



Tax News

November 2019

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Market-based sourcing for independent contractors

Under the market-based sourcing rules that went into effect January 1, 2013, a nonresident independent contractor's income is sourced to the location where the customer received the "benefit of the services."

If the nonresident **performs** services from her or his home state, **and the benefit** is received in California, an independent contractor operating as a sole proprietor will have California source income under [California Code of Regulations \(CCR\), title 18, Section 17951-4\(c\)](#), when the business is unitary.

Unitary business

The independent contractor who operates as a sole proprietor has a unitary business within and without California when there is an interrelationship between in-state and out-of-state activities.

A business is deemed unitary by satisfying one of two tests to determine whether the activities in and out-of-state are sufficiently interrelated, dependent upon, or contributory to one another. First, under the **3 unities test** there must be unity of:

- 1) Ownership
- 2) Operations in a central manner
- 3) The centralized executive operation and systems

Under the alternative **contribution or dependency test**, a business is unitary if the operation of the business within California depended upon or contributed to the operation of the business outside of the state.

For example, a nonresident writer who lives in Arizona and contracts to write screenplays for California LLCs is operating a unitary business within and without California as the owner of a sole proprietorship. (**Appeal of Blair S. Bindley**, [2019-OTA-179P](#), May 30, 2019.)

Benefit of the service

Once the sole proprietor qualifies as operating a unitary business, the amount of income sourced to California depends upon where the purchaser of the service receives the benefit of it, according to [R&TC Section 25136-2\(a\)\(1\)](#). Regulation 25136-2(a)(1) provides instructions and examples for determining the location of the benefit of the service.

Corporate or business entity customer

When a corporate or business entity is the customer of an independent contractor, the analysis starts with the first of the cascading rules at Regulation 25136-2(c)(2)(A).

First, under (A): the location shall be where the contract or the taxpayer's books or records indicate the benefit of the services occurs. (CCR 25136-2(c)(2)(A). If the benefit cannot be

ascertained, or if the presumption of where the benefit is received can be overcome by the taxpayer or the FTB, proceed to (B).

Under (B): the location where the benefit is received shall be reasonably approximated. If the benefit cannot be reasonably approximated or determined under (A), then the analysis proceeds to (C).

Under (C): the location where the benefit of the service is received shall be presumed to be in California, if the location from which the taxpayer's customer placed the order for the service is in California. However, if the location cannot be determined under (A), (B), or (C), then the analysis proceeds to (D).

Under (D): the benefit of the service shall be in California if the billing address of the taxpayer's customer is in this state.

For example, a nonresident independent contractor graphics and web designer contracts with a California hospital with multiple facilities throughout the state. His contract is to redesign the internal corporate communications for the administrators and medical staff located in California so he would have California source income to report. More examples of scenarios can be found at CCR 25136-2(c)(2)(E).

Location of customer's customer

The current version of Regulation 25136-2 focuses on the taxpayer's direct customer's location as the location of the benefit and does **not** include a look-through provision for establishing the benefit of the service at the location of the customer's customer.

Revision of Regulation 25136-2

Amendments to Regulation 25136-2 have been proposed, but the governing regulation remains the current version until any amendments are finally adopted. Go to our [Regulatory activity webpage](#) for more information on the proposed regulations.

[Legislative update](#)

The following bills were chaptered in the 2019-2020 session of the California State Legislature:

[AB 37](#) (Chapter 792, Statutes of 2019) PIT Deduction/Commercial Cannabis Activity:

Under the Personal Income Tax Law, specifies that the federal disallowance of tax expenditures related to the illegal sale of drugs would not apply to licensees engaged in the trade or business of commercial cannabis activities in the State.

[AB 91](#) (Chapter 39, Statutes of 2019) Loophole Closure and Small Business and Working Families Tax Relief Act of 2019:

Under the Personal Income Tax Law, did the following:

- Provision No. 1: Modified the California Earned Income Tax Credit

- Provision No. 2: Created the Young Child Tax Credit
- Provision No. 3: Conformed to the Achieving a Better Life Experience Accounts Increased Contributions and Internal Revenue Code Section 529 Account Rollovers
- Provision No. 4: Conformed to the Death and Disability Exclusion for Cancellation of Indebtedness of Student Loans
- Provision No. 5: Conformed to Disallowance of the Federal Deposit Insurance Corporation Premiums Deduction
- Provision No. 6: Conformed to the Limitation of a Deduction for Excessive Employee Remuneration
- Provision No. 7: Eliminated Net Operating Loss Carrybacks
- Provision No. 8: Conformed to the Small Business Accounting Method Changes
- Provision No. 9: Modified Conformity to the Loss Limitations for Non-Corporate Taxpayers
- Provision No. 10: Conformed to the Repeal of Technical Partnership Termination
- Provision No. 11: Modified Conformity to the Limitation on Like-Kind Exchanges to Real Property
- Provision No. 12: Disallowance of Separate State IRC Section 338 Elections

[AB 101](#) (Chapter 159, Statutes of 2019) Housing Development and Financing:

Under the Personal Income Tax Law and the Corporation Tax Law, modified the Low-Income Housing Credit.

[AB 136](#) (Chapter 511, Statutes of 2019) Charitable Contribution Deduction:

Disallowed a charitable contribution deduction made to a postsecondary institution or to the Key Worldwide Foundation, and a deduction for a business expense related to a payment made to the Edge College and Career Network, Limited Liability Company, by taxpayers who met specified conditions, including that they are named in a specified criminal complaint.

[AB 263](#) (Chapter 743, Statutes of 2019) Tax Expenditure Information:

Under the Revenue and Taxation Code, repealed and replaced existing law requiring legislation authorizing a new tax credit to include specific goals, purposes, objectives, and performance measures to instead apply to legislation authorizing a new tax expenditure.

[AB 308](#) (Chapter 421, Statutes of 2019) Exemption from Annual Tax and Minimum Franchise Tax for Small Business Limited Liability Companies and Corporations Owned by a Deployed Member of the U.S. Armed Forces:

- Under the Personal Income Tax Law and the Corporation Tax Law, allowed an exemption from the annual tax or the minimum franchise tax for certain small business Limited Liability Companies and corporations that are solely owned by a deployed member of the United States Armed Forces. If double-joining language becomes effective before

January 1, 2020, this bill would also modify the minimum franchise tax for corporations having less than \$15 million in gross receipts.

[AB 414](#) (Chapter 801, Statutes of 2019) Minimum Health Care Coverage/Establish Health Care Penalty Fund:

Under the Revenue and Taxation Code, required the Franchise Tax Board to report to the Legislature specified information regarding the Minimum Essential Coverage Individual Mandate, Individual Shared Responsibility Penalty, and state financial assistance paid for health care coverage.

[AB 614](#) (Chapter 431, Statutes of 2019) Agriculture Product Donations to Food Bank Credit:

Under the Personal Income Tax Law and the Corporation Tax Law, expanded eligibility for the existing donated fresh fruits or vegetables credit (Fruits and Vegetables Credit) to additional agricultural products (Agriculture Product Donation Credit).

[AB 984](#) (Chapter 445, Statutes of 2019) Suicide Prevention Voluntary Tax Contribution Fund:

Under the Personal Income Tax Law, allowed a taxpayer to make a voluntary contribution to the Suicide Prevention Voluntary Tax Contribution Fund on the state personal income tax return.

[AB 991](#) (Chapter 497, Statutes of 2019) Code Maintenance:

Made numerous technical, but no substantive changes as a matter of code maintenance to various California codes, including to the Revenue and Taxation Code.

[AB 1130](#) (Chapter 750, Statutes of 2019) Personal Information: Data Breaches:

Under the Civil Code, changed the definition of personal information to include certain government identification numbers and biometric data.

[AB 1296](#) (Chapter 626, Statutes of 2019) Tax Recovery in the Underground Economy (TRUE) Criminal Enforcement Program:

Under the Government Code, expanded the required membership and duties of the Joint Enforcement Strike Force (JESF) as provided for in the Unemployment Insurance Code, and required information sharing among the JESF members and the continuation of two investigative teams maintained by the Department of Justice.

[SB 63](#) (Chapter 468, Statutes of 2019) Student Loan Debt Relief:

Under the Personal Income Tax Law, provided an exclusion from gross income for student loans that are forgiven when the borrower is unable to complete a program of study because a school closes, the borrower successfully asserts the school did something wrong or failed to do something it should have done, or where the borrower attended Brightwood College or The Art Institute of California, under specific circumstances.

[SB 78](#) (Chapter 38, Statutes of 2019) Health Omnibus:

Created the California Minimum Essential Coverage Individual Mandate, a program similar to the Affordable Care Act administered by the Internal Revenue Service, but the state program will be administered by the California Health Benefit Exchange and the Franchise Tax Board.

[SB 92](#) (Chapter 34, Statutes of 2019) Office of Tax Appeals: Establish Alternative to Appear Before a Tax Appeals Panel:

Under the Government Code, required the Office of Tax Appeals to establish a process for appellants to elect to appear before one administrative law judge instead of appearing before a tax appeals panel.

[SB 309](#) (Chapter 325, Statutes of 2019) California Senior Citizen Advocacy Voluntary Tax Contribution Fund:

Under the Personal Income Tax Law, repealed the minimum contribution requirement for the California Senior Citizen Advocacy Voluntary Tax Contribution Fund.

[SB 451](#) (Chapter 703, Statutes of 2019) Rehabilitation of Certified Historic Building Credit

Under the Personal Income Tax Law and the Corporation Tax Law, created a tax credit for a portion of the costs paid or incurred to rehabilitate certain historic structures.

[SB 637](#) (Chapter 327, Statutes of 2019) Prevention of Animal Homelessness & Cruelty Voluntary Tax Contribution Fund:

Under the Administration of Franchise and Income Tax Law, this act modified provisions of the Prevention of Animal Homelessness and Cruelty Voluntary Tax Contribution Fund.

[SB 790](#) (Chapter 332, Statutes of 2019) State Only Election/Partnership Audit Adjustments:

Under the Administration of Franchise and Income Tax Law, clarified when the Franchise Tax Board would be required to grant a partnership's request to make a state election to report federal audit adjustments different from its federal election.

[New law will help California cannabis businesses](#)

In October, Governor Newsom signed Assembly Bill 37 into law, eliminating California's conformity with Internal Revenue Code (IRC) Section 280E for licensed Personal Income Tax (PIT) cannabis businesses.

Background

Californians legalized recreational and medicinal cannabis with the passage of Proposition 64 and the Legislature's passage of the Medicinal and Adult-Use Cannabis Regulation and Safety Act (MAUCRSA). At that time, California conformed to IRC Section 280E for taxpayers operating under the PIT Law, such as:

- Individuals operating sole proprietorships

- Partnerships and their partners
- PIT investors in S-corporations
- Limited Liability Companies treated as partnerships and their members

IRC Section 280E does not allow deductions, other than cost of goods sold, for cannabis businesses.

What is changing with the new law?

Licensed (under the MAUCRSA) PIT cannabis businesses may now deduct ordinary and necessary business expenses on their California income tax return. The bill is effective for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

What about unlicensed businesses?

Unlicensed businesses operating under the Personal Income Tax Law are still subject to the restrictions of IRC Section 280E and may only deduct cost of goods sold, not ordinary and necessary business expenses.

Are corporations affected by this new law?

Cannabis businesses operating under California's corporate tax law have not been subject to IRC Section 280E and may continue to deduct both cost of goods sold and ordinary and necessary business expenses.

Where can I get more information?

Visit our [cannabis webpage](#) for additional information on businesses income taxes.

Top 500 Delinquent Taxpayer List

We updated our website with the current list of taxpayers owing the [top 500 delinquencies of personal income tax](#) (released October 4, 2019) or the [top 500 delinquencies of business entity tax](#) (released September 13, 2019) in excess of \$100,000.

Guide to DBAs

Naming a business is an important branding strategy for a person or entity involved in a for-profit trade or business in California. An individual or a business entity must file a fictitious business name (FBN) statement with the Registrar-Recorder/County Clerk's office in the county where the business will be located when the name of the business does not include the owner's last name.

This process is also known as registering a "Doing Business As" (DBA) or "Trade Name". If the business is not located in CA, the business needs to register with the Clerk of Sacramento County.

Filing a FBN statement makes the identity of the person doing business under the fictitious name available to the public.

Registration is necessary when:

- A sole proprietorship will be doing business under a name that does not contain the owner's last name.
- A partnership or other association that will use a name that does not include the surname of each general partner or a name that suggests the existence of additional owners such as "Company," "& Company," "& Son," "& Sons," "& Associates," "Brothers," and the like.

A limited partnership, corporation, or Limited Liability Company (LLC) will be doing business under a name not stated in the Articles of Incorporation or Articles of Organization filed with the California Secretary of State.

Example:

If Michael Rocco owns a sole proprietorship, and his business name is Michael Rocco Painting, he won't need a fictitious business name because people will know who the owner of the company is and the type of business.

If he wanted to go by either Michael and Sons Painting or House Painting Fast, he would need to file because the business name suggests additional owners and doesn't include his last name.

If Michael Rocco instead owned either an LLC or a corporation, and wanted to open up additional businesses under the LLC or corporation, he would need a fictitious business name statement for any business name other than the entity's legal name.

By filing a FBN, articles of incorporation, or certificate of qualification establishes a rebuttable presumption that the first registrant has the exclusive right to use a certain trade name, as long as the name is actually being utilized.

It is important to select a business name that is not already in use, does not closely resemble an existing business name, or misleads the public.

Many cities and counties offer a FBN search on their individual websites. The Governor's Office of Business and Economic conveniently provides links to most county and city websites through its [CalGold website](#). Although a business does not file a FBN statement with the [SOS](#), SOS is a good resource for determining if a business name is already in use.

The fee to file a fictitious business name statement varies depending on the city or county where it is filed. Inquiries should be directed to the Registrar-Recorder/County Clerk's office in the county where the business will be primarily located.

The filing is valid for five years or until the facts in the statement change, whichever occurs first.

A fictitious business name statement usually must be filed within 40 days of starting the business. Along with the original, the county or city may require several copies of the statement for filing. The clerk or recorder will certify and return all copies to the registrant, keeping the original.

Within 30 days after filing a fictitious business name statement, the registrant must publish the statement in a local newspaper of general circulation near the principal place of business. The notice must appear once a week for four successive weeks.

Within 30 days of the last published date, the registrant must file an affidavit of publication with the city or county office. Check with the Registrar-Recorder/County Clerk's Office to determine if there is a specific list of approved publications in which to meet this requirement.

Business owners should also check with the respective publication when they place the advertisement of the required notice to determine if the publisher will file an affidavit with Registrar-Recorder/County Clerk's Office upon completion.

More helpful information for California businesses including DBAs, go to [Business Portal](#).

Exempt organization filing due dates

Exempt organizations are required to both:

- File annual information returns by the 15th day of the 5th month following the close of their taxable year
- Permitted an automatic 6-month extension if they are not suspended

Organizations that follow a calendar year-end should plan to file the Form 199 or FTB 199N by November 15 to avoid late fees and penalties.

Our exempt call center is available to assist nonprofits with questions concerning exemption, missing returns, or balances due.

Contact us

Phone:

(916) 845-4171

(916) 845-6500 (outside the U.S.)

Weekdays, 7 AM to 4:30 PM

Closed state holidays

Mail:

Exempt Organization Unit MS-F120

Franchise Tax Board

PO Box 1286

Rancho Cordova CA 95741-1286

Visit [Charities and nonprofits](#) webpage for more information.

Interested Parties Meeting - Demand Penalty

An Interested Parties Meeting to elicit public input on potential amendments to the California Code of Regulations, title 18, Section 19133, regarding the Penalty for Failure to File Return Upon Notice and Demand will be held:

When: Wednesday, November 13, 2019 at 10:00 AM

Where:

Franchise Tax Board
North Lobby, Goldberg Auditorium
9646 Butterfield Way
Sacramento, CA 95827

View the [Notice of Interested Parties Meeting](#) for more information.

New Minimum Essential Coverage Individual Mandate Stakeholder Meeting

Franchise Tax Board and Covered California invite you to a stakeholder meeting to discuss the implementation of California's new individual health care mandate.

When: Thursday, November 14, 2019, from 1:30 PM to 3:30 PM

Where:

Franchise Tax Board
California Town Center
9646 Butterfield Way
Sacramento, CA 95827

This meeting is intended to provide an overview of the new health care mandate and solicit feedback from stakeholders.

Please feel free to submit your health care mandate questions prior to the meeting at FTBHealthcare@ftb.ca.gov.

In order to properly plan for the event, we kindly request you to confirm your attendance by emailing us at FTBHealthcare@ftb.ca.gov no later than Monday, November 4, 2019.

Our facility is architecturally accessible to persons with physical disabilities. If you have a disability and would like to request reasonable accommodation and/or material in alternate format, please make your request as soon as possible, but no later than five working days prior to the date of the event. Some alternate formats take longer to produce than others. Therefore, the sooner your request is received, the more likely we will be able to provide the alternate format you request.

To place your request, contact FTB's Accessibility Coordinator:

- **Phone**
 - Voice: (916) 845-7003
 - California Relay Service: 711 or (800) 735-2929

- **Email**

FTBAccessibilityCoordinator@ftb.ca.gov

We look forward to meeting with you.

Ask the Advocate

FTB gig economy board meeting



Like many of you, my work tends to be cyclical. There are projects, meetings, and initiatives that occur about the same time every year. This includes several annual meetings my staff and I coordinate or I chair as the Advocate. Recently though, we had something entirely new, an FTB Board Meeting covering the California Tax Landscape and the Gig Economy.

The meeting opened with three presentations covering the gig economy and tax compliance followed by two panel discussions. The first panel spoke about the challenges and opportunities for tax compliance in a gig economy while the second panel addressed the future of the gig economy and state tax obligations. The panelists were from academia, industry, and professional education providers for accounting, legal, and tax professionals. They provided insight and information about the current state of the gig economy. If you are interested in hearing what they had to say, here is a link to the [Agenda](#) and a YouTube [video](#) of the meeting.

While estimates vary as to the percent of the workforce earning income as part of the gig economy, it is by any measure significant. Unlike the more traditional forms of self-employment, there are few barriers to entry for much of the gig economy, e.g., transportation, task/project work, or selling products. Several platforms advertise just how easy it is to get started earning income right away. This ease of entry can lead to subsequent challenges for many of these new entrepreneurs. We have heard from gig workers that there isn't a lot of information readily available to them regarding their tax filing obligations, which can lead to unpleasant surprises at tax time.

One of my many roles as Advocate is to help develop education and outreach programs to taxpayers and tax professionals. Currently, nearly two-thirds of all personal income tax returns are prepared by tax professionals, and for this reason, many of our speaking event and other education and outreach efforts are primarily geared towards you. The issue of Tax News you are reading today is a great examples of this!

But, our outreach isn't just limited to tax professionals. We also participate in a variety of taxpayer-focused outreach events statewide, including financial literacy events and events hosted by elected officials. At small business fairs we provide information about what it means to be in business and we cover the various forms of business ownership including a sole proprietorship, which is the default entity for most gig workers. We present information about filing requirements, estimate tax payments, and return due dates. Our presenters answer questions and provide contact information for our small business liaison line.

One communication tool we're working on as part of our effort to provide tax help to gig workers is the FTB [Gig Economy](#) webpage. We are currently building content for this page. There are also some other great resources for gig workers including the IRS [Sharing Economy Tax Center](#), the [California Tax Service Center](#), and FTB's [Small Business](#) webpage. There is a lot of useful information on these webpages, but we want to do more.

Going forward, I believe our education and outreach about tax compliance and the gig economy will need to cast a wider net and take on many forms to better reach everyone in our external community, including partnering with gig platforms to make basic tax and self-employment information available to those working in the gig economy. We will continue seeking opportunities to educate in order to increase self-compliance and to working with you, our valued partners in the tax professional community.

All About Business

California Group Nonresident Return (aka Composite Returns) - Part 2

In our [August 2019 All About Business article](#), we touched on a business entity's ability to file a group/composite return on behalf of its nonresident individual:

- Shareholders
- Partners
- Members

Rather than each of the above having to file a California Nonresident or Part-Year Resident Income Tax Return (Form 540NR).

In this article, we will discuss issues to bear in mind if your client is considering making this irrevocable election to file a nonresident group return on behalf of its electing nonresident individuals.

California law imposes a tax on the income of a nonresident taxpayer that is derived from or attributable to sources within this state. However, a group nonresident return may be filed by:

1. A business entity, acting as the authorized agent for its electing nonresident individual shareholders/partners/members, to report the distributive shares of income from the business entity derived from California sources or from doing business in California.

2. A corporation, acting as the authorized agent for its electing nonresident directors, to report the directors' wages, salaries, fees, or other compensation from that corporation for director services performed in California, including attendance of board of directors' meetings in California.

In other words, the business entity/corporation files the return and pays the tax on behalf of the electing nonresident individuals. A group nonresident return is considered a group of individual returns that meets the California individual income tax return filing requirement. Thus, a qualified nonresident individual who elects to be included in the group nonresident return does not file a separate personal income tax return for the tax year.

However, the electing nonresident individuals and the business entity/corporation need to consider that filing a group Form 540NR return (composite return) in California subjects the nonresident income to the highest marginal rate and therefore does not allow the taxpayer to take advantage of lower graduated rates. For taxable years beginning on or after January 1, 2012, the maximum personal income tax rate increased to 12.3%. The nonresident individuals with over \$1 million of California taxable income are eligible to be included in group nonresident returns, however, an additional 1% mental health services tax will be assessed on their entire California taxable income if they elect to be part of the group return. As a result, these nonresident individuals will pay tax at a rate of 13.3%, the top personal income tax bracket.

In addition, filing a group Form 540NR return prevents the taxpayers from taking advantage of some deductions or credits that they may otherwise have been able to use. Individual deductions are not allowed on the group nonresident return. On the group nonresident return, no deductions or credits are allowed except those directly attributable to the business entity's activity. Individual deductions include, but are not limited to, the deduction for self-employment tax, the IRC Section 179 deduction, charitable contributions, itemized deductions, and the standard deduction. However, there is an exception for the deduction for contributions to a deferred compensation plan. Partners of a partnership and members of an LLC (but not shareholders of an S corporation) are allowed a deduction on the group nonresident return under IRC Section 401 through Section 424, as modified by California. However, if an electing nonresident individual has earned income from any other source, no deduction is allowed.

A Net Operating Loss (NOL) is also an individual deduction. Consideration should also be given if there are NOLs. An individual cannot claim an NOL deduction on the group nonresident return. An individual who reports a net loss on the group nonresident return forgoes any NOL carryover that could have resulted on an individual nonresident return from that net loss.

Credits

Credits that can be claimed on the group nonresident return are credits that are directly attributable to the business entity's activities such as the new employment credit, the low-income housing credit, and the research credit.

Individual credits, such as the personal, blind, senior, or dependent exemption credits and the other state tax credit, are not allowed on the group nonresident return.

For more information on Credit limitations go to [Publication 1067](#), Guidelines for Filing a Group Form 540NR, Section F, Individual's Decision to be Included in the Group Nonresident Return.

Moving estimated payments

You may need to move estimated tax payments “from the group nonresident return to the individual nonresident return” or “from the individual nonresident return to the group nonresident return.”

Schedule 1067B – Use Schedule 1067B, Group Nonresident Return Payment Transfer Request, to authorize us to move estimated tax payments. This form is included with our Publication 1067, Guidelines for Filing a Group Form 540NR.

Withholding

In order for withholding to be credited to a nonresident group return, the proper [Form 592](#) showing the allocation of these withholding credits needs to be filed. If Form 592 is not filed, withholding may not be properly credited to the group nonresident return.

If the withholding credit was not allocated to the nonresident group return, you will need to use Schedule 1067A, Nonresident Group Return Schedule, to allow us to move withholding credits to the group.

Time period to move the payments – Once a request is received, it takes six to eight weeks to move the estimated tax payments and/or withholding credits and have them available to be claimed on the return. You should allow sufficient time for the transfers to take place before filing the group or individual returns.

The election to be included in the group nonresident return is irrevocable – If your clients are considering this option, inform individuals being included in the group that once the group nonresident return is filed, it cannot be amended to either include or exclude a nonresident individual.

[Event Calendar](#)