



## Real estate withholding issues addressed

**The FTB is implementing changes that should improve matching withholding to the taxpayer.**

By Lynn Freer, EA  
Publisher

For the past two years, Spidell has presented real estate withholding matching problems to the FTB at the Taxpayer Bill of Rights Hearing. At a recent meeting with the FTB, they explained their plan to resolve these issues.

We believe both the temporary and long-term solutions will greatly improve the problem.

### The living trust problem

The most common problems for our clients involve withholding on

a property that is held in a grantor (commonly called living or revocable) trust. For example, the FTB has not been able to credit withholding on a property titled "The John Jones Trust" to John Jones as an individual even though the tax ID on the grantor trust is John Jones' Social Security number.

Although for tax purposes, the grantor trust does not need a new tax ID number and is treated as owned by the grantor, legally the property is owned by the trust. When a property is being sold, the escrow company does not determine whether the trust is a grantor (revocable) trust or an irrevocable trust. Thus, in most cases the escrow company submits the withholding under the name of the trust as recorded in the property records. The withholding

form instructions state to use the individual's name and taxpayer identification number.

According to the FTB's information, this problem accounted for approximately 4,000 unmatched withholding problems during a recent sample period (January 1, 2014 through October 31, 2014).

### Comment

The same problem arises when a property is sold by a single-member LLC. The property is titled in the name of the SMLLC, but the member's Social Security number is used.

### Current fix

In processing 2014 returns, the FTB's Withholding Services and Compliance Section implemented See **Real estate withholding**, page 50

## Are you including everything you should in the LLC fee computation?

**Don't forget to pay the estimated LLC fee on or before June 15.**

By Sandy Weiner, J.D.  
California Editor

The deadline for remitting the annual LLC fee is coming soon: the 15th day of the sixth month of the current taxable year — June 15, 2015, for 2015 calendar-year LLCs.<sup>1</sup>

Although taxpayers are not quite halfway through the year, they must estimate their total annual income attributable to California for the full year.

LLCs must use Form FTB 3536, Estimated Fee for LLCs, to remit the estimated fee.

### No estimated LLC fee required

If the taxable year of the LLC ends prior to the 15th day of the sixth month of the taxable year (June 15 for calendar year LLCs), no estimated fee payment is due. The LLC fee is due on the due date of the LLC's return.

In addition, only LLCs taxed as partnerships or disregarded entities are subject to the LLC fee.<sup>2</sup> LLCs taxed as corporations are not subject to the fee but must pay the corporate tax on net income if a C corporation or the 1.5% tax if an S corporation.

Finally, an LLC is not required to make an estimate of the fee in its first year of existence.<sup>3</sup>

### Estimating the fee

The estimated fee is required to be at least 100% of the current taxable year fee.<sup>4</sup> If the taxpayer's payment is late or less than the amount owed, the FTB will assess an underpayment penalty.

However, there is a prior-year exception if the timely paid estimated fee is equal to or greater than the

prior year's fee. There is no penalty for the LLC's first year doing business in California.

Unlike the corporation's estimated tax prior-year exception, there is no requirement that the prior tax year be a full 12 months.

The underpayment penalty is 10% of the difference between the fee paid and the fee owed, and there is no

See **LLC fee computation**, page 51

## Editorial Staff

### Publisher:

Lynn "Ms. California Tax" Freer, EA, is President of Spidell Publishing, Inc.® She works closely with all state tax agencies and is often consulted for input on policy decisions. She always has the inside information on what's happening at the state level because she devotes herself full-time to analyzing, writing about, and teaching California tax law and procedures. Lynn speaks at Spidell's annual Federal and California Tax Update Seminars as well as many other seminars.

### Editor:

Renée Rodda, J.D., is Editor of *Spidell's California Taxletter*® and *Analysis & Explanation of California Taxes*, and associate editor of *Spidell's Federal Taxletter* newsletter. Renée lectures extensively on tax issues that impact California taxpayers and aging Americans. She has authored numerous articles and publications including "A Practical Guide to Trusts" as well as self-study courses and webinars, including a course on the complicated issues facing California Registered Domestic Partners. She is a graduate of Chapman University School of Law with a Tax Law Emphasis.

### California Editor:

Sandy Weiner, J.D., brings almost two decades of experience as a lead California tax analyst at CCH Tax and Accounting, with emphasis on income and franchise taxes for the *California State Tax Reporter* and the *Guidebook to California Taxes*. She was a major contributor to the development of CCH's *Business Incentives Navigator* and *NexusExpert* and worked on the development of numerous products to assist practitioners with complex tax issues such as IRC conformity, apportionment and combined reporting. She is a graduate of Hastings College of the Law.

### Senior Editor:

Tim Hilger, CPA, is Associate Editor of *Spidell's California Taxletter*® and *Spidell's Analysis & Explanation of California Taxes* and editor of *Spidell's Federal Taxletter*. He has authored numerous articles, reports and self-studies on tax, financial and accounting matters. He has a Bachelor of Science in business administration (accounting) from California State University Long Beach and a Master of Science in taxation from Golden Gate University.

### Contributing Editor:

Kathryn Zdan, EA, is Spidell Publishing's Editorial Director. She writes and assists in research and editing articles for *Spidell's California Taxletter*® and *Spidell's Federal Taxletter*. She also updates many of Spidell's special reports. She has a master's degree from California State University Fullerton, and completed her undergraduate work at the University of Michigan.

Contributing Editor: Diane Fuller

Managing Editor: Austin Lewis

Layout: Ana Cervantes

## Real estate withholding, continued from page 49

a process to ensure that credit is available at the time a taxpayer files the return. Beginning in February 2015, the FTB:

- Manually processes those accounts that have not been credited to date. This might include contacting the real estate escrow company when Form 593 is filed with the FTB if the credit can't be applied due to an error on Form 593, such as incorrect tax ID numbers and missing information; and
- Validate the Return Information Notice (RIN) information to ensure accuracy prior to mailing a RIN with withholding credit problems.

This manual effort should greatly reduce the number of notices sent by the FTB. However, it might slow up processing of these returns. Although the affected returns might not process as quickly as a return where the credits match, refunds on problem returns will be faster because the taxpayer or representative will not have to contact the FTB and then wait for the issue to be resolved.

### Caution

There will still be RINs issued (called Notices of Tax Return Change starting this summer) if there are other processing problems.

### Where do errors on Form 593 come from?

According to the FTB, based on a recent study of 50,000 payments sampled, 70% of the real estate withholding forms received between January 1, 2014, and October 31, 2014, were processed successfully through their automated system.

Of the 30%, or about 15,000, that were unable to be processed, the FTB found the following errors:

- 8% — Business name with no ID or wrong ID type listed (grantor trust returns included in this group);
- 7% — No close of escrow date;
- 5% — Withholding amount is blank;
- 4% — No spouse ID number;
- 4% — No seller ID number;
- 1% — Missing spouse last name; and
- 1% — No seller last name.

For forms that can't be processed, 80% were due to incomplete or inaccurate information, and 20% were due to FTB keying, programming, or processing errors.

Of the 15,000 forms that couldn't be processed, about 4,000 were due to business or trust names being filed with individual ID numbers. Of the remaining 11,000, most fell out because of missing information.

## Passing withholding to beneficiary

When property is sold by an irrevocable (non-grantor) trust, the escrow company usually completes a Form 593 listing the name of the irrevocable trust as the seller. The trustee will receive a Form 593 in the name of the trust. If there was withholding on the sale, the trust must then file a Form 592 to transfer the withholding to the beneficiary and provide the beneficiary with a Form 592B.

Unfortunately, the current process does not allow the trust to pass through the withholding using the state withholding line on Schedule K-1.

Although currently the trust must file Form 592 and provide Form 592B to the beneficiaries, the FTB is looking at the possibility of using Schedule K-1 to pass through the withholding.

## Form changes

The FTB is revising Publication 1016, Real Estate Withholding Guidelines, and the form instructions to provide more details on how the forms work. Unfortunately, the FTB cannot change language on the forms without a change in the regulations. FTB legal staff is working with withholding staff to make the

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regulatory changes necessary to revise forms to process withholding on grantor trusts efficiently.

**MyFTB**

In the next major upgrade of the FTB's system, the FTB will reflect the real estate withholding for personal income tax in the taxpayer's MyFTB Account. This change is scheduled for September 2015.

**What to do this year**

The FTB is making progress toward resolving these issues. To be honest, even when the changes discussed here

are implemented, there will always be problems with mismatch due to human error. However, despite the additional time involved in processing trouble returns, we believe there will be improvement. We recommend that when you have a client with real estate withholding, you:

- Advise the client that the refund may be delayed because the return may need to be manually reviewed if the withholding credits can't be applied;
- Tell your client to send you any FTB notices received immediately so you can get the issue resolved;

- Keep copies of the escrow statement and Forms 592 and/or 593;
- If you notice an error in taxpayer name and ID number on Form 593 or a difference between withholding on the escrow statement and Form 593, have your client contact the FTB's Withholding Services and Compliance Section at:

(888) 792-4900

**LLC fee computation**, continued from page 49**2015 LLC annual fee amounts**

Total Income	Annual Fee
Below \$250,000	\$0
\$250,000 or more, but less than \$500,000	\$900
\$500,000 or more, but less than \$1,000,000	\$2,500
\$1,000,000 or more, but less than \$5,000,000	\$6,000
\$5,000,000 or more	\$11,790

reasonable cause exception for this penalty.

**Total income**

The fee is based on "total California-source income," which is essentially gross income under IRC §61 from all California sources before any apportionment or allocation plus cost of goods sold.<sup>5</sup>

If the LLC's income is solely from California customers, the fee is fairly easy to calculate. However, it gets more complicated when the LLC has customers in other states or receives income from other passthrough entities.

First, let's address some of the issues that arise in determining what's included in total income. Obviously, income from sales, lease, or rental of property is included, as is income from services performed. But "total income" also includes:

- Gross income from passthrough entities (other than income from another LLC that is subject to the fee, see "Tiered LLCs" on page 52 of this issue), including the distributive share of:
  - Gross ordinary income from the passthrough entities as well as the LLC's distributive share of COGS; and

- Interest, dividends, gross rents, and other distributive items of income;<sup>6</sup>
- Capital gains (not losses) and IRC §1231 gains (not losses). Under IRC §61(a)(3), the gains and losses are never netted;
- Income from the passive holding of intangible property;
- Income from occasional or isolated sales; and
- Expense reimbursements.

**EXAMPLE 5-1:** An LLC provides project management services for construction jobs. To keep the project moving along, the LLC pays vendors on behalf of the client and is then subsequently reimbursed by the client. According to the FTB, the LLC is required to include the vendor payment reimbursements in total income for purposes of calculating the fee.

**Income attributable to California sources**

LLCs with total income from California simply use their total

See **LLC fee computation**, page 52

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**LLC fee computation**, continued from page 51

income for purposes of determining the amount of the fee. However, for LLCs with income from both inside and outside California, total income attributable to California includes:

- Sales of tangible personal property delivered to a California purchaser

under the general sales factor destination rules;

- Income from services to the extent the customer receives the benefit of the service in California (note the cost of performance standard is no longer applied);

- Income from intangibles if the intangibles are used in California. If the income is from a passive interest in an intangible, the income is California income if the investment is managed in California;

**Tiered LLCs**

In a tiered structure, a parent LLC owns one or more subsidiary, or lower-tiered, LLCs. However, for purposes of calculating the LLC fee, allocations or attributions of income to one LLC from another LLC is excluded from total income if that income has already been subject to the LLC fee.<sup>7</sup>

**EXAMPLE 5-2:** LLC 1, LLC 2, and LLC 3 are all California LLCs with 100% of their income from California sources.

LLC 1 has a 100% ownership interest in LLC 2. LLC 2 has a 100% ownership interest in LLC 3.

For the 2014 tax year, the LLCs have the following California-source income:

- LLC 1 has \$2 million;
- LLC 2 has \$500,000; and
- LLC 3 has \$300,000.

The LLC fee for these entities would be determined as follows:

Entity	Total Income	LLC Fee
LLC 1	\$1.2 million (\$2 million – (\$500,000 + \$300,000))	\$6,000
LLC 2	\$200,000 (\$500,000 – \$300,000)	\$0 (Because total income is under \$250,000)
LLC 3	\$300,000	\$900

**Note:** All three LLCs are still required to pay the \$800 annual tax.<sup>8</sup>

**EXAMPLE 5-3:** ABC, LLC is a California LLC that develops educational software for California schools. It also has a 50% ownership interest in Big Ideas, LLC, an educational curriculum developer located in New York City. In addition, ABC, LLC is a passive investor in Big Investors, LLC, which is located and managed out of Nevada.

The table below shows the revenues earned by the various entities, distributions made to ABC, and how they are classified for purposes of computing ABC's LLC fee.

	Total revenues earned by entity	Revenues from California customers	Amount included in ABC, LLC's "Total Income"	Amount included in ABC, LLC's "Total Income Attributable to California"
ABC, LLC	\$5.5 million software sales	\$4 million	\$5.5 million total sales	\$4 million
Big Ideas, LLC	\$3 million curriculum sales	\$2 million	\$1.5 million passthrough distribution to ABC	\$0
Big Investors, LLC	\$1 million investment income	\$0	\$50,000 passthrough distribution to ABC	\$0

As the table above shows, ABC would only include the \$4 million of its sales to its California customers. It would not include the \$1.5 million received from Big Ideas, LLC because the income received from Big Ideas, LLC was subject to the LLC fee. Nor would it include the \$50,000 from its income from Big Investors, LLC because the income was from a passive investment that was managed in Nevada.

ABC's LLC fee would be \$6,000 based on its \$4 million of total income attributable to California sources.

**LLC fee computation**, continued from page 52

- Income from the sale, lease, rental, or licensing of real property located in California; and
- Sales from the rental, lease, or licensing of intangible property to the extent the property is located in California.

**Simplified assignment method**

For those LLCs with a sales factor numerator of less than \$5 million, the LLC may use the sales factor numerator and, using the assignment

rules discussed, subtract any passthrough income from other LLCs subject to the LLC fee, and then add the following income attributable to California:

- Nonbusiness income; and
  - Gross receipts excluded from the sales factor numerator under apportionment regulations dealing with specific industries.
- LLCs that have at least \$5 million in their California sales factor numerator pay the \$11,790 fee applied to LLCs

with total income of \$5 million or more, the LLC fee top bracket.<sup>9</sup>



<sup>1</sup> R&TC §§17942(d)(1), 24271

<sup>2</sup> R&TC §§17941(d); 17942

<sup>3</sup> R&TC §17942(d)(2)

<sup>4</sup> R&TC §17942(d)

<sup>5</sup> R&TC §17942(b)

<sup>6</sup> 18 Cal. Code Regs. §17942

<sup>7</sup> R&TC §17942(b)(1)(A)

<sup>8</sup> R&TC §17941; FTB Tax News (June 2013)

<sup>9</sup> 18 Cal. Code Regs. §17942(f)

## Repair regulations: conformity to partial asset dispositions

### The FTB clarifies corporate tax treatment.

By **Sandy Weiner, J.D.**  
California Editor

As part of the new tangible property repair regulations, taxpayers may elect to recognize gain or loss on the retirement, replacement, or other disposition of a partial asset (such as a roof on a building), rather than leaving a “stranded basis” on the books, as was previously required.<sup>1</sup> In instances involving casualty losses, gain deferrals, transfer in a step-in-the-shoes transaction, and sales of a portion of an asset, the partial disposition treatment is required.

California’s depreciation deduction for individuals, estates and trusts, partnerships, and S corporations generally follows federal law, so these taxpayers may follow the new federal treatment of partial asset dispositions.<sup>2</sup>

### C corporations

In contrast to the classification of capital expenditures, California’s corporate income tax (CIT) treatment of depreciation does not conform to federal law.<sup>3</sup> California does not conform to MACRS and never conformed to ACRS. So following standard California conformity analysis, many practitioners assumed that California would not conform to the partial asset disposition treatment for corporations.

However, the FTB has stated that they will follow the partial asset disposition

**EXAMPLE 5-4:** Premium Properties, Inc. (PPI) owns commercial rental property, including a small apartment building in San Francisco. In 2014, it replaced six of the 10 HVAC units in the building at a cost of \$500,000 and will make a partial asset disposition election under Treas. Regs. §1.168(i)-(8) on the federal return. If PPI does not make the partial asset disposition election, it would be required to continue to depreciate the HVAC units that were replaced as well as the replacement HVAC units.

The original cost of the six HVAC units that were replaced was \$120,000 (\$20,000 each), with a salvage value of \$500 each. PPI has had the property for 10 years.

For federal purposes, PPI has been using the straight-line method and is required to depreciate the units over a 27.5-year period. To date, PPI has depreciated \$43,455, leaving a basis of \$76,545.

For California purposes, PPI uses the 200% declining balance method over a 40-year period. To date, PPI has depreciated \$47,994, leaving a basis of \$72,006.

PPI elects to make a partial asset disposition by making the following adjustments on the federal and state returns:

	Disposed Property	Replacement Property
Federal	Claim loss of \$76,545	Depreciate new units purchased for \$500,000 over a 27.5-year period using the straight-line mid-month conversion
California	Claim loss of \$72,006	Depreciate new units over a 40-year period using the 200% declining balance method

rules for corporate taxpayers, because the rules do not conflict with the CIT. But California will not fully conform because taxpayers must still use California asset classes and useful lives for purposes of determining the depreciation amount, so the actual depreciation deduction will likely be different.<sup>4</sup>

### Separate elections

A separate California election is allowed for all taxpayers.<sup>5</sup> However,

if a casualty loss, gain deferral, step-in-the-shoes transaction, or sale of a portion of an asset is claimed on the California return for the partial asset, a partial asset disposition is required.



<sup>1</sup> Treas. Regs. §1.168(i)-8

<sup>2</sup> R&TC §§17201, 17250

<sup>3</sup> R&TC §24349

<sup>4</sup> FTB Tax News (March 2015)

<sup>5</sup> R&TC §§17024.5(e), 23051.5(e)

# Taxpayers who fail to update address generally face consequences

Don't assume the IRS and FTB will pick up changes from the USPS database.

By Diane Fuller  
Contributing Editor

Taxing agencies can only do so much to track down taxpayers who move. The two cases below demonstrate that the effort made by taxpayers to make their addresses known factors heavily in the outcome of their cases.

## Taxpayer didn't update address — loss

A taxpayer was held liable for \$100,000 in unpaid taxes, penalties, and interest where deficiency notices from the IRS were sent to the taxpayer's last-known address, even though the IRS had been informed by the Postal Service that mail to that address was not deliverable.<sup>1</sup>

In this case, taxpayer Christopher Gyorgy's primary complaint was that he never received any deficiency notices for tax years 2001 through 2003, for which he acknowledged he did not file returns. However, the IRS had sent a series of notices to the taxpayer as follows:

- March 2004: a deficiency notice for tax year 2001, sent to the most recent address in the IRS's database corresponding to his most recent tax return from tax year 2000;
- November 2004: Form 2797, Referral Report of Potential Criminal Fraud Cases, sent to a second address based on forms submitted by third parties; however, this information obtained from third parties was not considered "clear and concise notification" of Gyorgy's address change, and in any case, there was no response from the taxpayer;
- December 2006: a deficiency notice for tax year 2003, sent to the original address on the 2000 return, which was returned to the IRS as undeliverable and marked "unable to forward;" and

## California conformity

California conforms to the federal change of address notification. For California purposes, use Form FTB 3533, Change of Address, to change a home or business mailing address. You may also use federal Form 8822. This address change will be used for future correspondence. Generally, complete one Form FTB 3533 for each taxpayer who filed a separate return.

If you have a POA, attach a copy of your Form FTB 3520, Power of Attorney, and write "copy" at the top of Form FTB 3520.

For a list of state agencies that will likely need a change of address submitted, see the chart "Who to contact to report a change of address" on page 55 of this issue of *Spidell's California Taxletter*®.

- July 2007: a deficiency notice for tax year 2002, sent to the original address, which was again returned as undeliverable.

In 2009, a federal tax lien was filed against Gyorgy's real property.

Gyorgy claimed that the IRS had abused their discretion when they used his last-known address from tax year 2000 for the deficiency notices for tax years 2002 and 2003, even with full knowledge that they were marked as undeliverable.

Jacqueline McKechnie was a Canadian citizen who reportedly left the U.S. for Canada in February 1993, and subsequently lived in Germany for two years. According to the taxpayer, by the time the FTB issued an NPA in July 1997 for the 1993 tax year, her mail forwarding service had expired, so she never received any communication from the FTB. She stated that she was confident that her federal and state obligations were fulfilled, so she had

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**"If the IRS was supposed to use another address, it was Gyorgy's responsibility to contact the IRS and inform them of any change."**

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However, Gyorgy was unable to provide any documentation to support his contention that he had updated his address at any time. The court determined that no amount of due diligence on the part of the IRS would have uncovered a new address for the taxpayer because Gyorgy never submitted one. If the IRS was supposed to use another address, it was Gyorgy's responsibility to contact the IRS and inform them of any change.

## Taxpayer prevails over FTB

In another case with a more favorable outcome for the taxpayer, a California nonresident was able to prove that she had moved to Canada and then to Germany where the forwarding service had expired by the time the FTB mailed their Notice of Proposed Assessment (NPA).<sup>2</sup>

no need to contact the FTB and had always paid her taxes on time. She was unaware of any deficiency until March 2012, at which time she paid the FTB's assessment of \$4,764, and then filed a claim for refund of interest and penalties.

The FTB contended that by the time they issued the NPA, they became aware that the taxpayer no longer lived in Canada and used "reasonable diligence" in finding the Germany address, which was the last-known address at the time the FTB mailed the NPA.

In this case, the Board determined the FTB had abused its discretion in denying the taxpayer's request for abatement of interest, assessed from the date of the initial NPA in July 1997. Although regulations provide that, except for fraudulent or false

See **Address changes**, page 55

**Address changes**, continued from page 54

returns, every notice of proposed deficiency assessment must be mailed within four years of the date a taxpayer files his or her return,<sup>3</sup> the taxpayer was able to prove that the forwarding service had expired by the time the NPA was sent.

**Last-known address**

In 2001, regulations established that a taxpayer's last-known address "is the address that appears on the taxpayer's most recently filed and

properly processed federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address."<sup>4</sup> The same regulation further states that "change of address information that a taxpayer provides to a third party, such as a payor or another government agency, is not clear and concise notification"<sup>5</sup> in determining a last-known address. However, the IRS will update taxpayer addresses by referring to data maintained in the

U.S. Postal Service's National Change of Address database.



<sup>1</sup> *Gyorgy v. Comm.* (February 27, 2015) U.S. Court of Appeals, Seventh Circuit, Docket No. 13-3363

<sup>2</sup> *Appeal of Jacqueline McKechnie* (September 10, 2013) Cal. St. Bd. of Equal., Case No. 683821

<sup>3</sup> R&TC §18416

<sup>4</sup> Treas. Regs. §301.6212-2

<sup>5</sup> *Id.*

## Who to Contact to Report a Change of Address

Agency	Form	Website	Individual	Business
BOE	BOE-345-SP, Notice of Business Change	<a href="http://www.boe.ca.gov/permits_licenses.htm#changeaddress">www.boe.ca.gov/permits_licenses.htm#changeaddress</a>		✓
County Assessor	Contact county for form	<a href="http://www.boe.ca.gov/proptaxes/assessors.htm">www.boe.ca.gov/proptaxes/assessors.htm</a>	✓	✓
DMV	Form DMV 14, Notice of Change of Address	<a href="http://www.dmv.ca.gov/portal/dmv/detail/online/coa/welcome">www.dmv.ca.gov/portal/dmv/detail/online/coa/welcome</a>	✓	✓
EDD	Form DE 24, Change of Address	<a href="https://eddservices.edd.ca.gov/ezre/iAppsShared/EZRegHomePage.aspx">https://eddservices.edd.ca.gov/ezre/iAppsShared/EZRegHomePage.aspx</a>		✓
FTB	Form FTB 3533, Change of Address	<a href="http://www.ftb.ca.gov/individuals/faq/ivr/619.shtml">www.ftb.ca.gov/individuals/faq/ivr/619.shtml</a>	✓	✓
IRS	Form 8822, Change of Address	<a href="http://www.irs.gov/Help-&amp;-Resources/Tools-&amp;-FAQs/FAQs-for-Individuals/Frequently-Asked-Tax-Questions-&amp;-Answers/IRS-Procedures/Address-Changes/Address-Changes">www.irs.gov/Help-&amp;-Resources/Tools-&amp;-FAQs/FAQs-for-Individuals/Frequently-Asked-Tax-Questions-&amp;-Answers/IRS-Procedures/Address-Changes/Address-Changes</a>	✓	✓
Post Office	PS Form 3575, Change of Address	<a href="https://moversguide.usps.com">https://moversguide.usps.com</a>	✓	✓
Secretary of State	Form SI-200 for CA corporation or other forms listed by business entity	<a href="http://www.sos.ca.gov/business-programs/business-entities/forms/">www.sos.ca.gov/business-programs/business-entities/forms/</a>		✓
	Form SOS/NP 34 Notary Public	<a href="http://www.sos.ca.gov/business/notary/forms.htm">www.sos.ca.gov/business/notary/forms.htm</a>		✓
Social Security Admin.	Use my Social Security account online or contact local office to update address by mail	<a href="https://faq.ssa.gov/ics/support/KBAAnswer.asp?questionID=3704">https://faq.ssa.gov/ics/support/KBAAnswer.asp?questionID=3704</a>	✓	✓
Veterans Affairs	VA Form 20-572, Request for Change of Address	<a href="https://iris.custhelp.com/app/answers/detail/a_id/3045">https://iris.custhelp.com/app/answers/detail/a_id/3045</a>	✓	✓

# You can now ask FTB legal staff questions directly

**The FTB has released some statistics on the types of questions they have answered.**

**By Renée Rodda, J.D.**  
Editor

The FTB's new Ask a Legal Expert program allows you to submit "basic legal questions" directly to a specific Legal Division Bureau. At a recent FTB presentation on compliance and legal outreach, the FTB shared some information on the questions they have received, and the responses that have been provided.

While the program is designed to answer only basic questions, it seems that quite a few taxpayers have gotten answers to their questions. From October 2014 through February 2015, the legal experts received 154 questions, 94 of which received substantive answers.

We did not receive information on what specifically was asked, or what answers were provided, but we can tell you what subject matter each question addressed (in the three charts to the right).

### Types of questions

The legal experts will not answer questions that:

- Pertain to matters that are under audit, at protest, on appeal, in settlement, or in litigation;
- Request information on issues that a Chief Counsel Ruling or other formal guidance more properly addresses;
- Seek nonlegal advice; or
- Ask for clarification of federal law, federal rulings, or other federal guidance.

Questions that ask for explanations or interpretations of laws must describe the law or authority, and clearly state the question that is being asked. Technical tax questions must:

- Clearly describe the issues;
- Provide a complete material facts statement;
- Identify the relevant statutes or materials that prompted the inquiry;

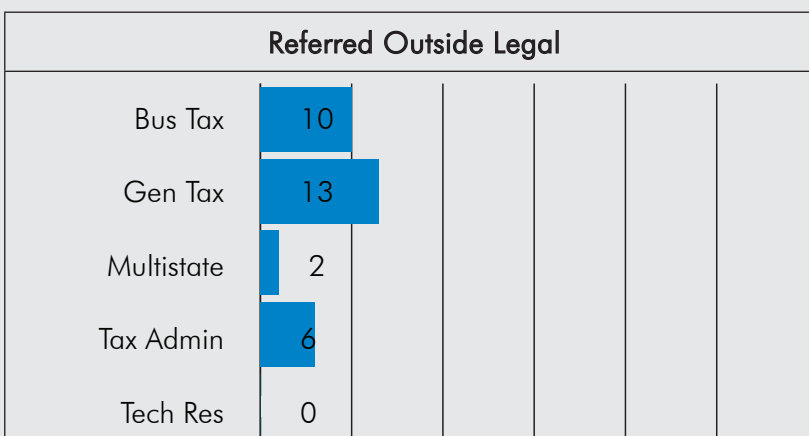
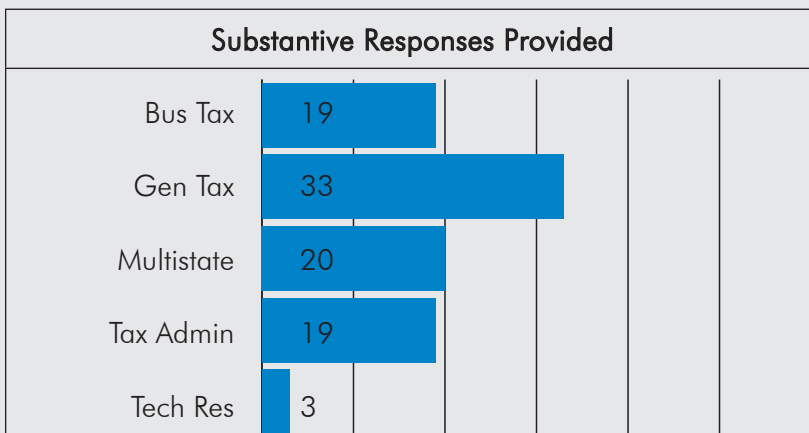
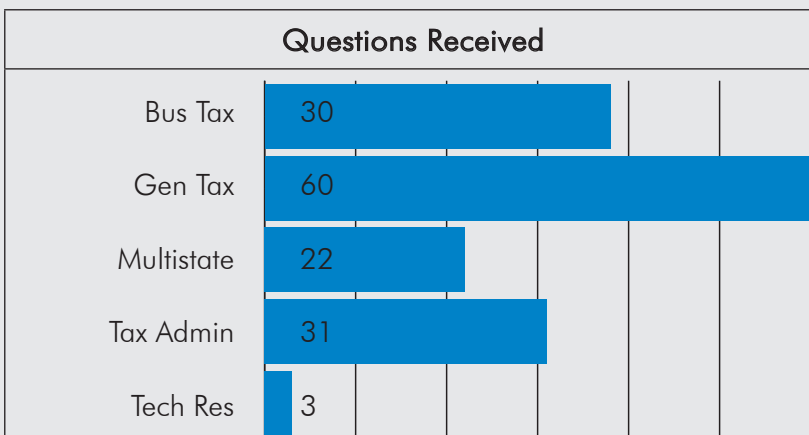
- Provide the research, if any, you undertook to resolve the question;
- Identify whether the question is applicable to:
  - California law only; or
  - California and federal law, where California law is based on federal law.

Before submitting the questions, you must determine the appropriate Legal Division Bureau to handle your question.

For example, a question regarding partnership issues would be sent to the Business Entity Tax Bureau.

For a listing of all the bureaus with the e-mail addresses, and which subject matters they handle, go to:

[www.ftb.ca.gov/law/Ask\\_a\\_Legal\\_Expert.shtml](http://www.ftb.ca.gov/law/Ask_a_Legal_Expert.shtml)





# How to appeal an EDD decision

**Employers or workers have the right to appeal most actions of the EDD that adversely affect their interests.**

By **Kathryn Zdan, EA**  
Contributing Editor

After an audit or classification decision, the EDD appeals process potentially has two steps. First, employees or employers may appeal to the California Unemployment Insurance Appeals Board (CUIAB) to have the issue reviewed at a hearing by an administrative law judge (ALJ). If the employer/employee disagrees with the outcome, the next step is to have the decision reviewed by the CUIAB.

Although a worker can certainly file a claim, this article focuses on an employer's appeal.

## What can be appealed?

When the EDD takes an action that may be appealed, the employer will be notified by mail. To begin the appeal process, the employer must file a petition for reassessment or review. The notice mailed by the EDD to the employer will explain the petition rights and responsibilities. Employers are advised to read all EDD notices carefully, as strict time limits apply for filing appeal petitions.

Actions that may be appealed are:

- An assessment for payroll tax contributions and/or California personal income tax and SDI withholdings;
- A denial (or approval) of a request to transfer an employer's Unemployment Insurance reserve account;
- A denial of a protest to an unfavorable adjustment to an employer's Unemployment Insurance contribution rate or the factors used to compute it;
- A denial of a protest to the amount of Unemployment Insurance benefits charged to an employer's reserve account;
- A denial of a claim for a credit or refund; and

- A denial of a request to make a voluntary Unemployment Insurance contribution to reduce an employer's Unemployment Insurance tax rate.

**Note:** Filing a petition for reassessment does not suspend the accrual of interest due on the assessed amount.

## Filing an appeal — ALJ hearing

The first step is to file a petition for a hearing before an ALJ. All judicial appeals and petitions must be filed in writing with the office location listed on the EDD Notice of Determination and/or Ruling, or any other document issued by the EDD that contains appeal rights.

The appeal must be in writing and must be timely filed (postmarked) pursuant to the date on the EDD Notice of Determination or other document containing appeal rights. If the appeal is not filed within the allotted time, it will generally be denied unless there is good cause for a late filing.

**Note:** The timeframe for filing an appeal varies depending on the type of appeal. The Notice will contain instructions for further appeal, and any rules that apply.

Once the appeal is received, a case

- The decision the ALJ has made; and
- The process for further appeal.

## Filing an appeal — CUIAB appeals

The ALJ's decision may be appealed to the CUIAB. All CUIAB appeals and petitions must be filed in writing with the office location listed on the decision letter.<sup>1</sup>

Appeals must be timely filed (postmarked) pursuant to the date on the decision letter. Untimely appeals will generally be denied unless there is good cause for delay.

Although the use of CUIAB's standard appeal Form DE 1430 is preferred, an appeal or petition may be in letter form. Once the appeal is received, an acknowledgement letter will be mailed to everyone involved in the appeal.

Unlike the judicial appeals, CUIAB appeals are usually limited to reviewing only the evidence that was presented at the initial hearing.

However, in special circumstances, and upon approval of the CUIAB, a participant can request, in writing, that new evidence be submitted. The participant must explain why this new

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**“Timing is important to the appeals process, so employers must take care to read all correspondence carefully.”**

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number is assigned, and it is now ready to be scheduled to be heard by an ALJ. At this point, a Notice of Hearing will be mailed to all parties involved in the case (employee, employer, etc.).

At least 10 days prior to the hearing, the petitioner will receive a written notice that includes the date, time, and location of the hearing.

**ALJ written decision:** After the ALJ has heard the case, he/she will issue a written decision. This decision will be mailed to all parties involved in the case.

In that decision, parties will be notified of:

- All of the issues and facts that were presented to the ALJ as evidence;
- An explanation of the laws that are related to these issues and facts, with a summary of how the ALJ has applied the laws to your case;

evidence is important and why it was not presented during the judicial appeal.

There will be no hearing scheduled for a CUIAB appeal. The CUIAB will issue its decision based on reviewing the entire case file. Two of the CUIAB members will separately review the case and give their separate decisions. If the two CUIAB members agree with the initial decision, the decision stands. If the two members disagree with the initial judicial decision, the decision is reversed. In the event there is a split decision, a third CUIAB member will be called upon to review the evidence and assist in the final determination. In all instances, a letter outlining the facts, reasons, and the decision is mailed to all parties involved.

This decision cannot be changed for any reason, other than clerical, after it

See **Appeal**, page 58

**Appeal**, continued from page 57

has been mailed. This concludes the employer's opportunity to appeal to the CUIAB.

**Filing a claim for refund**

If the CUIAB denies the petition, the taxpayer may file a claim for refund with the EDD after the liability is paid. If the claim for refund is denied, the taxpayer may file a second petition with the ALJ. If the taxpayer still does not agree with the ALJ's decision, the taxpayer may file another appeal with the CUIAB.

Once all of these administrative remedies have been exhausted, and the taxpayer is still dissatisfied with the

decision, the taxpayer may take the case to the Superior Court.<sup>2</sup>

**Civil court**

To appeal to the county Superior Court, file a Petition for Writ of Mandate within six months of the mailing date of the CUIAB's final decision.

For questions about the petition and hearing process for different types of appeals, see EDD Publication DE 44, 2014 California Employer's Guide, or contact the EDD at:

(888) 745-3886

For more information on the CUIAB process, go to:

[www.cuiab.ca.gov/Workers/fileAppeal.asp](http://www.cuiab.ca.gov/Workers/fileAppeal.asp)

For information on appealing a workers' compensation issue, go to:

[www.dir.ca.gov/WCAB/wcab.htm](http://www.dir.ca.gov/WCAB/wcab.htm)



<sup>1</sup> See CUIAB Board Appeal Form DE 1430, CUIAB — Board Appeal

<sup>2</sup> See EDD Publication DE 1009, Petition for Reassessment or Review

## FTB ruling helps determine when tribal members live on reservation

The legal ruling states that the FTB will apply the "closest connections test" to determine whether a tribal member is living on or off his or her tribe's reservation.<sup>1</sup> This determination is important because a member of a federally recognized Indian tribe who lives on his or her tribe's reservation is exempt from California income tax on income earned from sources within that tribe's reservation.<sup>2</sup>

This is often a complicated issue because many of these individuals claim to live on the reservation, but also own property off of the reservation. Under the "closest connections test," if it is determined that a tribal member's closest connections are with a dwelling or dwellings on the reservation, he or she will be deemed to be living on the tribe's reservation. However, if the closest connections are with a dwelling outside the reservation, he or she will be deemed to be living off the reservation, resulting in all income being subject to California income tax.

The ruling states that the types of documentation that tribal members will be able to provide will vary greatly from tribe to tribe, so the "closest connections" determination will be based upon the facts and circumstances of each individual tribal member.

If a tribal member is determined to be living on his or her tribe's reservation, he or she will continue to be treated as living on the reservation even when temporarily absent from the reservation. However, if the tribal member leaves his or her tribal reservation for other than a temporary purpose, he or she will cease to be living on the reservation.

For the full text of the legal ruling go to:

[www.ftb.ca.gov/law/rulings/active/2015/01\\_04222015.pdf](http://www.ftb.ca.gov/law/rulings/active/2015/01_04222015.pdf)

<sup>1</sup> Legal Ruling 2015-01

<sup>2</sup> *McClanahan v. Arizona State Tax Commission* (1974) 411 U.S. 164

## THUMB TAX

**Disabled Veterans' Exemption for 2016** — The BOE announced increases to the exemption amount and the household income limit for the disabled veterans' property tax exemption for 2016.<sup>1</sup>

For the 2016 assessment year, the exemption amount is \$127,510, increasing to \$191,266 if the claimant's household income limit does not exceed \$57,258.

Currently, the exemption amounts are \$126,380 and \$189,571, with a household income limit of \$56,751.

The exemption is discussed in more detail in "Disabled veterans eligible for retroactive property tax relief" in the April 2015 issue of *Spidell's California Taxletter*®.

<sup>1</sup> BOE Letter to County Assessors No. 2015/021

**Online payroll tax account registration** — Taxpayers can now use the EDD's e-Services for Business system to apply for an employer payroll tax account number.

Employers, both new and previously registered, as well as anyone who is authorized to act on behalf of the employer (i.e., agents, CPAs) can use this option.

See **Thumb Tax**, page 59

**Thumb Tax**, continued from page 58

**TAM clarifies treatment of cost-sharing arrangement payments for sales factor numerator** — The FTB has issued a technical advice memorandum addressing whether certain payments received by participants in a cost-sharing arrangement (CSA) are included in the California apportionment sales factor.<sup>1</sup> A CSA is an arrangement by which controlled participants share the costs and risks of developing cost-shared intangibles in proportion to their “reasonably anticipated benefits” shares.<sup>2</sup>

Payments received from controlled participants participating in a CSA for current operational research and development costs are essentially cost reimbursements. Therefore, they are not considered gross receipts and would not be included in the California apportionment sales factor.

In contrast, payments from controlled participants for resources or capabilities developed, maintained, or acquired outside of the CSA that are reasonably anticipated to benefit the development of cost-shared intangibles within the CSA are not reimbursements of costs. These payments are consideration for use of the intangible property or resources and therefore would be included in gross receipts for California sales factor purposes.

<sup>1</sup> FTB Technical Advice Memorandum 2015-01

<sup>2</sup> Treas. Regs. §1.482-7(b)

New users will need to enroll for a username and password prior to applying for an employer payroll tax account number online.

To see the information that employers must provide during the registration process, go to:

[www.edd.ca.gov/Payroll\\_Taxes/Am\\_I\\_Required\\_to\\_Register\\_as\\_an\\_Employer.htm](http://www.edd.ca.gov/Payroll_Taxes/Am_I_Required_to_Register_as_an_Employer.htm)

For additional information, visit the Register for Employer Payroll Tax Account Number FAQs:

[www.edd.ca.gov/Payroll\\_Taxes/FAQ\\_-\\_Register\\_for\\_Employer\\_Payroll\\_Tax\\_Account\\_Number.htm](http://www.edd.ca.gov/Payroll_Taxes/FAQ_-_Register_for_Employer_Payroll_Tax_Account_Number.htm)

**FTB reviewing interest calculations for some taxpayers**

— The FTB may have incorrectly calculated interest on some taxpayers’ accounts, and those taxpayers are entitled to refunds. This issue impacts a very select group of taxpayers — typically individuals and corporations with large tax liabilities.

The FTB is reviewing interest calculations related to:

- Individuals or business entities that elected to have overpayments applied to estimates for the next year, and:
  - The taxpayer filed an amended return for additional tax or received a deficiency assessment after the original return was filed for the same tax year; and

- In the next year, the required first quarter estimate payment was less than the requested overpayment transfer amount.
- Corporations with all of the following:
  - Previous refund or payment transfer; and
  - Subsequent deficiency or amended return for additional tax with interest for the same tax year.

The statute of limitations may soon expire for refund claims for tax year 2010. If you believe this applies to you or your clients, go to:

[www.ftb.ca.gov/current/Interest\\_Adjustments\\_April\\_2015.shtml](http://www.ftb.ca.gov/current/Interest_Adjustments_April_2015.shtml)

## CALIFORNIA CONTACTS

Your client can contact the FTB’s Withholding Services and Compliance Section:	(888) 792-4900
For a listing of all the bureaus with the e-mail addresses, and which subject matters they handle, go to:	<a href="http://www.ftb.ca.gov/law/Ask_a_Legal_Expert.shtml">www.ftb.ca.gov/law/Ask_a_Legal_Expert.shtml</a>
For questions about a Petition for Writ of Mandate, contact the EDD at:	(888) 745-3886
For more information on the CUIAB process, go to:	<a href="http://www.cuiab.ca.gov/Workers/fileAppeal.asp">www.cuiab.ca.gov/Workers/fileAppeal.asp</a>
For information on appealing a workers’ compensation issue, go to:	<a href="http://www.dir.ca.gov/WCAB/wcab.htm">www.dir.ca.gov/WCAB/wcab.htm</a>
To see the information employers must provide during the online payroll tax account registration process, go to:	<a href="http://www.edd.ca.gov/Payroll_Taxes/Am_I_Required_to_Register_as_an_Employer.htm">www.edd.ca.gov/Payroll_Taxes/Am_I_Required_to_Register_as_an_Employer.htm</a>
Visit the Register for Employer Payroll Tax Account Number FAQs for additional information:	<a href="http://www.edd.ca.gov/Payroll_Taxes/FAQ_-_Register_for_Employer_Payroll_Tax_Account_Number.htm">www.edd.ca.gov/Payroll_Taxes/FAQ_-_Register_for_Employer_Payroll_Tax_Account_Number.htm</a>
The FTB is reviewing interest calculations for some taxpayers. If you believe this applies to you or your clients, go to:	<a href="http://www.ftb.ca.gov/current/Interest_Adjustments_April_2015.shtml">www.ftb.ca.gov/current/Interest_Adjustments_April_2015.shtml</a>



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PERIODICALS

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### Spidell's 2015 Basic Understanding of Trusts Seminar

*Lay the groundwork for a thriving trust practice*

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- Learn about the different kinds of trusts, what they do, and how to handle them: living trusts, A/B trusts, disability trusts, and personal residence trusts
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