STATE OF CALIFORNIA
Franchise Tax Board

taxnews

Tax News

April 2016

Contents

When your clients cannot pay their taxes due…

Most taxpayers are able to pay the amount of tax owed for the year by the time they file their return. However, due to unforeseen circumstances, insufficient withholding and estimated payments, or simply less than perfect planning, not everyone is able to timely pay the entire amount owed on their return. Nearly every practitioner has had the experience of giving a client their tax return with a balance due, and then having the client tell them "I can't pay that right now!"

When this occurs, it's important to remember that even if your clients cannot immediately pay what they owe, they should always file on time and pay as much as they can with their tax return. By doing so, they will save money in penalties and interest. One option that we recommend is for your client to borrow the amount owed from a private source or pay with a credit card, including Visa, Master Card, Discover, and American Express.

Another option is an installment agreement (IA) with us. An IA allows your clients to make monthly payments if they are unable to pay their tax liability in full. We encourage taxpayers to make the largest monthly payment they can, because interest and applicable penalties will continue to accrue on the amount owed until paid in full, **even when an IA is in place**. We will also keep any future state tax refund(s) due your clients and apply it to the balance owed. We generally approve monthly IA requests if the balance owed is $25,000 or less and can be paid within 60 months; this assumes there is the ability to pay and a good compliance history. We may also approve IA requests that do not meet this criterion upon a showing of financial hardship. We generally do not file liens on these taxpayer's accounts, although we may do so. Information regarding available payment options including IA's is available on our website. IA's can also be set up using our automated phone service at 800.689.4776 with information available in both English and Spanish.

What happens though when your clients do not pay the amount owed and cannot or do not set up an IA? In these instances and generally after we have provided the required notices, we may, among other things, file liens against property owned by your client, levy financial accounts, or issue an Earnings Withholding Order for Taxes (EWOT) to your client's employer.

An EWOT is a wage garnishment that continuously seizes at most 25 percent of a taxpayer's disposable income (from wages) until we release the order. Once an EWOT is in place, our policy is not to release it, except under limited circumstances. In cases of financial hardship, we will modify an EWOT, but cannot reduce the balance due. If we issue an EWOT in error, we will release it as soon as we verify the error. We mail garnishment release notices, but we also fax them when requested. If you think we issued your client an EWOT in error, call 800.689.4776 so we can analyze your client's account. You should also call us at this number if your client has filed for bankruptcy, either before or once an EWOT is in place.

It is always best to pay the full amount of tax due by the original due date of the return to avoid penalties and interest. However, when that is not possible, an IA with us may be a viable option under certain circumstances. Having an IA in place may help your client avoid an EWOT, lien, and/or levy.

Sale or transfer of a business of substantial portion of business assets

Did you know that under California's Commercial Code (COM), the buyer of a business or substantial portions of business assets, required to provide notice of the proposed sale in compliance with the established procedures? The law's official name is Uniform Commercial Code—Bulk Sales (Bulk Sales).[1] The Bulk Sales Act is designed to protect the creditors of a business by giving them notice of a bulk sale (sometimes called a bulk transfer).

The general rule is that a purchaser of assets or a buyer of a business is not liable for a seller's obligations unless the buyer agrees to assume those obligations; however, there are a number of laws that create successor liability, also known as transferee liability, for the purchaser of a business.

The bulk sale is designed to protect buyers and creditors and has exemptions and distinctions.

Measured by the fair market value on the date of the bulk sale agreement, the key elements of the bulk sale are:

- Any sale outside the ordinary course of the seller's business.
- The sale is of more than half the seller's inventory and equipment.

[1] California Commercial Code (COM) Section 6101

In order for California Bulk Sales Law[2] to apply, two conditions must be met:

- Seller's principal business is the sale of inventory from stock, including those who manufacture what they sell, or a restaurant owner.
- Seller is located in California.

When it comes to California withholding, nonresident withholding on California source income, backup withholding, and real estate withholding, California Revenue and Taxation Code (RT&C) Section 18669 states the successor of business assets can be held personally liable for the amount of withholding taxes, interest, and penalties if the required withholding was not paid by the payer. It does not matter how the assets were acquired, whether purchased, transferred, inherited, or distributed in liquidation. The obligation to pay the required withholding tax transfers with the assets. The successor's liability is limited to the fair market value of the assets acquired.

When a successor liability is created, the successor, is required to withhold in trust a sufficient part of the purchase price or set aside in trust money or property to cover the amount of the taxes required to be withheld and any interest or penalties associated with the withholding tax obligation(s) that are due or unpaid by the business entity (payer).

A successor can submit a written request to us for the amount of withholding taxes, interest, or penalties due. For more information about submitting a written request for the bulk sale certificate, go to our May 2013 edition of Tax News Withholding on a Sale or Transfer of a Business or Substantial Portion of Business Assets, Not sure how much? Just Ask.

Need more information?

Send us an email at withholding services.

Give us a call at:

888.792.4900
916.845.4900

See also:

- Board of Equalization's publication, [Pub 74, Closing Out Your Account].
- Employment Development Department's form, [DE 2220, Release of Buyer Request Form].

[2] COM Section 6103(a)

Multistate Compact Election Return update – Tax years 2013 and after

Does your client use the three-factor apportionment formula in original returns for tax years 2013 and after?

On February 23, we issued FTB Notice 2016-01 providing taxpayers and their representative's guidance on our intended courses of action on compact election cases for years prior to the repeal of the compact. We also issued a Tax News article in February as a reminder that for tax year 2013 and after, taxpayers are required to use a sales-only apportionment formula unless there is an exception under Revenue & Taxation Code (R&TC) Sections 25128 and 25128.7. This month, we would like to let you know our plans for taxpayers that used the three-factor apportionment formula in their original returns for tax years 2013 and after.

In the coming months, we may begin contacting taxpayers regarding their method of filing to determine whether an appropriate method was used. For any cases currently under audit with this issue, we will proceed with our normal audit procedures. If we propose adjustments to a taxpayer's method of reporting, additional tax, penalties, and interest may apply.

Statute of limitations for refunding failure to withhold liabilities

We issued a Technical Advice Memorandum (TAM) 2016-02 to clarify the statute of limitation (SOL)[3] under R&TC Section 18668(a).

Statute of Limitation
SOL applies to both information returns and withholding agents, and therefore limits the period in which we may allow a refund or credit to a withholding agent for the failure to withhold liability. The four-year limitation period is calculated based on the due date of the original information return or one year from the date of the overpayment, whichever period expires later. If no information return is filed, the SOL begins to run on the due date of the original information return that was required to be filed, determined without regard to any time extension for filing the return.

Example: If a withholding agent was assessed a withholding liability under R&TC Section 18668(a) due on FTB Form 592 on January 15, 2012 and a payment was made on the liability on

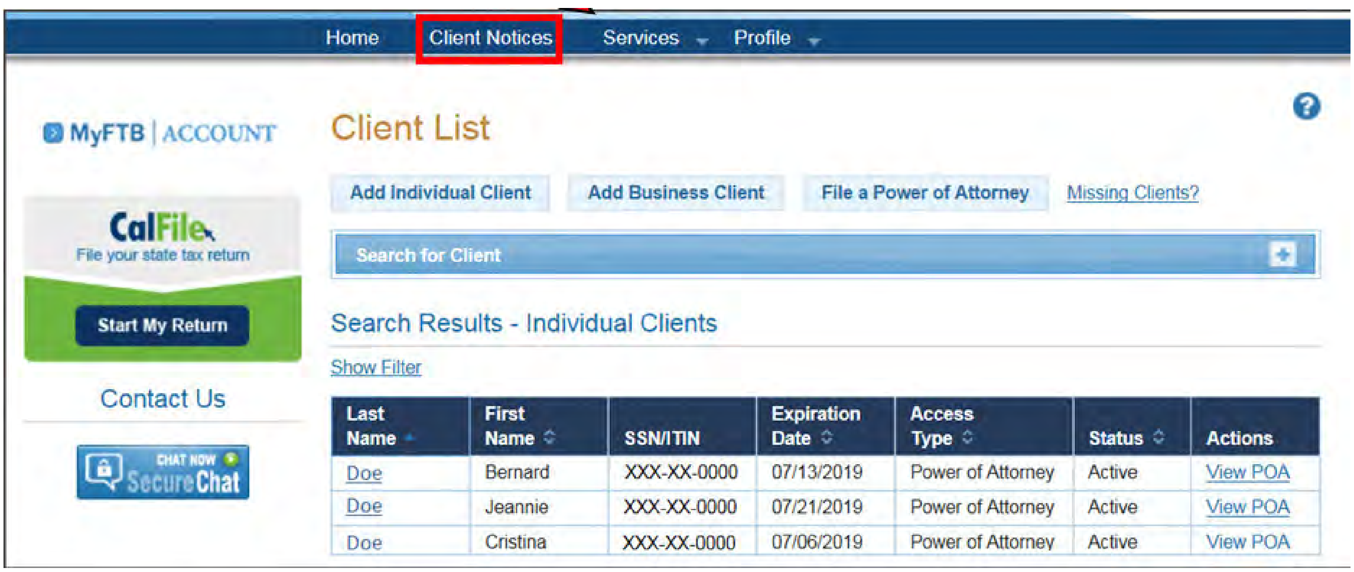
[3] R&TC Section19306

March 15, 2015, the SOL under R&TC Section19306 prevents us from issuing a refund after March 15, 2016 (one year from payment made on March 15, 2015 or four years from January 15, 2012, whichever period expires later).

Tax preparer client notices

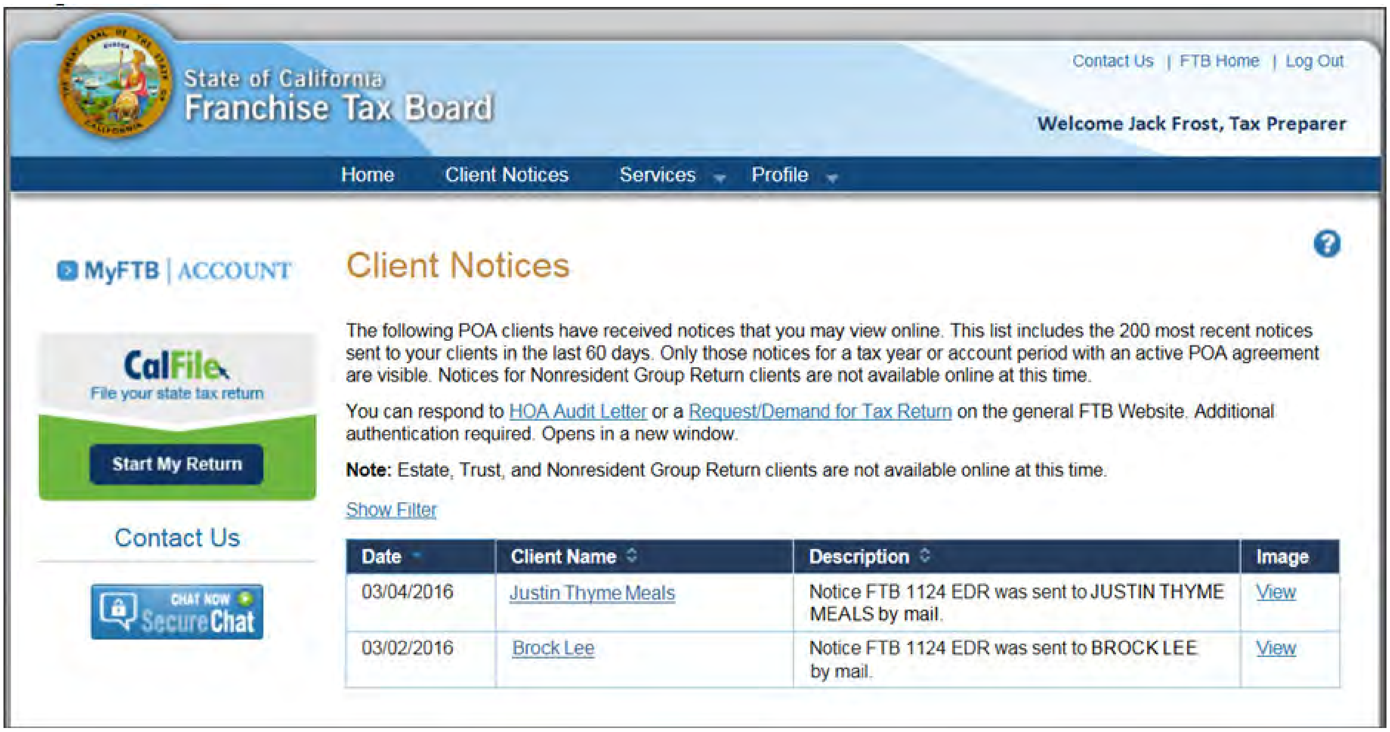
In MyFTB, Power of Attorney (POA) representatives can view most notices issued by FTB. Select **Client Notices** to view up to 200 notices sent to your client within the last 60 days.

Image 1



For Tax Preparers with 40 or less POA clients, your **Client Notices** page displays notices in date order, showing the most recently issued notices first.

Image 2



State of California
Franchise Tax Board

Contact Us | FTB Home | Log Out

Welcome Jack Frost, Tax Preparer

Home Client Notices Services Profile

MyFTB | ACCOUNT

CalFile
File your state tax return
Start My Return

Contact Us

CHAT NOW SecureChat

Client Notices

The following POA clients have received notices that you may view online. This list includes the 200 most recent notices sent to your clients in the last 60 days. Only those notices for a tax year or account period with an active POA agreement are visible. Notices for Nonresident Group Return clients are not available online at this time.

You can respond to HOA Audit Letter or a Request/Demand for Tax Return on the general FTB Website. Additional authentication required. Opens in a new window.

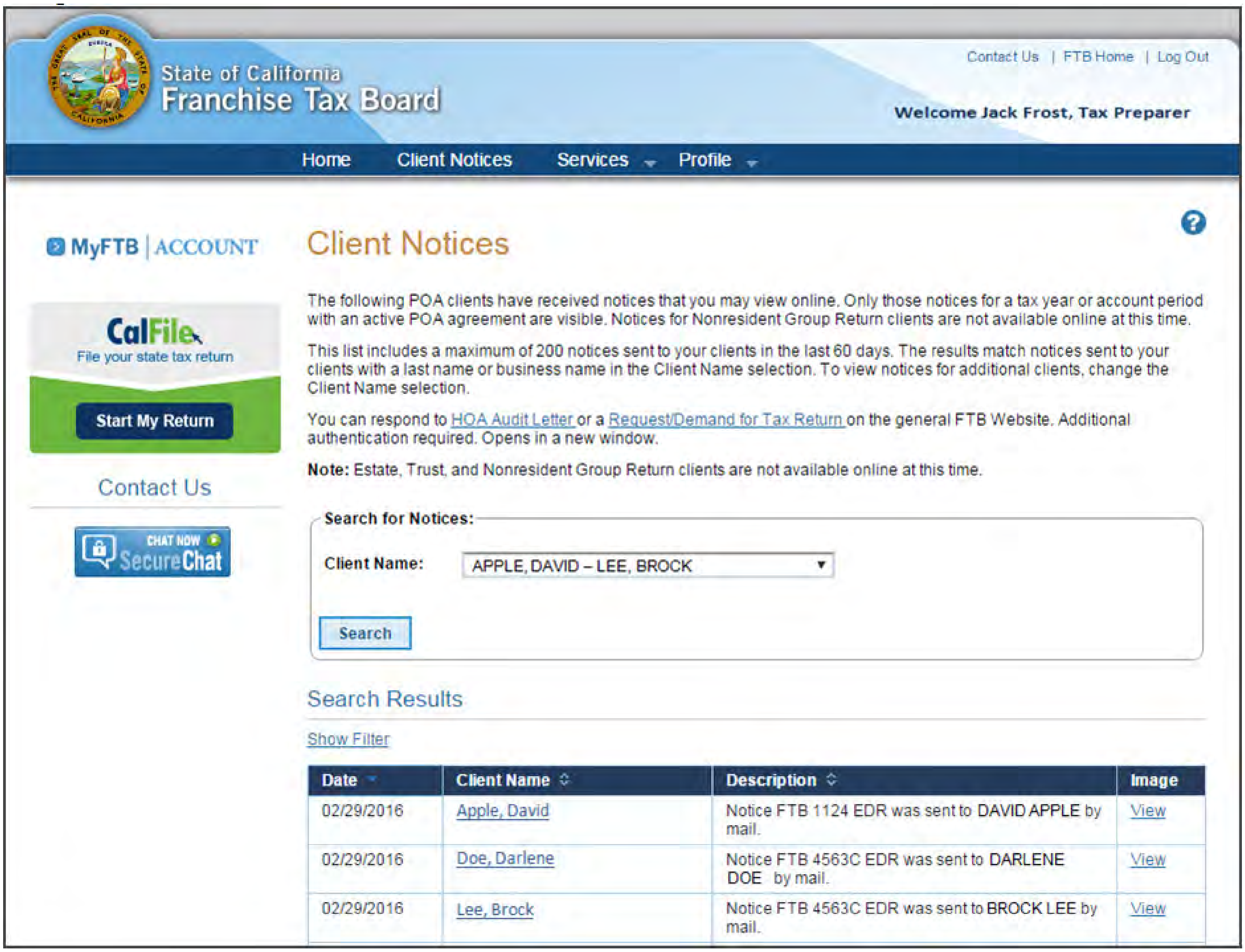
Note: Estate, Trust, and Nonresident Group Return clients are not available online at this time.

Show Filter

Date	Client Name	Description	Image
03/04/2016	Justin Thyme Meals	Notice FTB 1124 EDR was sent to JUSTIN THYME MEALS by mail.	View
03/02/2016	Brock Lee	Notice FTB 1124 EDR was sent to BROCK LEE by mail.	View

For Tax Preparers with more than 40 POA clients, your **Client Notices** page includes a dropdown menu that displays group selections of 40 clients in alphabetical order.

Image 3



Currently, Notices of Proposed Assessments are not yet viewable on the **Client Notices** page. This notice will be added to MyFTB in July 2016. We have been advising taxpayers to provide a copy of their notices to their POA representatives.

If you are a POA representative and you listed your email address on the POA declaration, you may receive an electronic notification when we issue a notice to your client. For additional information related to Power of Attorneys see **Important Information for Power of Attorney Representatives in 2016** and **Changes Coming for Power of Attorneys on January 4, 2016.**

Tax preparer client list page – Search for client

We updated the **Client List** page to make it easier to search for your clients. The **Search for Client** section is now expanded by default; making the **Client Type** search options easier to find (see image 1 below). When you select a different client type, select the **Search** button to view the search results.

For more specific search results, select the **Advanced Search** link and enter additional client information about your client, such as last name, SSN, business name, and ID number (see image 2 below).

Image 1

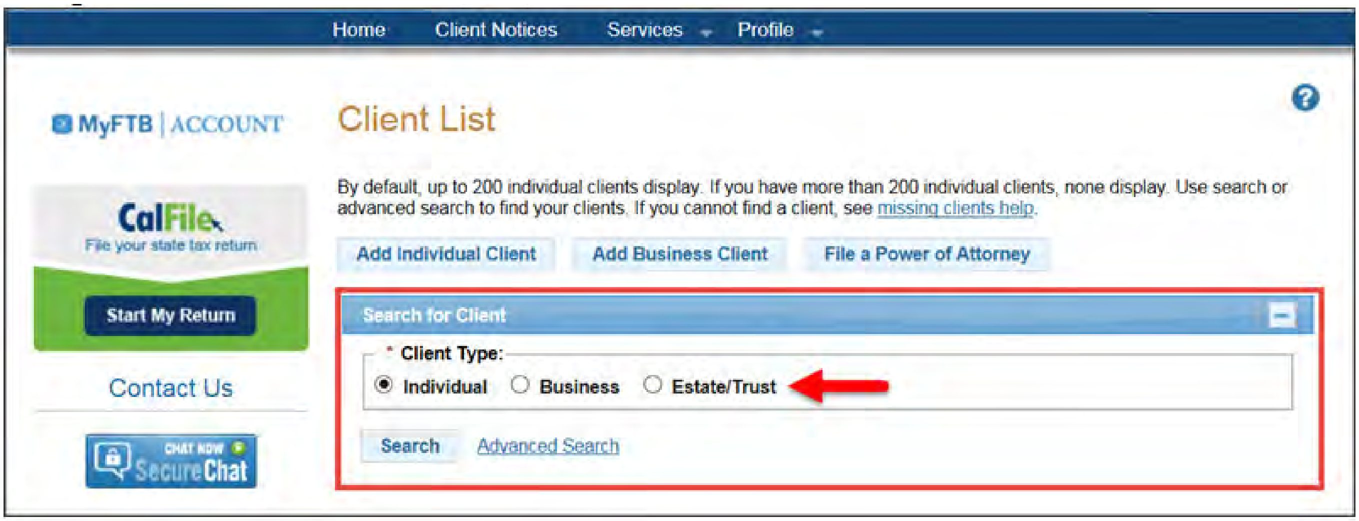
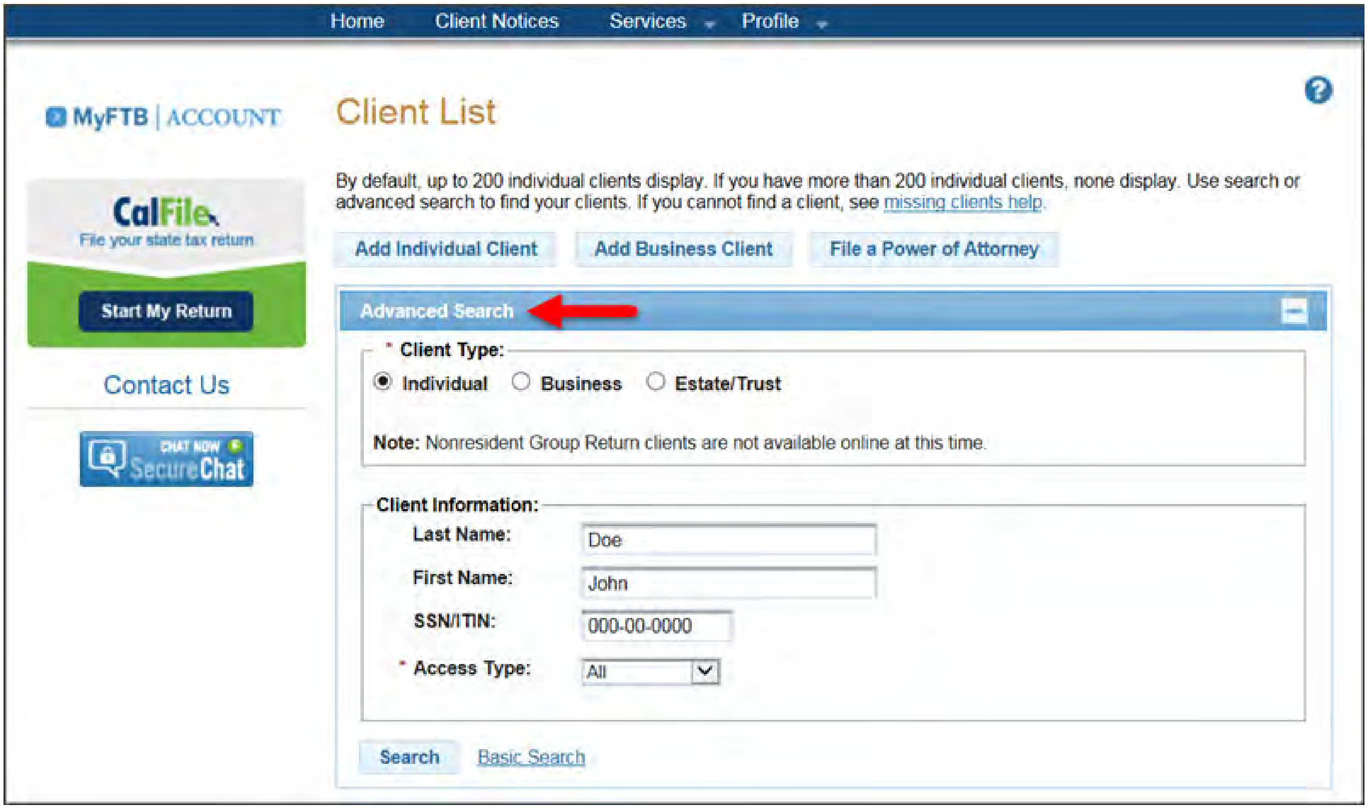


Image 2



Ask the Advocate

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

When will my client receive their refund?

Updated refund timeframes and identity theft information.

This filing season FTB, along with many other states, has enhanced its security procedures surrounding refunds as part of a nationwide effort to protect taxpayers' money by preventing fraud, tax theft, and other abusive practices. So how does this impact the timing of refunds?

The short answer is that, while the majority of California taxpayers will see no delays in receiving their refunds, some taxpayers will experience longer than expected refund processing timeframes. To provide some perspective, approximately 84 percent of all refunds were issued this year within 7 to 12 days when the taxpayer elected to use direct deposit, down slightly from 90 percent in the past two years. I know that it can be frustrating when someone is expecting a refund and learns that it will be delayed. If your client has questions about the status of their refund, the quickest way for them to check the status is to visit FTB's website at ftb.ca.gov and select **Where's My Refund**. They may also track the status of their refund by downloading the FTB Refund Mobile App available for the iPhone.

As we have done in prior years, we will ask some taxpayers for more information before issuing a refund, both to confirm their identity and verify the figures reported on their return. Other returns will go through additional reviews checking for accuracy, completeness and for common indicators of fraud or identity theft practices. If FTB suspects your client may be a victim of identity theft, the first step we take is to notify them by mail at their address of record. As a practitioner, you can help move this process forward by having your client respond to us as soon as possible.

Speaking of identity theft, I wanted to share some information in case you or your client logs into MyFTB and discovers a return not belonging to them was filed for a tax year. If this happens, your client should contact FTB immediately as they may be a victim of identity theft. The first step is to complete Form 3552 – Identity Theft Affidavit, which is available on our public website. The form can be mailed or faxed to us. In these circumstances, do not use the fax number shown on the form; instead, fax the Form 3552 to 916-843-6124, and contact our Fraud Unit at 916.845.7646.

With just over two weeks left before the April 18 filing due date, I know many of you have been putting in long hours to meet the deadline. I appreciate all of your hard work during this 2016 filing season helping taxpayers meet their filing obligations and wish you some well-deserved time off soon.

Jozel Brunett
Chief Counsel

Per Partner Penalty

Did we impose a per partner penalty on your client?

Pass-through entities like partnerships, multiple-member limited liability companies classified as partnerships for tax purposes (LLCs), and S corporations, that are "doing business" in California have a California return filing requirement. For taxable years beginning on or after January 1, 2011, taxpayers are doing business if they actively engage in any transaction for the purpose of financial or pecuniary gain or profit in California (see subdivision (a) of California Revenue and Taxation Code Section 23101) or if **any** of the following conditions are satisfied:

The taxpayer is organized or commercially domiciled in California (see paragraph (1) of subdivision (b) of Section 23101).

The taxpayer's California sales, property, or payroll exceed the amounts[4] or percentages then applicable under paragraphs (2), (3), or (4) respectively, of subdivision (b) of Section 23101. (Subdivision (d) provides that these amounts include a taxpayer's pro rata or distributive share from partnerships and "S" corporations.)

Please be advised that a pass-through entity that has an interest in a partnership or entity classified as a partnership for tax purposes may have a California return filing requirement even if its Schedule K-1 shows a loss. The same may be true in the case of a multi-tiered structure where all of the entities are partnerships for tax purposes.

In addition, pass-through entities have a return filing requirement if they are registered with the Secretary of State, or receive California source income, even if they are not doing business in California within the meaning of subdivisions (a) or (b) of Section 23101.

[4] These amounts are indexed for inflation. (See R&TC Section 23101(c).)

For a partnership or LLC, the original due date to file is the 15th day of the fourth month following the close of its taxable year. For an S corporation, the original due date is the 15th day of the third month following the close of its taxable year.

With the implementation of the Enterprise Data to Revenue (EDR) project, we have more income information and other records to identify potential partnerships, LLCs and "S" corporations that have California return filing requirements but have not filed their required returns. If a partnership, LLC or S corporation that has a return filing requirement does not file a timely return or files a return that fails to include the required information, we can initiate a filing enforcement action that can result in penalties for late filing.

The penalty under R&TC Section 19172 for partnerships and LLCs (the per partner penalty) that fail to file a timely return is calculated as follows:

$18.00 x number of partners x months the return is late (not to exceed 12 months)

The penalty under R&TC Section 19172.5 for S corporations (per shareholder penalty) that fail to file a timely return is calculated as follows:

$18.00 x number of shareholders x months the return is late (not to exceed 12 months)[5]

The Legislature added the penalties under R&TC Sections 19172 and 19172.5 to encourage these entities to file timely returns so that the owners received their Schedule K-1s in time to file accurate and timely returns. Thus, for entities that have many partners, members, or shareholders, the penalty can increase significantly for each month that the return is late, up to a maximum of 12 months.

A taxpayer can avoid the per partner or per shareholder penalties for failing to file a timely tax return by establishing that the failure to file timely was due to reasonable cause and not willful

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[5] R&TC Sections 19172 and 19172.5 are patterned after Internal Revenue Code sections 6698 and 6699, which impose per partner and per shareholder penalties against partnerships and "S" corporations that fail to file a timely return. The difference is that the federal penalty is computed at $195.00 multiplied by the number of partners or shareholders during any part of the tax year for each month that the return is late, not to exceed 12 months.

neglect.[6] In order to establish reasonable cause, the taxpayer must show that it exercised ordinary business care and prudence but was unable to timely file a return. Reliance on a knowledgeable tax professional for advice on when the law requires a return to be filed can constitute reasonable cause. However, a taxpayer cannot rely on the tax professional to perform the taxpayer's non-delegable duty to file a timely return.

Because the burden of proof is on the taxpayer to show reasonable cause reliance on a tax professional, taxpayers should provide credible and competent evidence to show, for example, that the taxpayer sought timely advice, the taxpayer provided the tax professional with all the relevant information and the taxpayer acted in good faith on the tax professional's advice. Although lack of knowledge of the law is typically not reasonable cause, there can be reasonable cause if there was a reasonable and good faith attempt to comply with the law or the taxpayer was unaware of a filing requirement and could not reasonably have expected to know of the requirement.

If we impose a Section 19172 or 19172.5 penalty, contact the Tax Practitioner Hotline at **916.845.7057** to discuss reasonable cause relief. We look at the facts and circumstances of each case to determine if the partnership, LLC or S corporation has reasonable cause for failing to comply with the law.

Inside FTB

Beware of tax scams

We receive reports of scammers calling or emailing taxpayers claiming to represent us. Typically, we contact taxpayers by mail—several times, if necessary--so any unexpected call should raise suspicions.

Be wary of a caller who claims to represent FTB and:

- Asks for passwords or information about credit cards and bank accounts. Our agents never ask for this kind of information, and taxpayers should never disclose it.
- Threatens incarceration if a tax debt is not paid.
- Demands payment by third-party issued or prepaid debit cards.
- Claims that there is a problem with the taxpayer’s account.

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[6] The taxpayer may also be subject to a late filing penalty under R&TC Section 19131. This penalty also has a reasonable cause defense.

Go to our Report Identity Theft, Tax Fraud, & Scams webpage for more information.

All About Business

Clarification for LLCs – When to make an S corporation election

We want to clarify how to make an S Corporation election and the requirements for Limited Liability Companies (LLC). First, we explained Converting a California LLC to an S Corporation in our August 2009 edition. If within a tax year, you are a multiple-member LLC taxed as a partnership and terminated your partnership mid-year and want to make the S election, we gave an example in Timing is Everything in our February 2010 edition. In this article, we will provide examples of when an LLC makes the S election.

Eligible LLC's can complete and file federal IRS Form 2553, Election by a Small Business Corporation, to elect to be treated as an S corporation. If the election is made within two months and 15 days after the beginning of the tax year, then the election will take effect starting that tax year. However, if the election is made after the first two months and 15 days of the tax year, the election takes effect for the next tax year.

Example: Election made within 2 months and 15 days

LLC Z is a multiple-member LLC or a single member LLC (SMLLC) with a calendar tax year. LLC Z registered with the Secretary of State on June 14, 2015. LLC Z's 2015 tax year is from June 14, 2015, to December 31, 2015. LLC Z is an eligible LLC and wanted to elect to be taxed as an S corporation. LLC Z completed and filed federal Form 2553 by August 29, 2015 (within two months and 15 days). IRS accepted LLC Z's election and is automatically applied for state tax purposes. Starting in the 2015 tax year, LLC Z will be classified as an S corporation for state and federal tax purposes. For filing information for S corporations, refer to our FTB Publication Pub. 1060, Guide for Corporations Starting Business in California.

Example: Election made after 2 months and 15 days

LLC Y is a multiple-member LLC or a SMLLC with a calendar tax year. LLC Y registered with the Secretary of State on May 22, 2015. LLC Y's 2015 tax year is from May 22, 2015, to December 31, 2015. LLC Y is an eligible LLC and wanted to elect to be taxed as an S corporation. LLC Y completed and filed federal Form 2553 after August 6, 2015 (after two months and 15 days). IRS accepted LLC Y's election and is automatically applied for state tax purposes. However, since

LLC Y completed and filed federal Form 2553 after two months and 15 days of the 2015 tax year, the election takes effect for the next tax year, 2016. LLC Y's 2015 tax year will be classified as an LLC for tax purposes. Starting in 2016, LLC Y will be classified as an S corporation for state and federal tax purposes. For filing information for S corporations, refer to our FTB Publication Pub. 1060.

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.