STATE OF CALIFORNIA
Franchise Tax Board

taxnews

Tax News

September 2019

Contents

Board meeting for gig economy

We are hosting a Franchise Tax Board Meeting on Tuesday, October 1, 2019 to discuss the gig economy.

The Board will have presentations on the gig economy and the tax compliance challenges faced by those participating in the gig economy. Your participation, questions, concerns, and ideas may be presented during time reserved for public comments.

Anticipated discussion topics include:

- Background information about the gig economy
- California tax landscape
- Panel discussions:
  - Challenges and opportunities
  - The future of the gig economy and state tax obligations

For more information on the upcoming meeting, including how to participate, go to our Meetings page.

If you have any questions or comments regarding this Board meeting, please email us at FTBGigEconomy@ftb.ca.gov. If you plan to attend, we recommend using Light Rail or rideshare as our parking is limited.

Our gig economy webpage provides an overview and resources for those earning income in the gig economy.

Prepare now for new state minimum essential coverage individual health care mandate

By enacting Senate Bill 78 (Chapter 38, Statutes of 2019), the Legislature created the Minimum Essential Coverage Individual Mandate ("Mandate"). The Mandate takes effect on January 1, 2020, and requires Californians to maintain minimum essential coverage for each month on or after that date. Californians who fail to have qualifying health coverage will owe a state penalty for each month they lack coverage. In addition, those responsible for ensuring their spouse or dependents maintain coverage may owe a penalty if their spouse or dependents do not have minimum essential coverage. Californians who owe a penalty will pay when they file their tax year 2020 state income tax return in early 2021.

To avoid this penalty, California residents need to have monthly qualifying health insurance for themselves, their spouse and their dependents beginning on January 1, 2020.

Covered California, the state's insurance marketplace, will provide financial assistance to some households that meet certain income requirements, and issue certificates of exemptions to individuals who are exempt from the Mandate.

Non-wage withholding common errors

You prepared your client's tax return with all the information you had available and now they have a Notice of Tax Return Change. The notice reports they were not credited with the withholding they reported. Below are some of the most common errors that occur resulting in the taxpayer not receiving their credit:

- The **incorrect tax year form** was used. The year of the tax form(s) and the year of the withholding must be the same. The most current forms are available online.
- The taxpayer **identification numbers are not the same on the Form and the return**. It is important that the SSN/FEIN listed on the form matches the SSN/FEIN on the return so we can match the form to the account.
- If the payee is a **grantor trust**, the form should have the name and SSN or ITIN of the grantor that is required to file a tax return and report the income. Do not enter the name of the trust or trustee.
- If the payee is a **non-grantor trust,** the form should have name and FEIN of the trust that is required to file a tax return and report the income. Do not enter the name or SSN of the individual or trustee.
- The withholding agent filed Form 592-B instead of Form 592. When the withholding agent does not fulfill their requirement of filing Form 592, FTB does not know where to allocate the withholding. This results in your client's withholding credit not being available when the return if filed.

In all of the above situations, you have two options:

1. Call the withholding agent to get the correct information filed.
2. Call Withholding Services and Compliance Section to help get the correct information filed, and update the systems accordingly.

In each instance above, the form will need to be amended for corrections. If you notice any of these errors prior to filing the return, please reach out to us and we will do our best to assist you in getting the correct forms in place prior to the filing of the return. Connect with us.

AB 91 - Loophole Closure and Small Business and Working Families Tax Relief Act of 2019

Assembly Bill 91 modified the Earned Income Tax Credit, created the Young Child Tax Credit, disallowed a separate state election for certain qualified stock purchases, and selectively conformed, with modifications, to several federal Tax Cuts and Jobs Act provisions. In summary, AB 91:

(1) Modifies the Earned Income Tax Credit by increasing the maximum adjusted gross income limitation for eligible individuals up to $30,000.
(2) Enacts the refundable Young Child Tax Credit of up to $1,000 per year for families eligible for the EITC.
(3) Conforms, with modifications, to increase the amount of earnings that can be contributed to the ABLE account and allows rollovers between Section 529 plan accounts and other Section 529 accounts and ABLE accounts. These changes also it eliminated some differences in the qualification criteria for ABLE accounts and qualified education expenses under federal tax law and California tax law.
(4) Conforms, with modifications, to the exclusion from an individual's gross income the amount of student loan indebtedness discharged on or after December 31, 2018 due to the death or total and permanent disability of the student.
(5) Conforms, with modifications, to the disallowance of a deduction for a specified percentage of Federal Deposit Insurance Corporation premiums paid by certain large financial institutions.
(6) Conforms, with modifications, to the deduction limitation on excess employee remuneration, which revised the definitions of covered employee and publicly held corporation and disallowed the performance-based compensation and commission exceptions with respect to the deduction limitation relating to covered employees.
(7) Disallows a net operating loss (NOL) from being carried back by individual and corporate taxpayers for NOLs attributable to taxable years beginning after December 31, 2018.
(8) Allows a small business to use the cash method of accounting if its average annual gross receipts for the 3 taxable years do not exceed $25,000,000 and allows taxpayers to elect this provision to apply for taxable years beginning on or after January 1, 2018 and before December 31, 2018.
(9) Exempts a corporation engaged in farming from the accrual method of accounting if its average annual gross receipts for the 3 taxable years do not exceed $25,000,000 and allows taxpayers to elect this provision to apply for taxable years beginning on or after January 1, 2018 and before December 31, 2018.
(10) Exempts a taxpayer with average annual gross receipts for the 3 taxable years ending with the prior taxable year of $25,000,000 or less from the provisions that preclude the deduction of certain direct and indirect costs and determine whether those property costs are inventory costs or are capitalized and allows taxpayers to elect this

provision to apply for taxable years beginning on or after January 1, 2018 and before December 31, 2018.

(11) Exempts a small business with average annual gross receipts for 3 taxable years not exceeding $25,000,000 from the provisions that require a taxpayer to take inventories to clearly determine their income and allows taxpayers to elect this provision to apply for taxable years beginning on or after January 1, 2018 and before December 31, 2018.

(12) Exempts construction contracts entered into by a taxpayer with average annual gross receipts not exceeding $25,000,000 from the requirement that the taxable income from a long-term contract be determined by the percentage of completion method and allows taxpayers to elect this provision to apply for taxable years beginning on or after January 1, 2018 and before December 31, 2018.

(13) Conforms, with modifications, to the limitation on business losses from a non-corporate taxpayer for taxable years beginning after December 31, 2018. This provision will treat any disallowed excess business loss as a "carryover excess business loss" for the following taxable.

(14) Conforms to federal law regarding technical termination of a partnership. Repeals a provision that caused termination of a partnership resulting from the sale or exchange of 50% or more of the interest in a partnership within a 12-month period. It is operative for taxable years beginning on or after January 1, 2019. However, it also allows a partnership to elect to have this conformity apply to partnership taxable years beginning after December 31, 2017, and before January 1, 2019.

(15) Conforms, with modifications, for exchanges on or after January 1, 2019, to the limitation on deferral of recognition of any gain or loss through a Like-Kind exchange to the exchanges of real property, except with respect to certain individual taxpayers whose income does not exceed specified adjusted gross income thresholds.

(16) Disallows a separate state election for certain stock purchases treated as asset acquisitions, or where a taxpayer is deemed to have made an election under Section 338(e) of the Internal Revenue Code, relating to deemed election where the purchasing corporation acquires assets of the target corporation.

Go to California Legislative Information website for more information about AB 91.

Head of Household (HOH) Notices of Proposed Assessment

Beginning in late September through October 2019, we will be mailing 66,500 Notices of Proposed Assessment denying HOH filing status for the 2018 tax year.

What's new this year? We will no longer be sending education, demand, or document request letters this year. We will only be sending Notices of Proposed Assessment.

Taxpayers who may disagree with the Notice of Proposed Assessment may follow the same protest procedure as prior years. The instructions included with the Notice or they may follow the methods below:

- Go to ftb.ca.gov and log into MyFTB to upload the protest and/or substantiation. They will need their account number (FTB ID) from their Notice of Proposed Assessment or their social security number (SSN). Tax Professional: Submit Protest to a Proposed Assessment

- Mail the HOH Protest and substantiation to:

  FRANCHISE TAX BOARD
  PO BOX 942840
  SACRAMENTO CA 94240-5340

Go to our Head of Household webpage for more information about the HOH filing status or refer to California Head of Household Filing Status Publication 1540.

New IRS Tax Withholding Estimator

The IRS encourages everyone to use the new Tax Withholding Estimator. As part of a continuing effort to improve quality services for taxpayers, the IRS upgraded this tool, which replaces the Withholding Calculator, and gave it a facelift. This new tool helps your clients tailor the amount of income tax their employer should withhold from their paychecks and avoid unexpected results at tax time. The Estimator helps you target a tax due amount close to zero or a refund around $500.

Tips for using the Withholding Estimator:

- Gather your clients' most recent pay stubs and tax return.
- Use the links within the Estimator to see if they qualify for credits and deductions.
- Include other sources of income, like self-employment income and Social Security benefits.
- Revisit this tool if your clients' circumstances change.

Time is right

Helping your clients with tax planning for the last few months of 2019? It's especially important to use the estimator now:

- If they faced an unexpected tax bill or a penalty when they filed this year.
- If they made withholding adjustments in 2018.
- If they have or will experience a change in marital status, dependents, income or jobs this year.

- Because your clients can make estimated tax payments to the IRS instead of adjusting their withholding, and the next payment deadline is September 16.

Data security is everyone's business!

The Internal Revenue Service recently issued their Tax Security 2.0 – A "Taxes Security Checklist" through a five-part weekly series of IRS news releases. Each of these news releases focuses on one step or component of data security. The five releases are summarized below with a link to each of the steps. Please take the time to click on each link and review the full list of steps provided by IRS.

This information is vital and while extensive, it is definitely worth taking the time to read through everything. But, it doesn't stop there - we suggest comparing the recommended practices with what you currently have in place and make adjustments, if necessary.

The 'Taxes-Security-Together' Checklist

1. Deploy the "Security Six" measures: Step 1
   a) Activate anti-virus software.
   b) Use a firewall.
   c) Opt for two-factor authentication when it's offered.
   d) Use backup software/services.
   e) Use Drive encryption.
   f) Create and secure Virtual Private Networks.

2. Create a data security plan: Step 2
   a) Federal law requires all "professional tax preparers" to create and maintain an information security plan for client data.
   b) The security plan requirement is flexible enough to fit any size of tax preparation firm, from small to large.
   c) Tax professionals are asked to focus on key risk areas such as employee management and training; information systems; and detecting and managing system failures.

3. Educate yourself and be alert to key email scams, a frequent risk area involving: Step 3
   a) Learn about spear phishing emails.
   b) Beware of ransomware.

4. Recognize the signs of client data theft: Step 4
   a) Client e-filed returns begin to be rejected by the IRS or state tax agencies because returns with their Social Security numbers were already filed;

b) Clients who haven't filed tax returns begin to receive taxpayer authentication letters (5071C, 4883C, 5747C) from the IRS or a letter from FTB to confirm their identity for a submitted tax return.
c) Clients who haven't filed tax returns receive refunds.
d) Clients receive tax transcripts that they did not request.
e) Clients who created an IRS or FTB Online Services account receive a notice that their account was accessed or an IRS or FTB email stating their account has been disabled. Another variation: Clients unexpectedly receive an IRS or FTB notice that an online account was created in their name.
f) The number of returns filed with the tax professional's Electronic Filing Identification Number (EFIN) exceeds the number of clients.
g) Tax professionals or clients responding to emails that the firm did not send.
h) Network computers running slower than normal.
i) Computer cursors moving or changing numbers without touching the keyboard.
j) Network computers locking out employees.

5. Create a data theft recovery plan including (Step 5)
   a) Contact the IRS, reporting the data theft to your local IRS Stakeholder Liaison. They will notify IRS Criminal Investigation and others within the agency.
   b) Contact the State Tax Agencies where you prepare returns. To help tax professionals find where to report data security incidents at the state level, the Federation of Tax Administrators has created a special email address as a contact point: StateAlert@taxadmin.org.
   c) Contact security experts and your insurance company.

All of the above are useful steps you can use to help keep your systems and client data secure. It's definitely better to address any potential issues now, before a data breach occurs.

Ask the Advocate

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Taxpayers' Rights Advocate
Follow me on Twitter at
twitter.com/FTBAdvocate

2019 Advisory Board Meeting summary

Last month, I mentioned that the summer time is when my staff and I prepare for our annual meetings. As I write this, we recently had the first of our four meetings: our Executive Officer's Advisory Board which met here at FTB headquarters the first week of August.

The Advisory Board is made up of several representatives from industry, state and federal government, along with FTB staff. The Board provides our Executive Office and FTB staff with valuable insight about the many programs FTB administers. We also hear first-hand about challenges that exist when doing business with us. Hearing a non-FTB perspective is invaluable as it helps us better understand where things can be improved.

This year's meeting provided attendees with updates on litigation and legislation, followed by a presentation on FTB's efforts with the California Tax Education Council (CTEC) to combat "ghost tax preparers," i.e., paid preparers who charge a fee to prepare a return but never sign it. Frequently, these preparers are unlicensed and do not have sufficient continuing professional education. Ghost preparers as the name suggests, disappear after preparing the return, sometimes changing locations from year to year. Taxpayers are often left with no one to turn to in the event that FTB or the IRS has questions about their return. Preparing a return for compensation without signing the return as a paid preparer is not only against the law, it leaves these preparers open to substantial fines. Finally, whenever a taxpayer is victimized by an unscrupulous preparer, this has the potential to reflect poorly on our industry as a whole.

In addition to the updates, our Advisory Board members participated in two breakout sessions. The first session provided an overview of what a typical FTB audit looks like along with some alternative efforts undertaken to improve compliance. The second session dealt with the changes to FTB's website. We received many great questions from the attendees and some helpful feedback regarding how best to prioritize content on our new website.

With this year's Advisory Board meeting now in the books, one of things I am looking forward is attending the annual IRS Tax Forum, which takes place this year in National Harbor (MD), Chicago, New Orleans, Orlando and San Diego. The first four dates have already taken place, with the last stop (San Diego) coming up September 17 to 19, which is where I plan to attend. If you are also planning on being there, I hope you will make it a point to stop by my table and say hi.

For those of you who have never attended, this 3-day event provides continuing professional education, networking opportunities, and access to exhibitors with products and services that may interest you. IRS specialists are also at the Tax Forum and are available to help you resolve a difficult case you may have for one of your clients. One of the other highlights of this year's Tax Forum will be hearing from Charles Rettig, the new IRS Commissioner. He is the planned Keynote Address speaker at all locations and I look forward to hearing what he has to say.

In closing, I hope you had a great summer and were able to get some time away from the office doing something you enjoy.

All About Business

It's that time of year - make sure your clients that closed a business complete the process

The filing of a final return will not legally terminate a business and will not end its requirement to file and pay taxes. The entity is still required to submit the Certificate of Dissolution/Cancellation document to the California Secretary of State (SOS) to close/withdraw their business. If your client filed a corporate or Limited Liability Company (LLC) return (100, 100S, 100W, or 568) and marked it final the next step is to make sure the proper documents have been filed[1] with the SOS.

Simple 3-step process:

- Step one: Go to the California SOS bizfile page.
- Step two: find your entity
  You can search by either the LP/LLC/Corporation Name or Entity Number. [2]
- Step three: confirm the entity's status[3]

If the status is Active, now is the time to talk to your client.

Your client's business entity may avoid the minimum franchise or annual tax[4] for current and subsequent taxable years if it fulfills all of the following requirements:

- File its final franchise or annual tax return timely, including extension, for the preceding taxable year and mark it final.

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[1] See California Corporate Code 110

[2] Corporations need to put a "C" before their assigned number

[3] The status should generally be either dissolved, merged out, surrender, or canceled, if the status is active, suspended or forfeited the entity has not been legally terminated/canceled.

[4] California law generally requires a business entity to pay the minimum franchise tax whether it is incorporated or organized in the state (domestic entities); qualified or registered to do business in the state (foreign entities); or doing business in the state without having incorporated, organized, registered or qualified. We require a minimum franchise tax from all business entities (Corporation, S-Corp, Limited Liability Company, or Limited Partnership) whether active, inactive, and operating at a loss or filing a short-period return (less than 12 months).

- Conduct no business after the last day of the preceding taxable year.
- File the appropriate termination documents[5] with the SOS within 12 months of the filing date of its final tax return.

As stated in our June 2019 - All about business article SOS' bizfile allows authorized individuals to terminate LLCs Online. [6]

What if your client filed a timely return, but did not check the box as a final return? If the return for the preceding taxable year is their final return, no worries. Send to us all of the following (applies to all entities):

- A letter stating the entity did not conduct any business after the last day of the preceding taxable year.
- Attach a copy of the Certificate of Dissolution, Surrender, or Cancellation showing the date SOS granted the dissolution, surrender, or cancellation and that it was done within 12 months of the filing date of the timely final tax return.

Send the letter and documentation to:

Franchise Tax Board
P.O. Box 942857
Sacramento, CA 94257-0540

Suspended or forfeited entities

If your client's business entity is suspended or forfeited, the SOS cannot accept termination documents. You must complete all of the following requirements before you submit your termination documents to SOS:

- Pay all outstanding balances due
- File any delinquent tax returns
- File FTB 3557 BC, *Application for Certificate of Revivor*, (Banks and Corporations), FTB 3557 LLC, *Application for Certificate of Revivor*, (LLCs), or FTB 3557 E, *Application for Certificate of Revivor,* (Tax-Exempt Corporations)

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[5] A California or foreign (out–of–state or out–of–country) business entity can dissolve, surrender or cancel by filing the applicable termination forms with the California SOS. Please refer to the California SOS for complete filing forms, instructions, fees, any additional requirements and relevant statutory filing provisions.

[6] At this time the SOS does not have an online service for the termination of corporations.

For more information regarding the revivor process, go to ftb.ca.gov or call 888.635.0494 or 916.845.7033.

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.