information from the previous version, there were some necessary updates made due to the passage of the Tax Cuts and Jobs Act (2018).

We are hopeful that business owners will find this newly revised publication useful and educational. This publication will be available on our website soon.

## Reminder: We are taking appointments at our field offices

Our public counters provide tax filing and payment assistance to customers and their authorized representatives concerning personal income tax, business entity income tax, and non-tax debts.

Field offices began assisting customers on June 15 by appointment only. Appointments allow the field offices to abide by Centers for Disease Control and Prevention recommendations and ensure social distancing protocols are adhered to while providing a safe environment for staff and customers.

Customers can request an appointment by contacting their nearest Field Office directly by telephone:

- Los Angeles (213) 897-5196
- Oakland (510) 622-4693
- Sacramento (916) 227-6822
- San Diego (619) 688-2550
- Santa Ana (714) 558-4505

Customers can also submit their appointment request via email to:

[FTBFieldOfficeAppointments@ftb.ca.gov](mailto:FTBFieldOfficeAppointments@ftb.ca.gov)

We will contact the customer within two business days. The following information must be included in the request:

- Customer's name and telephone number
- Customer's reason for an appointment
- The location of the Field Office in the subject line of the email (Los Angeles, Oakland, Sacramento, San Diego or Santa Ana)

We sincerely appreciate the flexibility of our customers, staff, and stakeholders during these challenging times.

### California Competes Tax Credit – Application period began July 27, 2020

For Fiscal Year 2020/2021, the California Competes Tax Credit (CCTC) is available for allocation in three separate application periods:

- **July 27, 2020 through August 17, 2020**
- January 4, 2021 through January 25, 2021
- March 8, 2021 through March 29, 2021

For the first application period, \$80 million is available for allocation. Applications for the credit will be accepted at [calcompetes.ca.gov](http://calcompetes.ca.gov) from **July 27, 2020, until August 17, 2020**.

The CCTC is an income or franchise tax credit available to businesses that want to come to, or stay and grow in California. Tax credit agreements are negotiated by the Governor's Office of Business and Economic Development (GO-Biz) and approved by the statutorily-created CCTC Committee.

The Committee consists of:

- Director of GO-Biz (Chair)
- State Treasurer
- Director of the Department of Finance
- One appointee each by the Speaker of the Assembly and Senate Committee on Rules

Refer to GO-Biz's Program webpage on the [California Competes Tax Credit](#) for more information.

## Delinquency Control program will reduce the amount of notices sent to business entities

Starting September 2020, the Delinquency Control program is changing. This program will now only issue a Request for Tax Return to business entities who fail to file tax returns. This will reduce the amount of time a business entity has to respond by 30 days before we take further action. This change will begin with business entities such as corporations, limited partnerships, limited liability companies, and Real Estate Mortgage Investment Conduit (REMICs) who have not yet filed a 2017 return.

Every year we contact both individual taxpayers as well as business entities regarding missing returns. When we contact a business entity due to a missing return, the notification is sent through one of two programs:

- Filing Enforcement (FE)
- Delinquency Control (DLC)

After receiving income information reports:

1. The FE program identifies business entities who have not filed tax returns.
2. We issue a Demand For Tax Return notice advising the business entity that we did not receive a tax return from them by the extended due date. This notice allows 30 days for a response.
3. If we do not receive a timely response or determine the taxpayer may still have a filing requirement, we mail a Notice of Proposed Assessment to the business entity based on the income information reports.

Similarly, our internal accounting system identifies business entities who have not filed tax returns by the extended due date. As mentioned above, we call this the DLC program and when failure to file, we will notify the business entity. However, unlike the FE program, historically the current DLC program generated two notices:

1. A Request For Tax Return, which if not responded to within 30 days
2. It is followed by a Demand for Tax Return

This process allowed business entities up to 60 days to respond. Corporations, limited liability companies, and partnerships that fail to respond to the Demand for Tax Return notice are referred to Collections for resolution. If we do not receive a tax return or the business entity does not respond, we may suspend the business entity.

## Property managers and California withholding

Property managers are required to withhold 7% of the gross rent or lease payments in excess of \$1,500 per calendar year, and remit those payments to us if they both:

- Manage real property

- Collect rent or lease payments for California property owners that reside outside of California (nonresident owner)

The property manager may deduct its management fees.

This article will identify when a property manager is required to:

- Withhold taxes
- The amount that the property manager needs to withhold
- The consequences that will result if a property manager fails to withhold and remit the taxes to us

California law requires withholding of tax by persons having the control, receipt, custody, disposal, or payment of items of income, commonly termed “withhold at source.” (Title 18 California Code of Regulations (CCR) section 18662-1(a)(1)). As a property manager providing services to nonresident property owners, including but not limited to renting, leasing, or collecting rent or lease payments on behalf of the nonresident owner, you are considered the withholding agent for California withholding purposes. As a withholding agent, you are required to withhold 7% on rent or lease payments to nonresidents when the total payments of California source income, excluding property management fees, exceed \$1,500 for the calendar year. For example, a property manager who collects rents from tenants for a nonresident California property owner is required to withhold 7% of all payments associated with rents paid to nonresident owners when the payments are greater than \$1,500 per calendar year. The property manager may deduct its management fees and then calculate the seven 7% withholding based on the amount to be sent to the property owner.

For California withholding purposes, nonresident owners include one of the following:

- Individuals who reside outside of California
- Corporations, Partnerships, and LLCs that do not have a permanent place of business in California or are not registered with the California Secretary of State to do business in California
- Any trust without a resident grantor, beneficiary, or trustee, or estates where the decedent was not a California resident

As a withholding agent, you are responsible for withholding; however, there are various ways to be exempt or to withhold a reduced amount.

For California withholding purposes, the following property owners are exempt from withholding:

- California residents
- Corporations, Partnerships and LLCs registered with the California Secretary of State to do business in California, or who have a permanent place of business in California
- Estates where the deceased was a California resident at the time of death

- Nonresident owners whose gross payments do not exceed \$1,500 in a calendar year

California residents or corporations, partnerships, and limited liability companies with a permanent place of business in California, use Form 590, Withholding Exemption Certificate, to certify an exemption from withholding. When a Form 590 exemption is certified, no withholding is required.

California nonresident property owners or property managers may qualify for a waiver or reduced withholding. To request a waiver from withholding submit Form 588, Nonresident Withholding Waiver Request. To request reduced withholding submit Form 589, Nonresident Reduced Withholding Request.

If we grant a waiver or authorize a reduced withholding amount, we will notify the requester of the withholding by sending a Waiver Determination Notice or Reduced Withholding Approval letter.

If the nonresident owner is unable to obtain an approved waiver from withholding, then the property manager must withhold on the rental and lease payments collected if the gross payments exceed \$1,500.

Property managers report tax withheld on California source income to us using Form 592, Resident and Nonresident Withholding Statement. Withholding is remitted for the payment period associated with the income earned (April 15, June 15, Sept 15, Jan 15), along with the Form 592-V, Payment Voucher for Resident and Nonresident Withholding.

The property manager is required to send Form 592-B, Resident and Nonresident Withholding Tax Statement to the nonresident property owner by January 31 of the following calendar year. Form 592-B shows the California nonresident property owner the total amount withheld and reported on Form 592 for the tax year. The nonresident property owner must file Form 592-B with their California income tax return to claim the withholding credit.

**Example:**

A property management company collected rents for a property owned by a New York resident. The rents collected for each payment period total \$10,000. The property management fees per payment period are \$1,000.

Payment Period	1 (Due 4/15/XX)	2 (Due 6/15/XX)	3 (Due 9/15/XX)	4 (Due 1/15/X1)	Total
Rents Collected	\$10,000	\$10,000	\$10,000	\$10,000	\$40,000
Less management Fees	<u>(\$1,000)</u>	<u>(\$1,000)</u>	<u>(\$1,000)</u>	<u>(\$1,000)</u>	<u>(\$4,000)</u>

Payment Period	1 (Due 4/15/XX)	2 (Due 6/15/XX)	3 (Due 9/15/XX)	4 (Due 1/15/X1)	Total
Amount to be withheld upon	\$9,000	\$9,000	\$9,000	\$9,000	\$36,000
Multiply by withholding percentage	<u>7%</u>	<u>7%</u>	<u>7%</u>	<u>7%</u>	<u>7%</u>
Amount to be withheld and sent to FTB	\$630	\$630	\$630	\$630	\$2,520

In this scenario, the property manager would be required to send the withholding of \$630 to us for each payment per payment period along with a completed Form 592 and Form 592-V. By January 31 of the following year, the property manager is required to send the nonresident property owner Form 592-B, which shows the amount of rents collected of \$40,000 and withholding remitted of \$2,520.

The Form 592-B gives the property owner the information needed to claim the income and withholding on their California Tax Return.

If property managers, as withholding agents, fail to withhold and timely remit the required amount of withholding to us, they become liable for the amount that was required to be withheld, unless it is shown that the failure to withhold was due to reasonable cause. Property managers may also be liable for penalties and interest associated with their failure to withhold.

Visit our [Withholding on payments to nonresidents](#) webpage for more information.

## Offsets, what are they and have they resumed?

We frequently get asked questions about our offset programs, so we want to explain how we offset tax refunds and the COVID 19 pandemic relief we provided.

We have 2 offset programs:

- Interagency Intercept Collections (IIC)
- Treasury Offset Program (TOP)

These programs collect money from tax refunds or other government payments to satisfy taxpayer debts to us and other government agencies.

Most of the offset requests had been suspended under government order through July 15, 2020, including offsets of:

- California income tax refunds to state and local agencies



- Lottery prizes and unclaimed property.
- IRS refunds (including federal Economic Impact Payment checks)

As of July 16, 2020 these offset programs have resumed. Individuals and business entities that expected a refund and have other government debts may be impacted.

We administer the IIC program on behalf of the State Controller's Office. At the request of one of the participating agencies, IIC intercepts (offsets) refunds such as:

- Tax refunds
- Lottery winnings
- Unclaimed property payments

The offsets come from individuals or business entities when they owe delinquent debts to government agencies, including the IRS and California colleges.

An interagency intercept may occur against an individual when an intercept request is made by a:

- State
- County or city agency
- University
- Special district
- The Internal Revenue Service

For a business entity an interagency intercept may be requested by the:

- Employment Development Department
- California Department of Tax and Fee Administration

If the individual has an intercept request from any of the requestors listed and there is a refund due, we intercept that refund and remits funds, up to the amount of the debt, to the requesting agency. Furthermore, refunds from jointly filed tax returns may be applied to the debts of either taxpayer filing the return. After all tax liabilities are paid, the remainder will be refunded.

TOP is a centralized offset program that collects delinquent debts owed to federal agencies and states. We partner with TOP to offset federal payments and tax refunds in order to collect delinquent state income tax obligations. If a taxpayer has a California income tax debt and is entitled to a federal income tax refund, we are authorized to withhold from that refund, or offset it, to pay the balance due.

As you can see, our partnership with other state and federal agencies help resolve either delinquent income taxes or other government debt. Visit [interagency intercept collection](#) or [Treasury Offset Program](#) on our website for more information.

## California State Board of Equalization holds its Annual Taxpayers' Bill of Rights Hearing August 18, 2020

The California State Board of Equalization will hold its annual Taxpayers' Bill of Rights Hearing on August 18, 2020. This agency is responsible for the following programs:

- Property taxes
- Alcoholic beverage tax
- Tax on insurers

The hearing allows taxpayers, taxpayer and industry representatives, and local agencies involved in California's property tax system to provide comments on items discussed in the agency's Taxpayers' Rights Advocate Annual Report, and to present ideas, comments, and input on agency services. Parties have the opportunity to come before the five-member Board, one member elected from each of California's four equalization districts and the State Controller serving as the Board's fifth member, to have their voices heard. Parties can provide input or share ideas at the hearing about any of the programs administered by the agency. Additionally, taxpayers and industry representatives may present their proposals on changes to the Alcoholic Beverage Tax Law which may further improve voluntary compliance and the relationship between taxpayers and government. Visit [BOE's Taxpayers' Rights Advocate](#) website for more information.

## IRS subscription services

In our [May 2020 Tax News](#), we let you know about several useful [IRS resources during COVID-19](#). One of the resources we mentioned was the IRS' [e-News-subscription service](#). This month, we want to go into more detail about some of the content that is available to you from the IRS direct to your in-box.

IRS' current e-News subscription subcategories include:

- **News Releases, Tax Law Updates and General Tax Information**, which also provides for [IRS News in Spanish](#) (Noticias del IRS en Español) with tax tips and updates in Spanish.
- **Tax Professionals and IRS Partners**. Here you can find a [weekly e-News for Tax Professionals](#) to receive the latest IRS updates for the tax professional community.
- **Payroll Professionals** has [e-News for Payroll Professionals](#) where you can receive tax information affecting the payroll and human resource community,
- **e-News for Business**. This may be useful to you for your clients subject to the Foreign Account Tax Compliance Act (FATCA). You can receive [FATCA news and information](#) with updates on the latest IRS news, guidance, regulations and other public information related to FATCA.
- **Employees Plans** has [e-News for Employee Plans](#) geared toward retirement plan practitioners, including attorneys, accountants, actuaries and others.

Finally, there are additional online e-subscriptions for tax professionals and others who may be interested in **Tax Exempt and Government Entities** including:

- Indian Tribal Government News
- Tax Exempt Bond Community News
- Exempt Organizations
- Federal State and Local Governments

Regardless of the area(s) of your practice or interests, there is a great deal of information available to you from the IRS; all you have to do is sign up!

## Ask the Advocate

### New guidelines and contact information for Advocate Assistance



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Taxpayers' Rights Advocate.  
Follow me on Twitter at  
[twitter.com/FTBAdvocate](https://twitter.com/FTBAdvocate)

Now that we're past the July 15<sup>th</sup> initial filing deadline, FTB's contact centers will start hearing from tax professionals regarding notices issued for recently filed returns. This year, we expect notices for 2019 returns to start going out near the end of August. One of the most common filing notices sent is when there is a difference in withholding or payments between a return and FTB's records. While these and other issues your clients have with FTB can and will be resolved quickly, there are times when going through the normal channels doesn't resolve a problem or issue and additional assistance is needed.

One of my core functions as the Taxpayers' Rights Advocate is helping taxpayers when they are unable to resolve their issues with FTB through the normal channels. My staff and I work to protect taxpayers' rights and ensure that even the most difficult problems are handled promptly and fairly. To facilitate this, we have a formal account resolution process in place for when the normal channels don't work. This month, I want to let you know about some recent changes to this process.

Earlier this year, we transitioned three Account Resolution Specialists from our Executive Services Section to the Taxpayers' Rights Advocate's Office (TRAO). These three individuals have a broad range of knowledge and extensive experience working with taxpayers and accounts. Some of you may have already worked with one of our Specialists. They are very good at what they do and are a welcome addition to our team.

Requests for Advocate assistance primarily come into the TRAO three different ways:

1. Email: [FTBAdvocate@ftb.ca.gov](mailto:FTBAdvocate@ftb.ca.gov)
2. Mail or Fax: Taxpayer Advocate Assistance Request, [FTB Form 914](#)
3. Online form: [Unresolved Account Issues](#)

Regardless of how requests for assistance come in, my staff first reviews them to ensure they meet our criteria and warrant action. Broadly speaking, we primarily focus on taxpayers' problems with FTB that may cause unwarranted financial difficulties, have an immediate threat of adverse action, and repeated contacts have been made to FTB without a response or resolution.

This brings me to an important point: A request for Advocate assistance should not be your first step in the problem resolution process. We have a very small staff in TRAO and are limited to helping taxpayers who have been unable to resolve their issue through normal channels. For this reason, we may initially refer taxpayers and tax professionals to our contact centers or other business areas as their first step in the problem resolution process. We may also route a case to a different business area within FTB if their assistance is needed or when a case does not meet [Taxpayer advocate criteria](#).

I know that notices and other unforeseen problems can be frustrating, especially when your client believes the fault is not theirs. And, in many instances, the problem is not something they caused. Our contact center and other public facing staff work very hard to resolve issues as efficiently as possible and in nearly all cases, they are able to resolve an issue or notice with the first contact. Sometimes though, despite FTB's best efforts and yours, this isn't the case. When this happens, it may be time to request Advocate assistance. We will be there for you and will work with you to resolve the matter at hand.

## Chief Counsel Corner



**Jozel Brunett**  
Chief Counsel

### **1031 transactions: The importance of determining which party conducted the sale**

In the nonprecedential *Appeal of Sharon Mitchell* decision,<sup>1</sup> the Office of Tax Appeals (OTA) applied several longstanding tax principles to a unique set of facts concerning the disposition of property. The OTA determined the taxpayer, with the assistance of her partnership's managing partner, in the capacity as the taxpayer's agent, effected a qualifying exchange of property under Internal Revenue Code (IRC) section 1031,<sup>2</sup> as incorporated into California tax law. The OTA's panel of judges engaged in the same inquiry as the courts in *Commissioner v. Court Holding Co.*,<sup>3</sup>

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1 2018 – OTA – 210, nonprecedential; 2020 – OTA – 001, nonprecedential Opinion on Petition For Rehearing.

2 Referred to herein as a "1031 exchange."

3 *Commissioner v. Court Holding Co.* (1945) 324 U.S. 331.

*Bolker v. Commissioner*,<sup>4</sup> and *Chase v. Commissioner*,<sup>5</sup> to determine the fundamental question of who negotiated and controlled the sale of property. The Tax Court's opinion in *Bolker, supra*, begins: "The first question we must consider is who made the exchange... [t]his question is one of fact."<sup>6</sup> The *Appeal of Mitchell* decision's dependence on its particular facts does not negate the application of standard legal doctrines to future factual inquiries.

Courts have long engaged in the review of which party actually participated in the transaction to secure a tax benefit, or which person should realize and recognize income. For example, there are a number of decisions which address this inquiry. California taxpayers continue to have a published Board of Equalization decision<sup>7</sup> to serve as guidance in a 1031 exchange, where the statute's criteria were reviewed. Taxpayers can also look to the persuasive federal decision in *Chase, supra*, which dealt with who effected the sale of California real property in a disallowed 1031 exchange. Doctrines such as substance over form, and the assignment of income, where income must be realized by the person who earned it,<sup>8</sup> are not limited to 1031 exchanges, and remain viable arguments in a variety of transactions to ensure proper tax reporting by all California taxpayers. A 1031 exchange requires the same person to relinquish and receive like-kind property. In order to determine the person who must satisfy all the criteria of IRC section 1031, as considered in *Chase, supra*, proper attribution of any realized income must reflect the reality of the sale.

Tax practitioners have recently attempted to cite the nonprecedential decision in *Appeal of Sharon Mitchell* in response to Franchise Tax Board (FTB) audit inquiries regarding whether the required elements of a 1031 exchange were satisfied, including ensuring the party negotiating the disposition of its relinquished property obtained replacement property. Courts have long distinguished between civil law formalities such as deed preparation, and the tax effects resulting from a transaction, as confirmed by the statement: "The labels, semantic technicalities, and formal written documents do not necessarily control the tax consequences

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4 The Tax Court analyzed the facts as to whether Mr. Bolker negotiated the sale of the relinquished property for his own behalf, or on behalf of his corporation. *Bolker v. Commissioner* (9th Cir. 1985) 760 F.2d 1039 *affg.* (1983) 81 T.C. 782.

5 *Chase v. Commissioner* (1989) 92 T.C. 874.

6 *Bolker, supra*, 81 T.C. 782, 794.

7 *Appeals of Brookfield Manor, Inc., et. al*, 89-SBE-002, decided January 11, 1989.

8 *Commissioner v. Culbertson* (1940) 337 U.S. 733,739-40.

of a given transaction. Rather, we are concerned with economic realities and not the form employed by the parties."<sup>9</sup>

In fact, in the *Appeal of Sharon Mitchell*, the decision undertook the required inquiry of determining which party engaged in a series of required acts, as opposed to precluding such an inquiry. The OTA panel determined the partnership's managing partner, as agent for the taxpayer, negotiated the independent sale of property by the taxpayer, allowing the taxpayer to complete the exchange with the use of a qualified intermediary. The result in this particular appeal affirms an adjudicatory body's duty to examine the objective economic realities of a transaction, rather than rely on the satisfaction of the technical requirements for the passage of title under state law.<sup>10</sup>

FTB continues to apply the longstanding rule "the incidence of taxation depends upon the substance of a transaction," and will determine whether or not a person was used as a conduit to effect a sale by other parties. Taxpayers continue to have the opportunity to establish independence in sales negotiations, including the sales terms, timing of the sale, price, and other conditions, to establish whether they, or some other person or entity, was the true seller of property, whether in a reported 1031 exchange, or some other transaction.<sup>11</sup>

## Event Calendar

As part of education and outreach to our tax professional community, we participate in many different presentations and fairs. We provide a [calendar](#) that shows the events we attend (virtually), as well as other events happening with us, such as interested party and board meetings.

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9 *Houchins v. Commissioner* (1982) 79 T.C. 570, 589, citing *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978); *Estate of Franklin v. Commissioner*, 64 T.C. 752 (1975), aff'd. on other grounds 544 F.2d 1045 (9th Cir. 1976).

10 *Gaggero v. Commissioner*, T.C. Memo. 2012-331 (citing *Frank Lyon Co. v. United States* (1978) 435 U.S. 561, 573).

11 *Salvatore v. Commissioner* (1970) 29 T.C.M. 89, T.C. Memo 1970-30.