



# Tax News

September 2016

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## Disaster loss information for your clients

With the recent State of Emergency Proclamations issued in July and August by Governor Brown for fires, we wanted to touch base on how to claim a disaster loss. Beginning on or after January 1, 2014, and before January 1, 2024, your clients may deduct a disaster loss for any loss sustained in California that is proclaimed by the Governor to be in a state of emergency. California law generally follows federal law regarding the treatment of losses incurred as a result of a casualty or a disaster.

**Casualty loss:** If taxpayers' property is lost or damaged due to an earthquake, fire, flood, or similar event that is sudden, unexpected, or unusual, and insurance or other reimbursements do not repay them for the damage to their property, they will usually qualify for a casualty loss deduction.

**Disaster loss:** For California purposes, a casualty loss becomes a disaster loss when both of the following occur:

- Sustained the loss in an area the President of the United States or the Governor of California declares a state of emergency.
- Sustained the loss because of the declared disaster.

Your client can claim a disaster loss in the taxable year the disaster occurred or in the taxable year immediately before the disaster occurred. The advantage of claiming a loss in the preceding year is that the loss will generally reduce that year's tax liability generating a refund that we can issue quickly.

If they e-file, they will need to use the appropriate disaster code from the Qualified Disasters chart.

If they file a paper return, they will need to print the following information in red ink across the top:

- Disaster.
- Name of disaster in Governor's [State of Emergency Proclamation](#).
- The year the loss occurred: year from Governor's proclamation.

**Example: Disaster – Carlsbad Rainstorms – 2015**

The FTB Publication 1034, Disaster Loss – How to Claim a State Tax Deduction, is designed to help with the financial recovery and provides more detailed instructions on how to claim the loss on the California tax return.

We will replace lost or damaged California tax returns at no charge to disaster victims. You or your client may be able to obtain a copy of their California tax return(s) through MyFTB. To request a copy you or your client can complete form FTB 3516, Request for Copy of Tax Return. Print the name of the disaster at the top of the form, and we will send copies of the most recently filed tax return.

California automatically follows federal postponement periods as announced by the [Internal Revenue Service \(IRS\)](#).

For more information visit our Disaster Loss page.

### [SB 1255 does not change Head of Household filing status](#)

On July 25, 2016 Governor Brown signed SB 1255 (Moorlach), Stats. 2016, ch. 114, Dissolution of marriage: date of separation, which amends the definition of the “date of separation” within the Family Code.

Previously, a spouse was required to live in a separate residence in order to be considered living separate and apart from the other spouse for purposes of characterizing the earnings of the spouse.

Effective January 1, 2017, SB 1255 amends the “date of separation” definition to mean the date that a complete and final break in the marital relationship has occurred as evidenced by the spouse’s expression of his or her intent to end the marriage and conduct that is consistent with that intent.

### **What does this mean for the Head of Household filing status in California?**

No Change. California conforms to federal tax law regarding the Head of Household filing status. When changes are made to California family law, the application of the federal and California tax laws does not change. Therefore, when it comes to the qualifications for the Head of

Household filing status, the California Franchise Tax Board (FTB) will continue to conform to the current federal tax law. This includes, among other qualifications, that to be considered unmarried, the spouse must not have lived in the home at any time during the last six months of the year.

To qualify for HOH filing status, one of the requirements is that a taxpayer must be unmarried at the close of the year. However, Internal Revenue Code (IRC) section 2(c), to which California conforms, provides that certain married taxpayers “living apart” with intent to sever marriage may nevertheless qualify for HOH filing status, if they meet the requirement under IRC Section 7703(b) to be considered not married.

These requirements include the taxpayer furnishing more than one-half the cost of maintaining the household during the year **and** during the last six months of the taxable year, the taxpayer’s spouse may not be a member of the household. The Treasury Regulations under IRC Section 7703 [Reg 1.7703-1(b)(5)] define not being a member of the household as not constituting the spouse’s place of abode. Therefore, even if a couple were living “separate and apart” under the same roof for purposes of the Family Code, for HOH filing status by living under the same roof during the last six months of the year, they would not meet the requirements for HOH filing status if still married.

## California residents on group nonresident returns

### **Schedule S: Other State Tax Credit**

Tips to avoid additional information requests or an adjustment to a return during processing.

We analyze and validate data on the tax return and checks for math errors, missing or inaccurate information, identity theft, etc. To ensure smooth processing of a taxpayer’s return, it is important to provide complete and correct information and all required forms are completed and attached. Generally, if a return is incomplete, we will make an adjustment based on information provided on the return which may result in a bill, adjusted refund, or denial of refund. This can result in us contacting the taxpayer or their authorized representative if we need more information to process the return, inconveniencing the taxpayer and increasing the cost to process returns.

As a result of new validation rules, we began adjusting or disallowing the other state tax credit (OSTC) because of incomplete or missing information on the Schedule S. California residents included in other state composite (group) returns may claim a credit for their share of income taxes paid to the other state, as long as the state does not allow a credit for taxes paid to California for the group. Although the credit is not normally allowed for taxes paid to Arizona, Indiana, Oregon, and Virginia, the credit will be allowed for a California resident that is included in a group return filed in one of these states, unless any of these states allow a credit for taxes paid to California for the group. According to Schedule S instructions, the taxpayer must attach a composite schedule or statement explaining that he/she is included in a group return.

Below are tips to avoid requests for additional information or an adjustment to a return during processing when claiming OSTC:

- Fill out each Schedule S completely and attach all applicable Schedule S forms.
- Do not lump all of the income or credits under “Various,” “See attached,” or under a particular state.
- For California residents belonging to a group, attach a composite schedule or statement that you are in a group. Attach all applicable Schedule S forms.

Providing all complete Schedule S forms and a composite schedule or statement (if it applies) with the return will:

- Speed up the processing of the return.
- Avoid delay in any applicable refund.
- Avoid receiving a Notice of Tax Return Change.

## College Access Tax Credit – A donation with a difference

The College Access Tax Credit (CATC) has more than a billion dollars to allocate to California taxpayers for 2016!

To receive the credit, taxpayers make a donation to the CATC Fund.

Contributing to the CATC Fund has multiple benefits:

1. Donation supports higher education in California through the Cal Grant program.
2. Taxpayers receive a 50 percent California tax credit for 2016 (which can be used to offset tax below tentative minimum tax).

3. Taxpayers may be able to deduct the donation as a charitable contribution on their federal tax return as well as receive the tax credit.

Taxpayers make the donation to the CATC Fund through the California Educational Facilities Authority (CEFA). CEFA will issue the certificate upon completion of the donation, which will allow the taxpayer to claim the credit. Instructions to donate and obtain the certificate for the credit are available [here](#).

The tax credit is available for 2016 and 2017. Additional information on the tax credit is available [here](#).

## Ask the Advocate



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

### SMLLC filing requirements

The concern was the frequency with which practitioners encounter individually-owned SMLLCs, who fail to recognize their disregarded entity has an entity return filing required by the state of California. Failure to recognize this filing requirement can be quite expensive, especially when penalties and possible suspensions are factored in. We decided to do a feasibility study to see where we could make improvements to this process. Recently, we completed this feasibility study in regards to the SMLLC filing requirements.

One suggestion we heard was that we should step up interaction with the computer tax processors group to program software in such a way that the filer recognizes the need to file three tax returns, i.e., a federal Form 1040, a California Form 540 (Individual) and a California Form 568 (LLC). As a result, we will increase our education and outreach activities to remind tax practitioners, tax software providers, and taxpayers of the California filing requirements for SMLLCs and the difference between federal and state filing requirements including:

- Educating taxpayers to ensure they are accurately acknowledging existence of an SMLLC when using tax preparation software. Also, encourage tax software developers to make the SMLLC election option easily noticeable.
- Encouraging tax software companies that currently do not support SMLLC e-file to include that feature in their basic software packages. If companies are unable to support

this feature, request that the software clearly alerts taxpayers of this limitation and provide options so taxpayers can still comply with the SMLLC filing requirements.

- Publishing a *Tax News* article each year regarding the SMLLC filing requirements, business e-file requirement and waiver process, and what to look for to properly complete and successfully transmit an SMLLC tax form using software.

In addition, it was also suggested we incorporate the SMLLC Form 568 filing requirement right into the Form 540 as a schedule of the Form 540, rather than as a third tax return, especially since an SMLLC does not complete a full Form 568 but only certain parts anyway.

We recognize that this suggestion would simplify filing requirements for SMLLCs. However, it would require significant changes to our accounting systems for a very small population of taxpayers. For tax year 2014, there were approximately 34,000 SMLLCs with an owner who was an individual.

#### Tax News recognized

I am pleased to announce that *Tax News* received an Award for Publication Excellence (APEX) in the category of Newsletters – Electronic and Email.

With over 1,600 entries, competition was exceptionally intense. APEX Awards are based on excellence in graphic design, editorial content, and the ability to achieve overall communication excellence.

I want to thank my staff for their top-notch writing, editorial, and ‘sleuthing’ skills to produce timely and relevant articles. I also want to thank our tax professional community for their continual input.

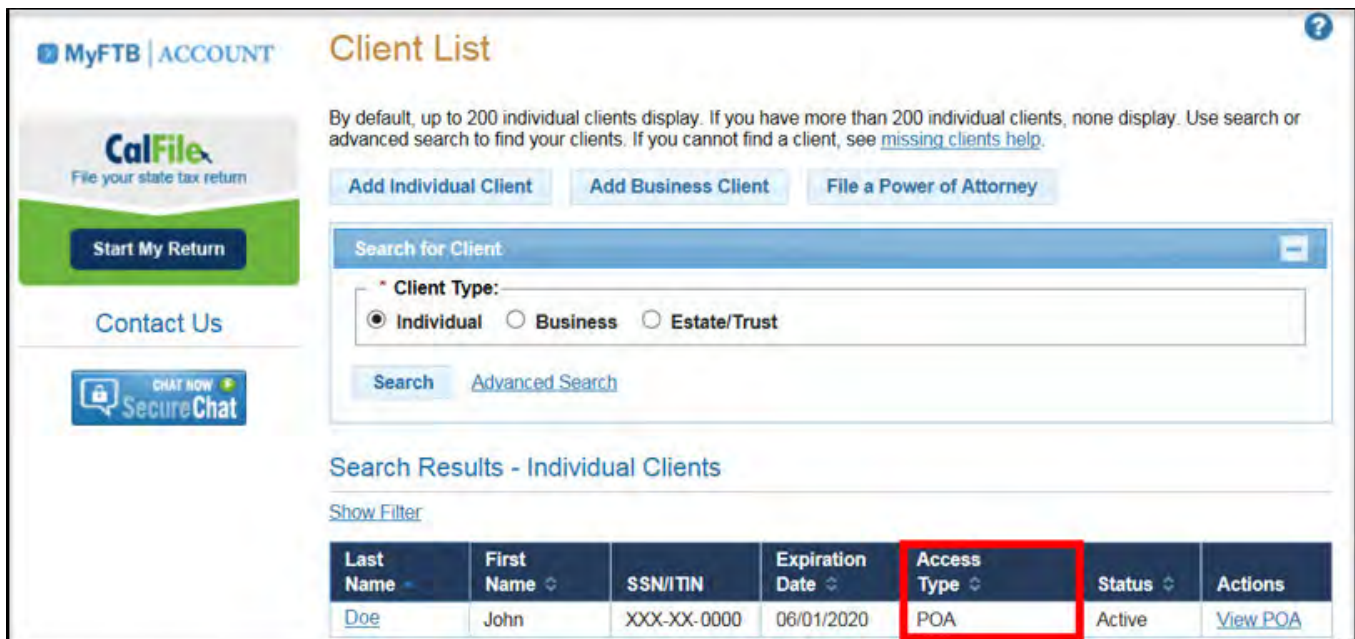
## MyFTB Corner

### POA representatives – Search for POA clients in MyFTB

Did you know that you can view the status of your clients' Power of Attorney (POA) declaration in MyFTB?

POA clients will display with an Access Type of *POA* in the **Access Type** column. By default Active Individual clients, including Active Individual POA clients, will display on your Client List. You will need to perform a search to view Inactive or Pending POA clients and business, estate, or trust clients.

**Note:** Only POA declarations submitted on or after October 1, 2014, will display on your Client List in MyFTB. If you want online access to your client's account for POAs submitted prior to October 1, 2014, you will need to resubmit the POA declaration. Once the POA declaration is resubmitted, your client will be notified of the processing of the declaration. For instructions on how to submit a POA in MyFTB, see Tax Preparer: How To Submit a FTB Form 3520, Power of Attorney Declaration.



The screenshot shows the MyFTB Client List interface. At the top, there are navigation links for "MyFTB | ACCOUNT" and "Client List". Below this, there are buttons for "Add Individual Client", "Add Business Client", and "File a Power of Attorney". A search bar is present with the text "Search for Client" and a search icon. Below the search bar, there are radio buttons for "Client Type": "Individual" (selected), "Business", and "Estate/Trust". There are also "Search" and "Advanced Search" buttons. Below the search bar, there is a section titled "Search Results - Individual Clients" with a "Show Filter" link. A table displays the search results for individual clients. The table has columns for "Last Name", "First Name", "SSN/ITIN", "Expiration Date", "Access Type", "Status", and "Actions". The "Access Type" column is highlighted with a red box, and the value "POA" is visible in the first row. The "Status" column shows "Active" for the same row. The "Actions" column has a link "View POA".

Last Name	First Name	SSN/ITIN	Expiration Date	Access Type	Status	Actions
<a href="#">Doe</a>	John	XXX-XX-0000	06/01/2020	POA	Active	<a href="#">View POA</a>

The POA statuses available for search are Active, Inactive, or Pending. Inactive statuses include Revoked, Rejected, Expired, and Canceled. Pending statuses include Pending and Pending Taxpayer Approval.



POA Status	Definition
Active	Declaration has been processed and accepted by FTB and is currently active.
Inactive	Declaration is not active. The declaration is Revoked, Rejected, Expired, or Canceled.
Pending	Declaration was submitted via MyFTB and is being processed by FTB.
Pending Taxpayer Approval	Declaration was submitted via MyFTB without a signed copy of declaration attached. FTB has processed and accepted the declaration, and the declaration is pending taxpayer approval (taxpayer must log in to their MyFTB account and approve the declaration).

Can't see your client on your Client List? For instructions on how to search for your clients in MyFTB, see [Tax Preparer: How to Search for a Client on the Client List](#).

## Inside FTB

### Top 500 Notice of Public Disclosure of Tax Delinquency

We mailed the 500 **Notice of Public Disclosure of Tax Delinquency** letters on August 12, 2016. We send these letters to the top 500 delinquent personal income tax (PIT) and business entity (BE) taxpayers who owe over \$100,000 subject to a recorded notice of state tax lien. We intend to publish this information on our public website during the week of October 3, 2016.

If your client receives a *Notice of Public Disclosure of Tax Delinquency* letter, you can contact:

- PIT: 888.426.8555
- BE: 888.426.8751
- [ftb.ca.gov](http://ftb.ca.gov) and search for **Top 500**

## All About Business

To file a business entity (BE) return or not to file a BE return, that is the question

If your BE client has a requirement to file a tax return don't stop your analysis at "doing business."

Pass-through entities like partnerships, multiple-member limited liability companies (LLCs) classified as partnerships for tax purposes, and S corporations, that are "doing business" in California have a California return filing requirement. But what if the business entity (BE) is not "doing business" in California? When it comes to determining if your BE client has a requirement to file a tax return don't stop your analysis at "doing business."

In California, a partnership must file a tax return on California Form 565, Partnership Return of Income, if the partnership is "doing business" in California **or** has income from sources within California.<sup>1</sup> California Revenue and Taxation Code (R&TC) Section 18633(a)(1) states, "Every partnership,..., shall make a return for that tax year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001)."<sup>2</sup> This subdivision goes on to require the tax return to contain specific information related to the entities (partners) who would be entitled to a share in the partnership items whether the partners are residents or nonresidents.

A LLC classified as a partnership, for California tax purposes, that is "doing business" in California will generally file a California Form 568, Limited Liability Company Return of Income. An out-of-state LLC that is not doing business in California,<sup>3</sup> or has not registered with the Secretary of State, may still have a requirement to file to comply with R&TC Section 18633. An

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<sup>1</sup> See regulation 17951-2.

<sup>2</sup> This refers to the partnership income not the partner income. A corporate partner's distributive share of partnership gross income is determined in accordance with Part 10, see R&TC Section 24271.

<sup>3</sup> Don't forget that an LLC that is a member or partner in another business entity may be considered to be doing business in California.

out-of-state LLC that is filing **only** to comply with the R&TC Section 18633 requirement to file and report income from sources within California or to file an election on behalf of a California resident may file using the California Form 565.

A corporation (C, S or LLC electing to be taxed as a corporation) that is “doing business” in California is required to file a tax return and pay the Corporate Franchise Tax imposed under Part 11, Chapter 2 (commencing with R&TC Section 23101). A corporation that is not “doing business” in California, but which has net income derived from sources within California, is required to file a tax return and pay the Corporate Income Tax imposed under Chapter 3 (commencing R&TC Section 23501), according to or measured by its net income.

### **Public Law (PL) 86-272 and Nexus issues**

PL 86-272 still applies to sellers of tangible personal property. As a result, if a BE taxpayer's activities in California stay within the protections of PL 86-272, a taxpayer also remains protected from the imposition of those taxes that are computed based on net income, namely, the California franchise and income tax. Nevertheless, if a taxpayer is considered doing business in California either under R&TC Section 23101(a) or (b), it still has a filing requirement and will be subject to the minimum tax, because that tax is not computed based on net income and therefore is not subject to the protections of PL 86-272.<sup>4</sup>

If your client cannot pay their taxes by the due date, the tax return should be filed on time and they should pay as much as they can. Although penalties for late payment of tax apply, the penalty for late filing of the tax return is usually higher.<sup>5</sup>

This statement is especially true for pass-through business entities, such as partnerships, LLCs,<sup>6</sup> and S corporations.

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<sup>4</sup> See R&TC Section 23151 for exceptions.

<sup>5</sup> All late filed returns may be subject to a late filing penalty (R&TC Section 19131), which is based on amount of unpaid tax due. This may be assessed with other penalties, such as the partnership or S-corporation late filing penalty.

<sup>6</sup> Limited Liability Companies – This article addresses LLCs that are treated for tax purposes as a partnership. Single Member limited liability companies and LLCs which have elected to be treated as corporations are not addressed in this article.

## **Delinquency Penalty: Failure to File**

The R&TC requires us to impose penalties for a taxpayer's failure to timely file a return (Sections 19131, 19172, and 19172.5) or a taxpayer's failure to timely pay tax (Section 19132), unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

Similar to the federal law (Internal Revenue Code (IRC) Sections 6698 and 6699), California law (R&TC Sections 19172 and 19172.5) imposes a partnership/shareholder late-filing penalty for the late filing of pass-through business entities tax returns (Forms 565, 568 and 100S) or if you file the tax returns without required information.<sup>7</sup> We impose these penalties even if all taxes have been paid or (as is the case with a general partnership) no taxes are imposed.

### **No reasonable cause - No "first-time" abatement**

The Internal Revenue Service (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 does the Franchise Tax Board have any formal administrative policy that is similar to the federal policy.

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<sup>7</sup> Failure to File a Timely Return or Provide Information unless failure is due to reasonable cause, a penalty will be assessed against the partnership if it is required to file a partnership return and one of the following occur:

It fails to file the return on time, including extensions.

It files a return, including Schedules K-1 (565), that fails to show all the information required.

Interest will be charged on the penalty from the date the notice of tax due is sent by the FTB to the date the return is filed.

For "small partnerships," as defined in IRC Section 6231, the federal exception to the imposition of penalties for failure to file partnership returns, does not apply for California purposes. For more information see R&TC Section 19172.

For tax returns filed on or after January 1, 2011, the partnership, LLC, and S-corporation late filing penalty will be \$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 part of the taxable year for which the tax return is filed after its due date. This penalty is in addition to the existing late filing penalty under R&TC Section 19131.

Although federal and California law both impose late filing penalties on pass-through business entities tax returns, as we outline in the following chart, there can be a significant difference when these penalties start to accrue and how much will be imposed.

**Note:** The chart below does not reflect The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Public Law 114-41, changes to the federal filing due dates for partnerships and LLCs effective for returns for taxable years beginning after December 31, 2015, nor does it reflect California proposed legislation, Assembly Bill 1775, that would modify California return due date similar to federal Public Law 114-41.

Partnership	Federal	California
<b>Form</b>	1065	565
<b>Due Date (Calendar Year Filer)</b>	April 15th (15th day of 4th month)	April 15th (15th day of 4th month)
<b>Application to Extend</b>	Application Required	Automatic (if the tax return is filed within 6 months of original due date)
<b>Extension Due Date</b>	Sept 15th (5-month extension)	Oct 15th (6-month extension)

Limited Liability Company	Federal	California
<b>Form</b>	1065	568
<b>Due Date (Calendar)</b>	April 15th (15th day of 4th month)	April 15th (15th day of 4th month)

Limited Liability Company	Federal	California
<b>Application to Extend</b>	Application Required	Automatic (if in good standing and the tax return is filed within 6 months of original due date)
<b>Extension Due Date</b>	Sept 15th (5-month extension)	Oct 15th (6-month extension if in good standing)
<b>Penalty Per Partner/Member</b>	\$195 per month (or fraction thereof)	\$18 per month (or fraction thereof)

S Corporation	Federal	California
<b>Form</b>	1120S	100S
<b>Due Date (Calendar)</b>	March 15th (15th day of 3rd month)	March 15th (15th day of 3rd month)
<b>Application to Extend</b>	Application Required	Automatic (if in good standing and the tax return is filed within 7 months of the original due date)
<b>Extension Due Date</b>	Sept 15th (6-month extension)	Oct 15th (7-month extension if in good standing)
<b>Penalty Per Shareholder</b>	\$195 per month (or fraction thereof)	\$18 per month (or fraction thereof)

After the tax return is processed, we will send a bill, including penalties and interest. If the business entity is unable to pay the balance in full by the due date on the notice, the business entity can enter into an installment agreement if it cannot pay the total balance in 90 days due to a financial hardship. Under this program, the business entity would agree to pay a specified amount on a specified day each month.

In order to qualify for an installment agreement, the business entity:

- Must file any delinquent tax returns.
- May need to complete and mail to us a financial condition form. If necessary, we may require other financial documentation.
- Must pay a \$50 fee to set up an installment agreement. We will add the fee to the business entity's balance due.

Our staff will determine if an account qualifies for an installment agreement and the time period allowed.

For more information, go to [ftb.ca.gov](http://ftb.ca.gov) and search for installment agreements - business.

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

## 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.