



# Tax News

January 2019

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## Reminder: Business entity payment notification letters going out soon

In our [November 2018 Tax News](#), we let you know that beginning later this month and into early February, we will be providing business entities that have taxable income or unrelated business income, a summary of their 2018 tax year estimated payment, transfer, and credit information – the same information available to our contact center staff. This is a pilot project aimed at reducing the need to contact us to verify business entity payments.

We will mail Summary of Account Payments, Transfers, and Credits (FTB 3713), to business entities who made an estimated limited liability company fee or estimated tax payment for their 2018 tax year.

## Request for, California Like-Kind Exchanges (FTB 3840), letters going out

Beginning in late December 2018 through February 2019, we are mailing letters to taxpayers who either failed to file or filed an incomplete [FTB 3840](#) for 2016. The letters request that taxpayers file FTB 3840 to include California-specific details.

As mentioned in our [October 2018 Tax News](#) in the article, **FTB 3840, California Like-Kind Exchanges, Filing Requirements and Tips for Correct Reporting**, California requires taxpayers to file form FTB 3840, California Like-Kind Exchanges, when they exchange real property located in California for like-kind property located outside of California. This requirement began with tax years beginning on or after January 1, 2014.

FTB 3840 must be filed in the year that the like-kind exchange occurs and every year thereafter as long as the gain or loss is deferred. The reporting continues until one of the following occurs:

- Deferred California sourced gain or loss is recognized on a California return
- Property is transferred through inheritance, eliminating the deferred California source gain or loss
- Replacement property is donated to a non-profit organization

In addition, if the out-of-state replacement property is later exchanged for another property as part of a tax-deferred exchange, an FTB 3840 is still required because the gain or loss deferral continues.

The [instructions for FTB 3840](#) require that the federal amounts reported on Part III, line 12 through line 25 of federal Form 8824 be entered on FTB 3840, Part II, line 7 through 20, respectively. In addition, Schedule A, Parts I, II, and III require California-specific information.

Common issues that we found on FTB 3840 include:

- A box on Question B has not been checked to indicate whether the FTB 3840 is an initial, amended, annual, or final form.
- Vague, incomplete, or omitted property descriptions. FTB 3840 instructions require that the full address (or assessor's parcel number, county, and state) must be reported.
- Missing ownership percentages.
- Omitted California source deferred gain (Schedule A, Part I, Line 8).

Search our website for FTB 3840 to get more information.

## Common personal income tax audit issues

One question we consistently get from tax professionals has to do with what the more common audit issues are for personal income taxpayers (PIT). It goes without saying that a large portion of our audit adjustments originate from IRS audits of California taxpayers, and, these of course, cover a wide range of issues. But, in terms of what our auditors focus on when we initiate an audit, include some of the more common areas:

- Sales of personal or real property, including like-kind exchanges
- Shareholder/partner/owner's Basis in a Pass-Through Entity
- California residency and sourcing of income
- Head of household (HOH) filing status
- Employee business expenses

It's worth noting that some audits of like-kind exchanges result from incomplete, missing, or improperly completed [California Like-Kind Exchanges](#) (FTB 3840) forms. We have a related article this month, **Request for, California Like-Kind Exchanges, letters going out (FTB 3840)**.

Finally, if your client is audited by the IRS and changes are made, we have an informational publication [Federal Tax Adjustments and Your Notification Responsibilities to California](#) (FTB 1008), which explains the responsibility for notifying us in this event and the different methods for doing so.

## Tax Appeals Assistance Program (TAAP) information now available

As of January 1, 2019, the Taxpayers' Rights Advocate Office began administering the franchise and income tax portion of the TAAP.

The TAAP is a valuable program that offers free legal assistance to eligible taxpayers of limited means who have filed an appeal to the Office of Tax Appeals on an action taken by the Franchise Tax Board. The TAAP can assist in cases acknowledged by the Office of Tax Appeals

where the amount being disputed or the amount of refund being claimed is less than \$30,000 for certain tax issues.

In circumstances that the TAAP may be a better option for your client, please refer your client to our website. We have added information about the TAAP on the [Taxpayers' Rights Advocate Office](#) page, in the **Your rights as a taxpayer** section. Taxpayers can email [ftbtaap@ftb.ca.gov](mailto:ftbtaap@ftb.ca.gov) or call **(916) 845-8227** for more information on TAAP eligibility.

## California Competes Tax Credit

The California Competes Tax Credit (CCTC) is an income or franchise tax credit available to businesses that want to come 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 a 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

**For Fiscal Year 2018/2019, the CCTC is available for allocation during three separate application periods:**

- July 30, 2018, through August 20, 2018
- January 2, 2019, through January 21, 2019
- March 4, 2019, through March 25, 2019

For the second application period, \$75 million is available for allocation. Applications for the credit will be accepted at [calcompetes.ca.gov](http://calcompetes.ca.gov) from **January 2, 2019, until January 21, 2019**.

GO-Biz is hosting a series of [webinars](#) designed to help businesses apply for the \$75 million credit.

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

## Conformity Hearing and Input

The federal Tax Cuts and Jobs Act (TCJA) has been on everyone's mind, including whether California will conform to various federal provisions. Many of our stakeholders wanted to

provide comments to us about this, so in late November we held a public two-part conformity meeting, with the morning session devoted to discuss business changes and the afternoon for personal income tax issues. A big **thank you** to all of those who participated.

We have videos of both sessions available: [Business](#) and [Individual](#); and a Summary of Federal Income Tax Changes ([SOFITC](#)) that may also be helpful in understanding the myriad changes coming.

### Delayed 1099-G (Certain Information Returns)

There are situations where a timely filed tax return requires additional review and validation. When this happens, the return may be held past the year in which it was filed. For example if a 2017 return is filed on October 15, 2018 and processing is delayed, we may not issue a refund until 2019.

When a refund is issued a year after the filing year, the [1099-G](#) will be issued for that year, i.e., **the year in which the taxpayer received the refund**. When required, taxpayers must report the refund in the year it was received and not the year the tax return was filed. In the example provided the refund should be reported in 2019 rather than 2018 and it may require an update to how you or your client report the income.

When tax preparation software is used, the 1099-G amount may be automatically populated for the year the tax return was filed. If this is the case, the 1099-G information should be updated to show the year the refund was received. If using a tax preparer, the taxpayers should notify their preparers of the year the refund was received to ensure the 1099-G information is accurately reflected on the return.

If the 1099-G is not available when it is time to prepare the return, the following methods can be used to verify the correct tax year and amount: MyFTB, Secure Chat, or Tax Practitioner Hotline.

### New 2019 California legislation changes CTEC requirements for CRTPs

California Assembly Bill 3143 was signed into law in September with new provisions and requirements that will extend the California Tax Education Council (CTEC) program until

January 1, 2023. The renamed Tax Preparation Act (California Business and Professions Code Section 22250) stipulates revisions that will impact CTEC Registered Tax Preparers (CRTPs).

### CRTPs must provide CTEC's website to clients

Effective January 1, 2019, CRTPs must provide the CTEC website, [ctec.org](http://ctec.org), to clients in writing prior to rendering tax preparation services. This is in addition to other information already required: tax preparer's name, address, phone number and bond number.

### Disciplinary actions against CRTPs made public

Beginning July 1, 2019, CTEC will post on its website:

- All disciplinary actions taken against registrants by the Council, including - but not limited to - misconduct that resulted in a suspension or revocation of a CRTP registration
- A list of registrants on probation, including the misconduct that resulted in the probation and any terms of probation

### Reporting bond claims

On or after July 1, 2019, a CRTP is required to report all paid claims against their surety bond to CTEC. CTEC is also required to post a notice of the paid surety bond claims on [ctec.org](http://ctec.org).

### IRS video portal offers a new webinar

The **Tax Reform Basics for Individuals and Families** webinar is available for viewing from the IRS Video Portal:

**Topic:** Tax Reform Basics for Individuals and Families  
**First Aired:** Thursday, October 18, 2018  
**View:** [IRS Video Portal](#)

The full transcript is provided as closed captioning and the PowerPoint is posted for downloading under the **Slides PDF** link.

The IRS offers programs for: [tax practitioners](#) and [small businesses](#).

Visit: [Internal Revenue Service](#) website and type *webinars* in the search box.

To view other archived webinars, visit:

[IRS Video Portal](#) and select the [All Webinars](#) link at the bottom of the page.

Please feel free to share this with others who may benefit from this information.

## Ask the Advocate



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

### Taxpayers' Bill of Rights Hearing summary

As I sit down to write this, we have just finished up with one of our more important meetings: the annual **Taxpayers' Bill of Rights Hearing**. The Hearing takes place during the last quarterly Franchise Tax Board meeting of each year. My staff and I facilitate the hearing and provide industry representatives, tax professionals, and individual taxpayers the opportunity to present to the three-member Franchise Tax Board proposals for changes to California's tax laws and suggestions on how FTB can improve the services we provide. 2018's hearing was held on Monday, December 10. If you were interested in the hearing, but were unable to attend or follow it live online, you can always access an archived video of this and other public meetings on our [Franchise Tax Board Meetings](#) webpage.

Some of the issues brought forward this year involved whether California should conform to certain changes in the federal Tax Cuts and Jobs Act (TCJA), simplifying accounting methods for small businesses, and FTB providing guidance on market-based sourcing for sole proprietors and single-member limited liability companies. There was a request for FTB to provide additional information on withholding on real estate sales and we also heard some positive comments about FTB's efforts in addressing some of the issues raised at the 2017 hearing. This last point is important, because it shows the value of the hearing. FTB listens to the concerns of those who conduct business with us, and when it is feasible, steps are taken to implement positive changes.

Another aspect of the hearing, and one that I will be working on soon with FTB's many business areas, is preparing written responses to the issues raised this year. We plan to have the responses completed by early February 2019 and will make these available online once we send them out to the presenters. We currently have several prior years' responses available on the Taxpayers' Rights Advocate page at [Taxpayers' Bill of Rights Hearing Responses](#). The issues raised at the hearing and FTB's responses are included in our Annual Report to the Legislature, which is also available online. [The 2018 Report](#) includes 2017's hearing issues and responses. The Annual Report is one of several ways that we communicate with the Legislature, keeping them informed about important issues and trends affecting FTB. My staff and I complete this report every November, making the end of the year a busy time for us.

I am sure the end of each year is busy for you, perhaps even more so this year. FTB has been working hard to update our systems for the many ongoing annual changes and to prepare the tax forms you will need to file, including a new expanded Schedule CA. It takes many people to



make the filing season run smoothly and to quickly address any problems that arise. There are many dedicated, hardworking, and talented people in FTB's filing and return processing areas and I am optimistic that everything will go well.

In closing, I hope the 2018 Holiday Season was a good one for you and that you were able to spend some quality time with your family and friends. My staff and I are looking forward to a busy and productive 2019 and continuing our efforts on behalf of you and your clients.

## Chief Counsel Corner



**Jozel Brunett**  
Chief Counsel

### Market-based rules and the tax effects on the sole proprietorship

Under California Code of Regulations, title 18, Section 17951-4 (Regulation 17951-4), subparagraph (c), if a sole proprietorship carries on a unitary business within and without California, its income is sourced in accordance with Revenue and Taxation Code (R&TC) Sections 25120 to 25139, the apportionment rules of the Uniform Division of Income for Tax Purposes Act (UDITPA). Previously, pursuant to California's UDITPA's rules, business income was generally sourced based on doubled-weighted sales, property and payroll factor methodology. More specifically, sales of services were sourced based on a "cost of performance" methodology. However, with the passage of Proposition 39 in 2012, for tax years beginning January 1, 2013, business income is

generally now sourced based on a single sales factor methodology. Moreover, sales of services are sourced based on a market approach, which means that the sales of services are sourced to the jurisdiction where the benefit of the service was received.

With respect to nonresidents that carry on a unitary business within and without California, if the nonresident performs services from her or his home state, but the benefit is received in California, pursuant to the market-based apportionment rules, the nonresident will have California source income that must be reported.

It is important to emphasize that Regulation 17951-4 uses the terms "carrying on" and "conducting" to describe the California business activity for sourcing. This is distinct from the "doing business" standard set forth in R&TC Section 23101, which is used for franchise tax purposes. For income tax sourcing purposes, the regulation uses these two common words interchangeably to indicate that the colloquial understanding of the phrases is to be applied.

Additionally, to understand the meaning of the term "unitary" as used in Regulation 17951-4, a careful reading of subparagraph (b) is helpful. That subparagraph provides a framework for the use of the term "unitary" for purposes of this regulation only. Specifically subparagraph (b) defines what is not unitary, leaving the other subparagraphs to describe the taxation of unitary



businesses. Businesses which are not unitary are "so separate and distinct from and unconnected with the part without the state such that the *respective business activities* are not part of a unitary business, trade or profession." (Emphasis added.) In other words, unitary businesses are those businesses where there is an interrelationship between in-state and out-of-state activities. Further, a taxpayer need not be present to derive income from California sources, as confirmed by the phrase in subparagraph (b) "if a nonresident owns a hotel in California... and is not significantly involved in the management of the hotel, only the net income from the hotel in California is derived from sources within this state."

Therefore, when sole proprietorships have customers in California, receiving the benefit of the services here, the sole proprietorships are carrying on business in California, under the plain meaning of that phrase. Their work in their home states shows they are conducting business there, too. This interrelationship of the in-state and out-of-state activities indicates that the taxpayers have California source income.

## MyFTB Corner

### Requesting Full Online Account Access in MyFTB

You can now request full online account access to your client's information at the time you submit your Power of Attorney (POA) declaration or Add Client Tax Information Authorization in (TIA) in MyFTB.

#### Filing a Power of Attorney Declaration

- Use the updated declaration [FTB 3520 PIT](#) or [FTB 3520 BE](#) that includes the **Request MyFTB Full Online Account Access for Tax Professional(s)** section
- Select **Yes** on the declaration (Part V) or **Full** in MyFTB (using the POA wizard)
- The information entered in MyFTB must match the declaration
- Request for online account access applies to all representatives listed on the declaration
  - Online account access level applies to all existing/active POA and TIA relationships you have with your client
  - The request will also apply to any relationships the other representatives have with the client
- Upload the POA declaration [FTB 3520 PIT](#) or [FTB 3520 BE](#)
  - You may not need to upload the POA declaration if your client has a MyFTB account; they can approve the declaration (which includes the request for full online account access) in their own MyFTB account.

#### Adding a TIA Client

- Select **Full** from the **Online Access Level** screen (there is no form to upload when adding a TIA client)
- The online account access level requested will apply to the TIA and any existing POA relationships you have with your client

If submitting a TIA by mail, use the updated [FTB 3534](#) that includes the **Request MyFTB Full Online Account Access for Tax Professional** section.

Once we approve the POA/TIA, you will automatically receive [limited online account access](#) to your client's information. If you requested full online account access, we will send your client a letter with the authorization code(s) to authorize or deny full online access for each representative listed on the POA/TIA.

See our November and December Tax News Articles, [Requesting Full Online Account Access Gets Easier](#) and [We're Expediting Full Online Account Access Requests for more information](#).

## All About Business

Business Income: Where are we today – Update/changes related to partner/partnerships begin in 2019

The Office of Administrative Law recently approved our proposed amendments to the regulations for the Apportionment and Allocation of Partnership Income under R&TC Sections 25137-1 and 17951-4. The amended regulations will be effective January 1, 2019. Our [FTB Final Regulations](#) page has the [Final Text](#) that shows amended text in single underline with single strikeout for deletions.

## 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 [calendar](#) that shows the events we attend, as well as other events happening with us, such as interested party and board meetings.