



03.29.2017

FTB NOTICE 2017 - 02

SUBJECT: Late Payment Penalty Relief, Amendments to California Code of Regulations, title 18, section 25136-2

PURPOSE

To provide the procedure for requesting relief from the penalty for a late payment attributable to compliance with new amendments to California Code of Regulations, title 18, section 25136-2 ("CCR section 25136-2").

BACKGROUND

Revenue and Taxation Code ("RTC") section 25136(b) authorizes the Franchise Tax Board ("FTB") to prescribe regulations to carry out the purposes of RTC section 25136, which provides for the assignment of sales of services and sales of intangible personal property based on the location of the taxpayer's market. CCR section 25136-2 was promulgated under this statute. CCR section 25136-2, effective March 27, 2012, and applying to taxable years beginning on or after January 1, 2011, provides cascading rules for sales from services and sales from intangible property.

On August 7, 2015, the FTB announced its proposal to adopt amendments to CCR section 25136-2, hereinafter referred to in this Notice as the "new amendments." On September 15, 2016, the Office of Administrative Law approved the new amendments to CCR section 25136-2. The new amendments became effective on January 1, 2017, and are to be applied to taxable years beginning on or after January 1, 2015.

The new amendments add definitions, assignment rules, and examples relating to marketable securities, dividends, goodwill, and interest. Therefore, compliance with the new amendments may require some taxpayers to file an original or amended return to report new or revised tax liabilities for taxable years beginning on or after January 1, 2015. For example, a taxpayer that previously assigned investment interest to the location of the customer determines it has a California filing requirement (original or amended) when the interest is assigned based on the location where the investment is managed as required by the new rules; or a taxpayer determines it has a California filing requirement (original or amended) when it discovers it has California sales in the form of marketable securities.

To the extent pass-through income is impacted by the new amendments, partners, shareholders, or members may be required to file an original or amended return, including an original or amended group return¹ if so elected.

PROCEDURE

Reasonable Cause Penalty Relief

RTC section 19132 provides FTB is required to impose a penalty for late payment of tax when a taxpayer fails to pay the amount shown as tax on the return on or before the due date of the return,² unless the taxpayer establishes the late payment was due to reasonable cause and not willful neglect.

Because the new regulatory amendments apply to taxable years beginning on or after January 1, 2015, but became final on September 15, 2016, FTB will presume reasonable cause and not willful neglect in the case of a late payment attributable to the new amendments and waive the associated penalty. Relief under this Notice is limited to late payment penalties imposed with respect to tax liabilities shown 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 in satisfaction of the penalty.

FTB will not grant similar relief of delinquent filing penalties.³ FTB will not presume reasonable cause with respect to the new amendments for tax returns filed after the due date (including any extensions). A taxpayer's remedy in the case of a delinquent return would be to submit a claim for refund of amounts paid to satisfy a delinquent filing penalty. FTB will consider such claims in the normal course, on a case-by-case basis, to determine whether a taxpayer has established the requisite reasonable cause and lack of willful neglect for the delinquent filing.

In addition, properly imposed penalties for which the statutes do not provide a reasonable cause exception cannot be waived. For example, a penalty for underpayment of estimated

¹ RTC section 18535 authorizes FTB to provide for the filing of a group return for electing individuals who are nonresident partners, shareholders, or members. FTB Publication 1067 provides guidelines for filing a group Form 540NR. Resident individuals and business entities are not eligible to be included in a group return. A group nonresident return is filed on behalf of the electing nonresident individuals as a convenience. Only California-source pass-through income of the electing nonresidents is reported on a group return. A nonresident individual with other California sources of income is not eligible to elect to be included in a group return.

² Generally, a taxpayer is required to pay its tax liability at the time for filing its tax return, without regard to extensions. For taxable years beginning on or after January 1, 2015, and before January 1, 2016, a taxpayer classified as a corporation is generally required to file its tax return on or before the 15th day of the third month after the close of its taxable year. An individual or a taxpayer classified as a partnership is generally required to file its tax return for the 2015 taxable year on or before the 15th day of the fourth month after the close of its taxable year. (Rev. & Tax. Code §§ 19001, 18566, 18601, 18633, and 18633.5.)

³ Delinquent filing penalties are generally imposed under RTC sections 19131, 19172 and 19172.5.

tax⁴ is mandatory upon such an underpayment, and relief from the penalty is not available upon a showing of "reasonable cause" or a "lack of willful neglect."⁵

Eligibility for Relief

Business entities or individual taxpayers, including nonresident individuals properly included in a group return pursuant to RTC section 18535, are eligible under this Notice to request relief of the late payment penalty imposed with respect to tax liabilities shown on timely filed returns for taxable years beginning on or after January 1, 2015, and before January 1, 2016, to the extent the late payment is attributable to compliance with the new amendments.

Requesting Relief

Applicable only for taxable years beginning on or after January 1, 2015, and before January 1, 2016, taxpayers seeking relief of the late payment penalty imposed under RTC section 19132 should submit FTB 2924, *Reasonable Cause – Business Entity Claim for Refund*, or FTB 2917, *Reasonable Cause – Individual and Fiduciary Claim for Refund*. Taxpayers should use these forms to claim a refund of a paid late payment penalty or for prepayment relief of the late payment penalty. Completed forms should be mailed to the address indicated in the instructions to the form.

Taxpayers should complete the applicable form as indicated in the instructions to the form. In addition, taxpayers should do the following:

- On the top of the form, write "25136-2 Penalty Relief."
- On Part 3 – Reasonable Cause Explanation and Refund Amount, compute and explain the amount of the late payment attributable to compliance with the new amendments to CCR section 25136-2 for taxable years beginning on or after January 1, 2015, and before January 1, 2016. Identify the amount of the late payment penalty imposed and attach a copy of the notice received showing the amount of the penalty imposed.
- If the form is being filed for prepayment relief of the late payment penalty, enter "zero" for the "Refund Amount."

The principal author of this Notice is Anne Mazur of the Franchise Tax Board, Legal Division. For further information regarding this Notice, contact Ms. Mazur at P.O. Box 1720, Rancho Cordova, CA 95741-1720.

⁴ Rev. & Tax. Code §§ 19136 and 19142.

⁵ *Appeal of Weaver Equipment Company*, 80-SBE-048, May 21, 1980; *Appeal of J. F. Shea Co., Inc.*, 79-SBE-120, August 16, 1979; *Appeal of Decoa, Inc.*, 76-SBE-032, April 5, 1976.