



Tax News

July 2017

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Legislative bill watch list

As the legislative season progresses, many interesting tax bills have come to our attention. Many bills made the first cut, and with revisions, moved to the second house. Many other bills did not make it out of their house of origin, and will not move on.

Here are a few interesting tax bills that remain alive:

- AB 71-(Chiu) *Low-Income and Farmworker Housing Credit/Disallow 2nd Home Interest Deduction*
- AB 94-(Rodriguez) *Exempt Organizations/Simplify Application Method for Veteran's Organizations*
- AB 420 (Wood), *Personal Income Tax Deduction for Medical Cannabis or Marijuana Activity*
- AB 490-(Quirk-Silva) *College Access Credit/Extend Repeal Date to 2023*
- SB 289-(McGuire) *Tax Exclusion for Earned Income From Indian Country In This State*
- SB 813-(Sen Gov and Finance Committee) *Voluntary Disclosure Program/Expand Eligibility & Penalty Relief*

For more information on these and other bills we are currently analyzing, search for **legislative information** on our website. You can also follow bills as they are amended and move through the houses by using our Bill Tracking Report. You can also follow legislative bills by using [Legislative Counsel's website](#).

Contacting business entity tax nonfilers

We recently sent letters to over 41,000 California businesses that have not filed their 2015 state income tax returns.

Each year we review more than 10 million income records received from the IRS, the Employment Development Department, the Board of Equalization, financial institutions, and other businesses. We match this information against our tax records to identify potential nonfilers. Last fiscal year, we collected approximately \$63.2 million from businesses that failed to file tax returns.

We give business nonfilers 30 days to file a tax return or show why one is not required. Businesses that disregard the letter will get a tax assessment based on income and other information reported to us. The tax assessment includes interest, fees, and penalties.

If you have a client that received a letter, go to Request/Demand for Tax Return on our website. Businesses can request more time to respond, retrieve information that can help them file a return, sign up to receive an email reminder to file, and much more. Information is also available by phone at 866.204.7902.

FTB public meetings

We held an FTB Board Meeting on June 15th, two Interested Parties Meetings (IPMs), and one formal regulatory hearing:

Date	Topic
June 16	Space Transportation Regulation – A formal regulatory hearing under the Administrative Procedures Act to allow public comment on proposed regulations regarding apportionment of income related to space transportation activities.
	Sales Factor Regulation – To get public input on potential amendments to California Code of Regulations, title 18, section 25136-2, regarding Market-Based Rules for Sales Other Than Sales of Tangible Personal Property.
June 30	Alternative Apportionment Method Petition Procedures – To get public input on potential regulations pertaining to the consideration of Section 25137 petitions by the three-member Franchise Tax Board.

We hold board meetings several times each year. We post formal notices on our website at least 10 business days before the meeting so interested individuals may prepare to attend, participate by phone, or listen live to our Board Meetings on our audio streaming page.

If you would like to be informed of upcoming public meetings, you can subscribe on our Subscription Services webpage. Subscription Services is our free automated service providing

you important information by email. You can choose from a variety of topics and change or discontinue the topics you subscribe to at any time.

Our next FTB Board Meeting is scheduled for September 7, 2017.

IRS reopening preparer tax identification number (PTIN) system

On June 1, 2017, the United States District Court for the District of Columbia upheld the Internal Revenue Service's (IRS) authority to require the use of a Preparer Tax Identification Number (PTIN), but enjoined the IRS from charging a user fee for the issuance and renewal of PTINs. As a result of this order, PTIN registration and renewal was suspended on June 2, 2017.

The IRS is currently working with the Department of Justice to determine on how to proceed regarding fees previously paid for PTINs. As additional information becomes available, it will be posted on IRS' [Tax Professionals page](#).

FAQs

Q: Are federal tax return preparers still required to have a PTIN?

A: Yes. The court decision upheld the IRS' authority to require the use of a PTIN. Anyone who prepares, or assists in preparing, all or substantially all, of a federal tax return for compensation is required to have a PTIN. All enrolled agents must also have a valid PTIN.

Q: Will PTIN holders be receiving refunds for previous fees paid?

A: The IRS, working with the Department of Justice, is considering how to proceed. As additional information becomes available, it will be posted on the IRS' [Tax Professionals page](#).

Q: If I request or renew my PTIN now at no cost, will I have to pay for it later?

A: IRS cannot make determinations with respect to future activity at this time.

Q: Is the IRS PTIN Helpline reopening?

A: Yes. It reopened on June 21, 2017.

Q: Is a PTIN still required to file a tax return, to be an Enrolled Agent, or to schedule an appointment for the Special Enrollment Examination?

A: Yes.

Q: Will I be able to view my continuing education records when the PTIN system reopens?

A: Yes. All previous information will still be displayed in online PTIN accounts.

Q: Do I need to contact the IRS or file a claim for refund for previously paid PTIN fees?

A: Do not contact the IRS. Any questions regarding claims or refunds should be directed to the [PTIN Fees Class Action Administrator](#).

Ask the Advocate

Business entities return due dates



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

One of the goals of Tax News is to provide information that is accurate, timely and relevant to you, the tax professional. We do this informally, through monthly articles and the occasional Tax News Flash. I am proud of my staff and the work that they do each month getting Tax News out to you.

Of course, there are also other ways that FTB communicates with you, including issuing formal notices.

FTB Notices provide important information and may be issued for several reasons, including letting taxpayers and tax professionals know about recent law changes. We provide links to both active and withdrawn notices on our Notices page. This month, I want to talk a little bit about FTB Notice 2016-4 and the return due date for California group nonresident returns, commonly referred to as “composite returns,” in light of the changes to business entity return due dates beginning for 2016.

By way of background, qualifying business entities that derive income from California sources or are doing business in California may elect to file a composite return on behalf of their nonresident individual shareholders, partners, and members who receive distributive shares of California source income. This return is filed by the business entity in lieu of each individual shareholder, partner, or member filing their own California return. The business entity filing the composite return pays the tax on behalf of the electing individuals, and the tax is computed using the highest marginal rate, and without deductions. Overall, this method of filing is frequently more convenient for California nonresidents.

AB 1775 (2016), which conformed California law to corresponding federal law, changed the filing due dates for business entity returns. We discussed these changes in our October 2016 issue of Tax News. FTB Notice 2016-4, issued after the enactment of AB 1775, addressed automatic paperless extensions and explained FTB's position on when a business entity, corporation, S corporation, or a partnership must file its return to be considered timely. In addition, AB 119, recently enacted, would address extensions to file for partnerships. However, FTB Notice 2016-4 did not address composite returns and their filing due dates.

Because a composite return may be filed by a corporation, partnership, or LLC to report pass-through income or director's compensation, the question has come up whether you look to the return due date of the business entity filing the group nonresident return or whether there is a distinct due date for group nonresident returns. The answer is that there is a distinct due date for group nonresident returns. A composite return has an original due date of April 15, with an automatic (paperless) six-month extension, generally October 15. FTB Publication 1067 provides an extensive amount of information about composite returns, including who may file, who may be included, and how the electing nonresidents will be taxed. I encourage you to refer to Publication 1067 -- it's a great starting point for learning about composite returns and whether this method of filing might be best for your clients who are nonresidents yet have income from a California business entity.

Inside FTB

Updated web addresses

In an effort to improve our search functionality for our website, we changed some web addresses with underscores and replaced them with dashes.

Example:

Old address

https://www.ftb.ca.gov/businesses/avoiding_problems.shtml

New address

<https://www.ftb.ca.gov/businesses/avoiding-problems.shtml>

We want this to be a seamless process for you, but if you come across a "page not found" message when attempting to access our webpages, look at the URL, and try replacing the underscore with a dash.

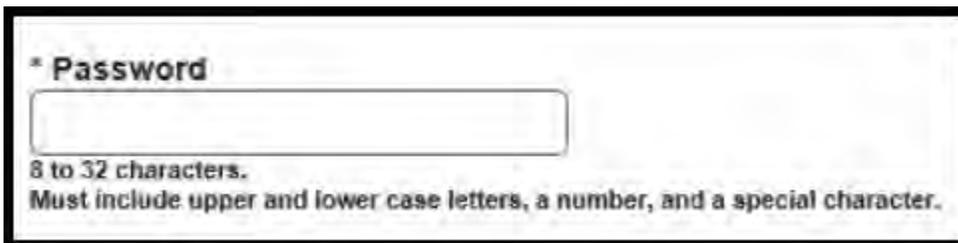
MyFTB Corner

MyFTB password and email changes effective June 25, 2017

Password changes

You will be required to include a special character in passwords when you register or change your password.

We increased the required password strength to include a special character when registering or changing your password for MyFTB.



A screenshot of a web form showing a password input field. The field is labeled with an asterisk and the word "Password". Below the input field, there are two lines of text: "8 to 32 characters." and "Must include upper and lower case letters, a number, and a special character."

If you are an existing user, you can continue to log in with your existing password that does not contain a special character. When you change your password, you will need to include a special character.

Email changes

MyFTB Login and **Profile Change** emails we send you will include your user name and link to deactivate your account.

We added the **User Name** and a **Deactivate** link to the *MyFTB Login* and *Profile Change* emails. The *Profile Change* emails include changes to your password, email address, security questions/answers, and your user name.

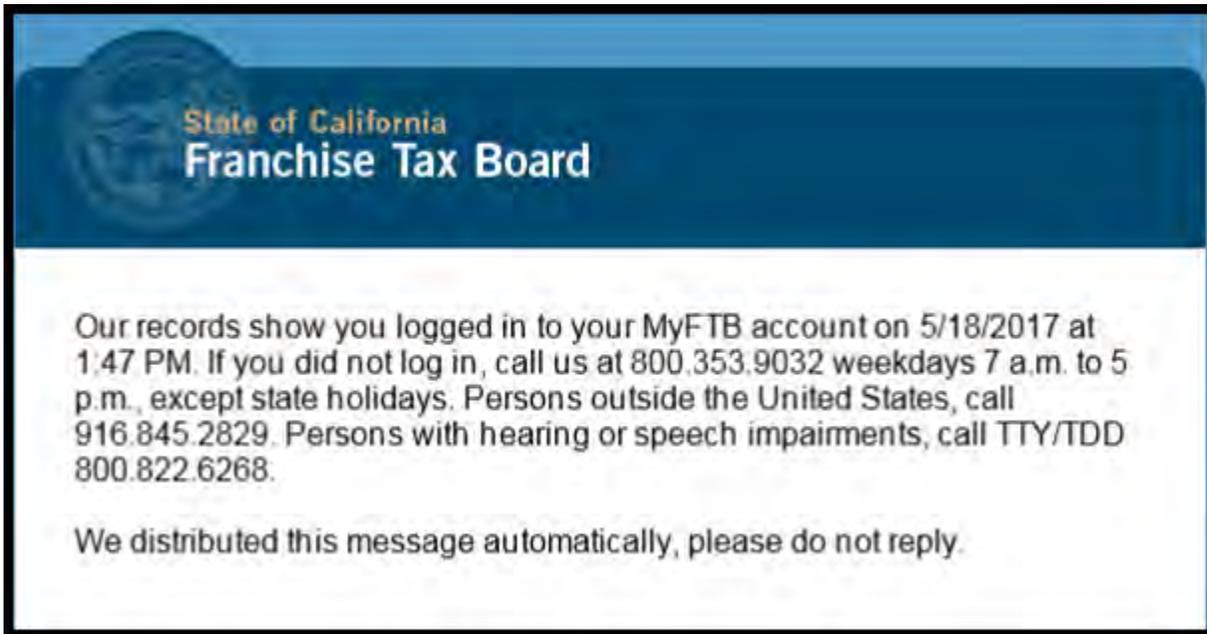
By making these changes, you have the ability to deactivate your account outside of our business hours if you were not the person that logged in or changed your profile information.

This also more clearly communicates which account the email was in reference to by including the **User Name** in case you have more than one account (e.g., individual and tax preparer).

Examples of before and after changes to login email

(Highlight changes also apply to **Profile Change** email)

Log in email before change



Log in email after change:



MyFTB Corner

What's coming in September?

To better assist you, effective September 25, 2017, you will be able to:

- View notices and correspondence for your tax preparer clients.
- View proposed assessment information.
- Update your profile.

Stay tuned for more details.

All About Business

Business income where are we today – Requirement to file

In our June 2016 edition of Tax News, we looked at an out-of-state taxpayer that does business both in and outside of California and focused on the sole owner of a disregarded entity doing business in California. In this article, we will focus on those out-of-state taxpayers that are members of multiple-member limited liability companies classified as partnerships for tax purposes.

In this article, we use general terms like “out-of-state taxpayer” when discussing issues that can apply to a nonresident, an out-of-state formed partnership (general or limited), an out-of-state-formed (foreign) limited liability company (LLC), an out-of-state-formed (foreign) corporation (C corporation or an eligible entity that has elected to be taxed as an S corporation).

What has not changed?

In California, an out-of-state taxpayer must file tax return(s) if the taxpayer is doing business in California or has income from sources within California. Failure to recognize this filing requirement can be quite expensive, especially when demand penalties are factored in. This statement is especially true for pass-through business entities, such as partnerships, LLCs,¹ and S corporations.

Similar to federal law (IRC Sections 6698 and 6699), California law (Revenue and Taxation Code (R&TC) Sections 19172 and 19172.5) imposes a late filing penalty for the late filing of pass-through business entity returns (Forms 565, 568 and 100S).² These penalties are imposed even if all taxes have been paid or as is the case with a general partnership, no taxes are imposed.

For returns required to be filed on or after January 1, 2011, the partnership/S corporation late filing penalty is \$18 for each month or part of a month (for a maximum of 12 months) multiplied by the total number of partners, members, or shareholders in the entity during any

¹ This penalty apply to corporations (C and S) and LLCs, including LLCs that are disregarded or taxed as a partnership. It does not apply to partnerships, general (GP), limited (LP), or limited liability partnerships (LLP).

² These penalties can also be assessed if you file the returns without required information.

part of the taxable year for which the return is filed after its due date. This penalty is in addition to the late filing penalty discussed below.

If we sent the business entity³ a demand-to-file notice, we may impose a \$2,000 penalty per tax year (R&TC Section 19135) on nonqualified,⁴ suspended, or forfeited business entities doing business in California, if they do not file a tax return within 60 days after we send them a legal demand (i.e. FTB 4684 or FTB 4685) to file their return. The penalty is in addition to the demand and delinquent penalties and the filing enforcement fee.

We also impose a demand penalty if a business entity does not file a tax return after we send them a formal legal demand (i.e. FTB 4684 or FTB 4685) to do so. The demand penalty (R&TC Section 19133) also applies to individuals. In this article, we only discuss the demand penalty for business entities and their failure to file a return.

The amount of the demand penalty is 25 percent of the lesser of the tax shown on the:

- Notice of Proposed Assessment (NPA), **before** applying any payments or credits.
- The tax shown on the return **before** applying any payments or credits.

If the business entity files its original return after the NPA goes final and the tax on the return, before refundable credits, is less than the proposed assessed tax, we will reduce the penalty. Please note that since the penalty is computed before applying credits and payments, the business entity may owe penalties and interest even if the tax return shows that a refund is due.

In addition to the demand penalties (R&TC Sections 19135 and 19133), and the penalties for a taxpayer's failure to timely file a return (R&TC Sections 19131, 19172, and 19172.5), there is a penalty for failure to timely pay tax (R&TC Section 19132). The law requires us to impose this

³ This penalty apply to corporations (C and S) and LLCs, including LLCs that are disregarded or taxed as a partnership. It does not apply to partnerships, general (GP), limited (LP), or limited liability partnerships (LLP).

⁴ For this penalty to apply, a nonqualified business entity must be “doing business” in California and the business entity must have been required to register with the Secretary of State (SOS) pursuant to California’s [Corporations Code](#).

failure to timely pay penalty, which is based on unpaid taxes if this penalty is greater than the sum of the penalties imposed under R&TC Sections 19131 and 19133. The cost of not filing a timely return depends on the business entity's actual facts and business type. The following is an example of the amounts:

Example: Assume the following business entities did not file their 2015 tax return by the extended due date, only owe the minimum/annual tax, and were owned by two shareholders/members/partners, with no payments made, including estimate payments. This chart also assumes that each entity received a notice and demand penalty pursuant to R&TC Section 19133, non-qualified, suspended, or forfeited penalty pursuant to R&TC Section 19135, or had a filing enforcement (FE) fee imposed. Other penalties and interest may apply.

2015	C Corporation	S Corporation	LLC
Tax:	\$800	\$800	\$800
Estimate Tax Penalty	\$22	\$22	
Demand (19133)	\$2,000	\$2,000	\$2,000
Delinquent Penalty:	\$200	\$200	
Underpayment/monthly:			\$200
Shareholder / Member Penalty:		\$432	\$432
Filing Enforcement Fee	\$365	\$365	\$226
Total:	\$3,387	\$3,819	\$3,658

After a late filed return is processed, we will send a bill, including penalties and interest.

No reasonable cause - No "first-time" penalty abatement

The IRS has an administrative policy that provides for a first-time abatement procedure. Pursuant to the first-time abatement procedure, the IRS will abate timeliness penalties, based on compliance history, without making a separate reasonable cause determination, if the taxpayer had not previously been required to file a return or if no prior penalties (except the

estimated tax penalty imposed under IRC Section 6655(a)) have been assessed in the prior three years. The R&TC has no provision similar to this federal first-time abate policy, nor do we have any formal administrative policy that is similar to the federal policy.

California law generally requires penalties to be imposed, unless the taxpayer can show their failure to comply is due to reasonable cause and not due to willful neglect. You or your clients may use either form below to request penalty abatement due to reasonable cause:

- FTB 2917, Reasonable Cause – Individual and Fiduciary Claim for Refund
- FTB 2924, Reasonable Cause – Business Entity Claim for Refund

For more information on penalties we may assess, see FTB 1024, Penalty Reference Chart.

What has changed? - Enforcement

Each year, we compare our records of filed tax returns with millions of records, contacting people and business entities that may have a filing requirement, but did not file a California income tax return. Generally, we will issue a **Notice to File LLC Return** to nonregistered foreign LLCs that are members/partners in another pass-through entity that has filed a return in California.

Here is a tax professional's question we received as an example:

What is the FTB's position regarding a prior/current member who receives a Schedule K-1 but was not a member at the time the LLC did business in California? Are members considered to be doing business based on the activities of the LLC prior to and/or after their affiliation?

If an LLC is considered doing business in California at any time during its year, the LLC is required to file a return and must disclose gross income and deductions of the entity, the number of members, their identification, and whether they are California resident or nonresident members. A Schedule K-1 is required to be provided to each member who held an interest **at any time** during the year in the LLC.

A taxpayer that is treated as a partnership for tax purposes that had ownership changes during the year would need to consider whether those membership changes caused a technical

termination for both federal and state purposes, under IRC Section 708, which would in turn require the filing of short period return(s).

A nonregistered foreign LLC that is solely a nonresident partner/member of another pass-through entity would not be considered to be doing business in California if their membership is only for a portion of a year, and the pass-through entity did not do business in California for the portion of the year they were a member.

Additional resources

Voluntary Disclosure Program (VDP) and Filing Compliance Agreement (FCA)

The Voluntary Disclosure Program (VDP) allows qualified entities, qualified shareholders, or beneficiaries that may have incurred an unpaid California tax liability or an unfulfilled filing requirement to disclose their liability voluntarily.

If you or your client is a business entity, partnership, or trust described in RT&C Section 19192 and you are not eligible for VDP, you may apply to enter into a Filing Compliance Agreement (FCA).

For more information, search **VDP** and **FCA** on our website.

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.