



Tax News

May 2017

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Status of second round of proposed amendments to Regulation Section 25136-2

A second round of amendments to market-based sourcing rules set forth in California Code of Regulations Section 25136-2 addresses, among other issues:

- (1) The reintroduction of asset management fee examples
- (2) Issues in connection with the benefit of the services received, including the assignment of services performed on tangible personal property and the assignment of long-term government and research and development contracts
- (3) Issues in connection with the sale of intangible property, including interest and dividends
- (4) Issues in connection with reasonable approximation

On January 20, 2017, staff held the first interested parties meeting for the second round of amendments and received feedback from stakeholders. Most comments addressed issues in connection with (2) benefit of the services received and (4) reasonable approximation. A first interested parties' meeting (IPM) Summary of Comments for this second round of amendments will be posted to our website. A second interested parties meeting is scheduled for June 16, 2017. Staff will present draft language for the less controversial issues of the proposed amendments at the second IPM. Additionally, we anticipate that at the second interested parties meeting, stakeholders will furnish additional feedback on the more controversial issues. This feedback will provide the basis for draft language of those more controversial issues, to be presented at a third IPM.

Reminder on FTB filing requirements for federal forms 8886 and 8918

Did you know that California has reportable transaction requirements for taxpayers and material advisors that are similar to federal requirements?

Since 2005, taxpayers and material advisors have had a requirement to disclose reportable transactions to us. Reportable transactions include listed transactions and transactions of interest.

The IRS recently made the **Syndicated Conservation Easement Transaction** a listed transaction under IRS Notice 2017-10. Go to the full copy of the [Syndicated Conservation Easement Transaction](#) for more information.

The IRS also recently made the **Micro-Captive Insurance Transaction** a reportable transaction under IRS Notice 2016-66. Go to the full copy of the [Micro-Captive Insurance Transaction](#) for more information.

Filings for the **Syndicated Conservation Easement Transaction** and the **Micro-Captive Insurance Transaction** must be made with the IRS and us by May 1, 2017.

Substantial penalties could apply to both taxpayers and material advisors who fail to make the appropriate disclosures regarding their participation in a reportable transaction. For more information about our reporting requirements go to our webpage on General Information: Registration & Reporting Requirements.

[Secure email service](#)

Have you seen this message in your email in-box?



CONFIDENTIALITY NOTICE: This email from the State of California is for the sole use of the intended recipient and may contain confidential and privileged information. Any unauthorized review or use, including disclosure or distribution is prohibited. Because FTB places high importance on the security of private and confidential information, this email is encrypted. If you are not the intended recipient, please contact the sender and destroy all copies of this email.

One of our foundational principles is to protect taxpayer information and privacy. We use secure email to securely communicate with external customers on an ongoing basis when the external customer:

- Has an established relationship with our staff.
- Agrees to communicate via secure email.
- Validates their current email address.

Our secure email provides an easy to use web-based interface, without installing software on your computer. To ensure email sent from us is protected, secure email may be initiated by our staff or automatically by us depending on the content of the email. Secure email **cannot be initiated** from an individual outside FTB.

We have information about how to open a secure email, troubleshooting, features, and restrictions that can be accessed through the help link located on the recipient's encrypted email. As a reminder, the IRS prohibits us from emailing Federal Tax Information outside FTB in **any** email, encrypted or not.

We offer technical assistance to our customers with issues or questions about secure email registration or technical issues. Our technical support staff responds to requests within 4 business hours. Our hours of operation are 7 a.m. to 4:30 p.m. Pacific Time, Monday through Friday, except state holidays.

For technical assistance, customers may email SecureEmailSupport@ftb.ca.gov.

Notice of Tax Return Change revised

We revised these notices to better communicate the adjustments we made to your client's personal income tax returns.

Last year, we revised two versions of the Notice of Tax Return Change (NTRC):

- Notice with a zero balance (FTB 5818A)
- Notice with a balance due (FTB 5818B)

We included more information about claimed and allowed amounts and the tax return adjustments. At the conclusion of the 2016 filing season, we identified additional improvement opportunities through feedback from usability testing and several business areas that interact with taxpayers.

Starting January 2017, you may have seen the following modifications we made to FTB 5818A, 5818B, and applicable inserts:

- Eliminated insert FTB 1140, *Personal Income Tax Collections information*.
- Created insert FTB 1025, *Bill of Rights and Penalty Information*. This new insert replaces FTB 1140, to include Taxpayers' Bill of Rights and penalty information while excluding unnecessary collection information.
- Added payment voucher FTB 7250A to FTB 5818B, allowing us to process taxpayer payments faster.
- Revised the explanation paragraphs on insert FTB 1020 to help taxpayers understand why we adjusted their tax return.
- Revised "Contact us" information to let taxpayers know what to do if they agree or disagree with our adjustments.

We also enhanced our Notice of Tax Return Change webpage, to help you and your clients resolve questions regarding the notice, including what information to gather before you contact us.

Did your client receive a NTRC?

As many of you are aware, we sent out more NTRCs last filing season than we did during the previous filing seasons.

Good news, this year we are sending out far fewer notices than last year. The reason is two-fold: First, we have improved our rules for our new Return Analysis processing system which is part of the new Enterprise to Data Revenue Project; and, second we incorporated best practices from our recently retired Return Validation system into Return Analysis. As a result we've been able to validate more returns with higher accuracy than ever before and this means fewer notices.

We listened to you. Last year we also had problems resolving some W-2 discrepancies. As a result of your feedback, we interviewed our contact center staff and recognized some procedural inconsistencies among them. We developed and deployed enterprise procedures for addressing W-2 discrepancies. Our enterprise practice is to accept the W-2 document as

provided with the return as the authority for W-2 withholding, provided there are no signs of alteration to the W-2. If the W-2 is not available, the year-end pay stub may be used in its absence. Without these documents we will allow the amount reported to us by the Employment Development Department (EDD).

Since W-2s are not filed with an E-file return, we will continue to recognize differences between wage withholding reported on the return and wage withholding reported by EDD. These differences will generate NTRCs. If your client receives a notice, and needs to contact us to resolve the matter, take advantage of the "Secure Chat" and "Send a Message" features in MyFTB. You can make contact and upload the W-2. The hotline is also available **916.845.7057**. Either way, our contact center staff will quickly resolve the account.

We are also making it easier for you to understand the reason for the NTRC. If you don't have a copy of the notice, your client may provide you with the code from the notice and you can look it up. For more information about the NTRC and explanations, see our updated webpage, Did you receive a notice?, that describes why a notice was sent and an interactive page, Notice of Tax Return Change, where you may type in the code from the notice and the explanation is provided.

New and improved Common Business Expenses Publication



We are pleased to announce that we recently revised FTB 984, Common Business Expenses. While it still keeps most of the important and valuable information from the previous version, we revised and added to it. They include:

The Cover - We completely redesigned the cover. We changed from a white cover with green lettering to a new layout that features an eye-catching design with our new logo. Now, the FTB 984 really stands out!

The Content - In this revised version, the primary focus is business expenses that may be taken by Sole Proprietorships. We felt it was necessary to revise to keep business owners informed and up-to-date because of the new law changes that deal specifically with business expenses.

The Back - On the back cover is a new “Additional Information” section. Here, more detailed information is given for some of the more common business expenses.

We hope that businesses will find this newly revised publication useful and educational. Please look for and ask about FTB 984, *Common Business Expenses*, at our many education and outreach events!

New option for small businesses claiming a Federal Research Credit

The California Research Credit can reduce your **income or franchise tax only**. This research credit is claimed by filing Form FTB 3523.

For federal purposes only, a new option is now available for small businesses when claiming a federal Research Credit. The IRS has issued guidance explaining how eligible small businesses can now apply part or all of their research credit against their payroll tax liability. Originally, the only way to apply this credit was to their income tax liability.

This new option has been made available by a provision included in the Protecting Americans from Tax Hikes (PATH) Act that was enacted in December 2015, and will be available to any eligible small business filing its 2016 federal income tax return.

An eligible small business with qualifying research expenses can choose to apply up to \$250,000 of its research credit against its payroll tax liability. In order to choose this option, a business must fill out IRS [Form 6765](#), Credit for Increasing Research Activities, and attach it to a timely filed return. To claim the payroll tax credit, the business must fill out IRS [Form 8974](#), Qualified Small Business Payroll Tax Credit for Increasing Research Activities, and attach it to its payroll tax return. For more information, see IRS [Notice 2017-23](#), Interim Guidance and Request for Comments; Election by Qualified Small Business to Claim Payroll Tax Credit for Increasing Research Activities.

IRS offers several convenient options for making tax payments

The IRS offers several convenient options:

[IRS Direct Pay](#) is free. You can securely pay your taxes online directly from your checking or savings account without any fees or pre-registration. Schedule payments up to 30 days in advance and receive instant confirmation that you submitted your payment. With Direct Pay, you can view details about your payment, and change or cancel your payment using the Look-Up a Payment feature up to two business days before the payment date.

[Debit or credit card](#), card processors charge a fee, IRS does not. Both paper and electronic filers can pay their taxes by phone or online through any of the several authorized debit and credit card processors.

The [Electronic Federal Tax Payment System \(EFTPS\)](#) is free. It gives you a safe and convenient way to pay individual and business taxes by phone or online. With EFTPS, you can pay various types of taxes year-round. You first must enroll in EFTPS and receive your PIN.

You can use the [IRS2Go](#) mobile app to pay with IRS Direct Pay and a debit or credit card.

If you can't pay your tax bill in full, a payment plan may be an option. Most individual taxpayers can set up a payment plan online at [IRS.gov/online-payment-agreement-application](#).

You can make a payment, apply for an installment agreement, and find more information about payment options at [IRS.gov/payments](#).

National Small Business Week webcasts

Small business and industry

Give us 10 minutes and we'll share some tax tools to help you meet your Small Business Needs.

Two 10-minute sessions available each day at 8 a.m. and 11 a.m. Pacific Time:

May 1	Worker Classification
May 2	Third Party Payer
May 3	Sharing Economy
May 4	Small Business Taxes & Tax Calendar Online
May 5	Business ID Theft

Register:

Email: SBSE.SL.Web.Conference.Team@irs.gov

Include the following information in your email:

- Name
- Email address
- Session date and time

Closed Captioning will be available.

Continuing Education credits will not be offered.

Questions? Email us: SBSE.SL.Web.Conference.Team@irs.gov

Principal Business Activity code – Additional information

Do you file an individual state tax return and operate a business?

If you answered “yes”, have you ever looked at your state tax return and wondered “what is the Principal Business Activity (PBA) code,” “where do I get the PBA code”, or “why do they need the PBA code”? Well, let us help you answer those questions.

The PBA code is captured on both the state tax return and federal Schedule C (Form 1040), line B. It is a six digit number that represents or best describes your primary business activity. The PBA code is used to identify individuals operating a business within the same or similar industries and to measure economic activity in the United States, Canada, and Mexico.

We rely on taxpayers to provide accurate information on state tax returns. One of the challenges we face is that the PBA code is not always reported accurately. For individuals operating a business, the PBA code is an essential element and assists in accurately processing your state tax return.

To view a complete list of PBA codes, see [NAICS](#).

For instructions on how to enter the PBA code, refer to Instructions for 540 – California Resident Income Tax Return.

Ask the Advocate

Filing-related penalties



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

As FTB's Taxpayers' Rights Advocate, I often hear firsthand the concerns and frustrations of tax professionals. One topic that frequently comes up in conversation are filing-related penalties, including the penalty for underpayment of tax.

Despite the best planning and making timely estimated payments, your clients may still find themselves underpaid and potentially subject to this penalty due to a variety of factors, including changes in existing law. One such change was the amendments made to the regulations for the reporting of sales from services and intangible personal property. These are more commonly referred to as the "market based sourcing rules" (Revenue and Taxation Code Section 25136). Definitions and assignment rules were added for sales relating to marketable securities, dividends, goodwill, and interest.

These changes could impact your clients' California taxable income and in some instances require the filing of original or amended returns. It is important to note that while the new amendments to the Regulations became effective on January 1, 2017, they are to be applied to taxable years beginning on or after January 1, 2015, **two years earlier** than their effective date.

The good news is that there are now relief provisions in place for underpayment penalties that may result from complying with these amendments. Therefore, I wanted to take some time this month to let you know about FTB Notice 2017-02 which explains the procedures in place and the steps you must take to request relief from a late payment penalty attributable to these changes.

Here are some of the key points of the Notice:

- Relief is limited to late payment penalties for tax liabilities reported on timely filed returns for taxable years beginning on or after January 1, 2015, and before January 1, 2016.
- FTB will consider both prepayment requests for relief, as well as claims for refund of amounts paid.

- Relief is available to business entities and individual taxpayers, including nonresident individuals properly included in a group.
- For pass-through income impacted by the new amendments, relief is available to partners, shareholders, or members who may be required to file an original or amended return, including an original or amended group return.

The Notice itself provides complete details about the qualifications for relief and information about how to apply. I encourage you to read it if you have clients that may be impacted.

Inside FTB

Audit customer experience survey

Last year, we launched an anonymous, confidential survey to hear from our customers subject to an audit so our decision-makers stay focused on them! We want both business and personal income tax customers to have the opportunity to give feedback about their audit experience.

Because of our customers' feedback, we:

- Gained insights and made recommendations to Audit leadership and decision-makers to consider.
- Reached out to those customers who wanted to talk more about their audit experience.

We will continue the survey in 2017. At the conclusion of an audit, we will invite customers to participate in the survey. We thank you in advance for sharing suggestions to further improve the audit customer experience.

MyFTB Corner

Manage tax preparer clients on your Client List in MyFTB

You can use the **Client List** to help manage your *Tax Preparer* clients and determine which clients should be renewed. *Tax Preparer* clients expire 13 months from the date you add them to your **Client List** in MyFTB. The **Renew** option in MyFTB is an easy and convenient way to renew your *Tax Preparer* clients in MyFTB.

When does the Renew link display on my Client List?

The Renew link will display *more* than 90 calendar days after the date the client was added or previously renewed, and *more* than 10 business days before the expiration date. Essentially, if you add a *Tax Preparer* client today, in 91 calendar days the **Renew** link will display on your **Client List** for that client.

This new feature allows you to renew your clients when it is most convenient for you. For instance, you may choose to renew all of your active clients all at one time prior to the next filing season or renew them on an as needed basis over time.



Search Results - Individual Clients

[Clear Filter](#)

Last Name ▾	First Name ▾	SSN/ITIN	Expiration Date ▾	Access Type ▾	Status ▾	Actions ▾
Doe	Barbara	XXX-XX-0000	07/08/2017	Tax Preparer	Active	Renew Remove

Will my client be notified when I renew them in MyFTB?

Yes. We will send a letter to your client *each* time you renew them as a client in MyFTB and let them know that you will have continued access for the next 13 months. Be aware that if you renew your client every time the **Renew** link becomes available, we will send a letter to your client *each* time. This can cause unnecessary letters to be mailed and cause confusion for your clients.

How can I best manage my Tax Preparer clients on my Client List?

You can manage your *Tax Preparer* clients in two easy steps:

1. Search by **Access Type** of *Tax Preparer*.

Client List Options ☰

Client Type:

Individual
 Business
 Estate/Trust

Client Access:

Access Type: Tax Preparer ▼

- Use the filter in the **Expiration Date** column to filter oldest to newest date. Renew *Tax Preparer* clients that you have a business need for continued MyFTB access and have the authorization to do so. Remember, you must **Renew** your clients *more* than 10 business days **before** the expiration date or they will fall off your **Client List**.

Search Results - Individual Clients

[Clear Filter](#)

Last Name	First Name	SSN/TIN	Expiration Date	Access Type	Status	Actions
<input type="text"/>						

For additional details, see [How To Renew a Tax Preparer Client on the Client List](#) and our December *Tax News* article [Renew Your Tax Preparer Client Relationships in MyFTB](#).

All About Business

Every SMLLC organized, registered, or doing business in California needs to file

Did you know every single member limited liability company (SMLLC) organized, registered or doing business in California needs to file Form 568, Limited Liability Company Return of Income, unless the business entity (BE) has elected to be taxed as a corporation, in which case the BE would need to file using a Form 100, 100W or 100S. When it comes to California, SMLLCs are required to file and pay taxes, the type of taxes (annual/franchise) and fees they are required to pay will depend on whether or not a federal "Check-The-Box" election was made. SMLLCs that are a "disregarded entity" are required to look to when its owners/members are required to file to determine when its Form 568 needs to be filed (due date or extended due date).

An SMLLC is commonly referred to as a “disregarded entity” because the “Check-The-Box” regulation¹ explicitly provides that a single-member unincorporated entity may be treated as a corporation or may be disregarded (treated as not separate from its owners).² California law [R&TC Section 23038(b)(2)(B)(iii)] specifically provides if the separate existence of the BE is disregarded for federal purposes, it will also be disregarded for California purposes, except for the requirements to file and pay (Revenue and Taxation Code (R&TC) Sections 17941 and 17942).

A disregarded entity is treated in the same manner as a sole proprietorship in the case of an entity owned by an individual, and in the same manner as a branch or division in the case of an entity owned by a corporation or other BE (i.e., partnerships, LLCs, and exempt organizations). An incorporated entity is always classified as a corporation. Most other business entities are considered “eligible entities” that have a default classification based on the number of owners (one owner- disregard/more than one owner – partnership) and can elect to be classified as an association taxable as a corporation or S corporation. An eligible business entity that has made an election for federal income tax purposes must file based on that election for California purposes.

Tax return due dates and extended due dates

SMLLCs follow the original and extended due dates of the owner. If an SMLLC is owned by a pass-through entity, the original due date is the 15th day of the 3rd month following the close of the taxable year. The due date for all other SMLLCs is the 15th day of the 4th month following the close of the taxable year.

California's paperless extension

It's not too late to file. Generally,³ California grants all taxpayers (individuals and BEs) an automatic extension of time to file a return. There is no request a taxpayer needs to make in

¹ For more information see Treas. Regs. Sections 301.7701-3, and Cal. Code of Reg., tit 18, Section 23038.

² For more information see Treas. Regs. Sections 301.7701-3(a) and (b)(1)(i) and (ii), and Cal. Code of Reg., tit 18, Section 23038(b)-(3)

³ If a business entity is either suspended or forfeited, it is not allowed an extension.

order to take advantage of this automatic extension to file a tax return. The extension is automatic as long as the taxpayer files their return within the extension period. An automatic extension to file a return does not extend the time for payment of tax, the full amount of tax must be paid by the original due date of the tax return.

For taxable years beginning on or after January 1, 2016, the original and extended tax return due dates for California returns have changed for business entities.

Original tax return due dates

Entity Type	Calendar Year Filer	Fiscal Year Filer
C Corporations and LLCs taxable as a corporation	April 15	15th day of the 4th month following the close of the taxable year
*S Corporations	March 15	15th day of the 3rd month following the close of the taxable year
Partnerships and LLCs taxable as a partnership	March 15	15th day of the 3rd month following the close of the taxable year
Exempt Organizations	May 15	15th day of the 5th month following the close of the taxable year

Extended tax return due dates

Entity Type	Calendar Year Filer	Fiscal Year Filer
C Corporations and LLCs taxable as a corporation	October 15	15th day of the 10th month following the close of the taxable year
*S Corporations	September 15	15th day of the 9th month following the close of the taxable year

Entity Type	Calendar Year Filer	Fiscal Year Filer
Partnerships and LLCs taxable as a partnership	September 15	15th day of the 9th month following the close of the taxable year
Exempt Organizations	November 15	>15th day of the 11th month following the close of the taxable year

*No change to original due date

Penalties

If the return is filed late, then no valid extension exists and the taxpayer is subject to a late filing penalty⁴ (California Code of Regulations Section 18567(a)).

In addition to the late filing penalty based on tax, pass-through business entities (such as partnerships, LLCs with two or more members, or S corporations) are also subject to a late filing penalty based on the total number of partners, members, or shareholders.

Similar to the federal law (IRC Sections 6698 and 6699), California law (R&TC Sections 19172 and 19172.5) imposes penalties for the late filing of pass-through business entities returns (Forms 565, 568 and 100S) or if the returns are filed without required information. These penalties are imposed even if all taxes have been paid, or when (as is the case with a general partnership) no taxes are imposed.

California's Paperless Extension is for Filing Not Paying

A late payment penalty will be assessed if the tax owed is not paid timely by its original due date. This penalty can be waived if the taxpayer can show their failure to pay was due to reasonable cause. The fact that it may have been difficult to estimate the proper amount of tax due is not sufficient to prove reasonable cause. Taxpayers must be able to prove that despite the exercise of ordinary business care and prudence, they were unable to pay the correct amount of tax.

⁴ To avoid the late filing penalty the taxpayer would need to show their failure to file was due to reasonable cause.

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

Interest

Even if your client can show reasonable cause for either the late filing or late payment of tax, interest is charged. Interest is not a penalty. Since 1982, California law requires interest to be compounded daily. Interest is charged from original due date for underpayments because the liability for tax arises on the original due date and ends on the effective date of payment.

To find both current and past adjusted interest rates 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.