

chair **Betty T. Yee**
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State of California
Franchise Tax Board

02.04.2015

Lynn Freer
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PO Box 61044
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Dear Ms. Freer:

Thank you for your letter submitted for the Taxpayers' Bill of Rights Hearing held on December 4, 2014. *Below is my response to the proposals you submitted.*

Conformity to Federal Self-Employment Health Insurance Deduction

California currently conforms to the federal deduction for self-employed health insurance premiums, including the amount deductible for self-employed taxpayers who are allowed the Internal Revenue Code (IRC) Section 36B refundable credit for coverage under a qualified health plan. There is no difference between federal and state law with respect to the amount that self-employed taxpayers may deduct for health insurance premiums, including taxpayers who are allowed the IRC Section 36B credit.

Revenue and Taxation Code (R&TC) Section 17201 conforms to IRC Section 162(l) as of the "specified date" of January 1, 2009. R&TC Section 17201.1 conforms to the IRC Section 162(l) changes to the self-employed health-insurance deduction made in the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152), effective for the same periods as effective for federal purposes.

Thus, California follows Treasury Regulation Section 1.162(l)-1T(a)(1), which provides that a self-employed taxpayer is allowed an IRC Section 162(l) deduction for specified health insurance premiums not to exceed an amount equal to the lesser of (1) the specified premiums less the premium tax credit attributable to the specified premiums, and (2) the sum of the specified premiums not paid through the advance credit payments and the additional tax imposed under IRC Section 36B(f)(2)(A) and Treasury Regulation Section 1.36B-4(a)(1) with respect to the specified premiums after the application of the limitation on additional tax in IRC Section 36B(f)(2)(B) and Treasury Regulation Section 1.36B-4(a)(3).

Consequently, the amount of health insurance premiums deductible under IRC Section 162(l) for California income tax purposes is the same as the amount deductible for federal income tax purposes.

Real Estate Withholding

The majority of real estate withholding is processed with no problems. However, there are still many times when the real estate withholding is not correctly applied to the taxpayer's account. This results in a discrepancy when the taxpayer files their return. This is primarily the result of escrow company mistakes, such as improper reporting or submitting incorrect

withholding amounts. We realize this problem creates additional burdens for taxpayers. Because of this, we have increased our education and outreach efforts to help escrow companies understand the importance of accurately reporting real estate withholding. Beyond education and outreach, we are also evaluating internal steps that we can take to improve the process when the withholding is improperly reported. For example, we are developing a process that would identify unapplied withholding credits for tax year 2015 and create a worklist so that we can focus on making the corrections this calendar year. This proactive effort will include contacting the Real Estate Person to make corrections to the Form 593, if applicable. Our goal is to minimize the impact to the taxpayers and make sure the appropriate withholding credit is available when their tax year 2015 return is filed. We look forward to providing results of this proactive effort by June of 2016. Finally, we prefer education over enforcement; however, we will assess withholding penalties against the escrow companies when appropriate.

We agree that including real estate and nonresident withholding information in MyFTB Account would be beneficial by allowing the taxpayers to verify the withholding available prior to filing their tax return. Because of this, we are planning to have Individual nonwage withholding information, which includes real estate withholding, viewable on MyFTB Account with the summer of 2015 Enterprise Data to Revenue release. We are still evaluating this option for Business Entity information.

We completed an analysis of Form 593 and identified changes that we would like to make to the form to address the issue to match withholding for taxpayers who have grantor trusts where SSN is used and the name of the trust matches. We plan to work with Legal in the near future to add clarifying language to the form such as including the words "Individual's name/Grantor's name" above the individual name fields. Another idea is to replace the words "Business name (if applicable)" with "Business name/Non-grantor trust name (if applicable)" within the business field. However, these changes will require a formal regulatory process, which will include an Interested Parties Meeting. We expect this process to be complete in mid-2016, with the anticipated changes made to the forms for the 2017 tax year. In the meantime, we are currently implementing a manual process to identify these inaccurate or incomplete forms to ensure that the 2015 tax year credit and beyond are available for the taxpayers when they file their returns. Our goal is to add clarity to the issues regarding the difference between non-grantor and grantor trusts and improve the matching of withholding for taxpayers in situations such as this.

We understand the concern of having duplicate paperwork reporting the withholding credits. We started the process of drafting new pass-through entity withholding regulations which will allow us to address these types of concerns. We shared these comments with Legal and will include this K-1 issue for consideration during this process.

Clean the Books of Dead Corporations and LLCs

Our staff will expand the scope of the departmental team that was formed as a result of AB 1529, to review the dissolution, surrender, and termination processes for all business entities. The team will continue to look at ways to streamline these processes, which could include possible administrative dissolution, surrender, and termination processes, and develop a legislative proposal if necessary. Changes to these processes would involve other state agencies and therefore may need to wait until the obsolescent computer system, as mentioned in the governor's veto message for AB 1529, is replaced.

In the interim, we continue to educate taxpayers about their annual or minimum tax requirements, including information on our forms and website. In addition, the Secretary of State continues to include caution language on formation documents (LP-1, LLC-1, ARTS-GS, etc.) about the ongoing liabilities for the annual or minimum tax.

Ralite-type Entities

Currently, the Franchise Tax Board attempts all reasonable means to acquire any delinquent entity returns and/or any balances due from the entity itself. For those entities where a shareholder could be held responsible for the entity's debt, FTB evaluates the applicable tenets of the law, including liability in equity as outlined in the *Appeal of Howard Zubkoff and Michael Potash, Assumers and/or Transferees of Ralite Lamp Corporation*, 90-SBE-004, (April 30, 1990) (referred to as "*Ralite*").

Prior to pursuing a transferee assessment, we analyze and consider the facts of the collection case for collection remedies against the transferor entity. For transfer of liability at equity, the *Ralite* decision and California law requires us to have "exhausted all reasonable remedies against the "taxpayer-transferor" prior to pursuing a transferee assessment. Exhausting such reasonable collection remedies against the entity as required by law admittedly delays assessment against any transferee/shareholder(s), but is necessary to protect the taxpayer's rights to due process.

Shorten the 540

The California tax law does allow us to provide designation of voluntary contributions on a separate schedule that must be attached to the primary return. Currently, the voluntary contributions are included on the tax return for taxpayer convenience in making their contributions. However, we will explore other alternatives for reporting voluntary contributions on the tax return as part of our annual changes for next year.

We currently use the minimum type size and format that meet specifications which allow enhanced data capture capability through both 2D barcode and Optical Character Recognition (OCR) technologies. Although the form increased in length, these changes significantly increase our ability to quickly and accurately capture and process tax return data from about 4 million paper filed returns received yearly.

Sincerely,

Susan Maples, CPA
Taxpayers' Rights Advocate

cc: Hon. Betty T. Yee, Chair
Hon. Jerome E. Horton, Member
Hon. Michael Cohen, Member