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FTB refund glitches plagued the last few weeks of filing season

Disappearing withholding data and tight security are to blame.

By Lynn Freer, EA
Publisher

Until early April, tax return processing seemed to move along with few problems. Then, all of a sudden we received a rash of calls, e-mails, and Message Board posts about the Form FTB 4734D, Request for Information and Documents, and taxpayers' refunds being reduced. We have been in contact with the FTB about these issues, and here's what we know so far.

Two known problems

Although there could be other issues, here are the reasons certain clients may be getting their refunds reduced:

- Fourth quarter withholding data was missing from the FTB's system. The FTB and EDD are working together to figure out what happened. This problem affects both W-2 payments and 1099-R payments; and
- According to the FTB, Northern Trust reported pension withholding late for the third and fourth quarters of 2015. This affects Los Angeles County retired firefighters.

Form 4734D

The FTB has mailed approximately 60,000 Forms 4734D, stating that the return could not be processed without a copy of the taxpayers' Social Security cards, W-2s, year-to-date paycheck stubs, and 1099s.

The biggest problem is that the form states that failure to provide the information within 15 business days will result in a "denial of the taxpayer's request for refund."

Apparently this is not a misprint on the form. If the taxpayer does not respond within the 15 business days, the FTB has said that they will mail a denial letter and the refund won't be sent. If the taxpayer subsequently provides information, the FTB will review the information provided and evaluate whether the additional refund should be allowed. If the refund is allowed, it will take up to two months from the date the required documentation is sent.

Form 4734D is also automatically sent if the FTB's new computer system found any sort of mismatch. For example, if the taxpayer's Social Security number, address, or name doesn't match the FTB's records, or possibly records from other sources, the FTB holds up the refund until the taxpayer can verify his/her identity.

Comment

A letter is not always sent just because there is a mismatch. When a mismatch occurs, the FTB first reviews the return and considers historical and other information. Multiple factors are taken into account before sending a Form 4734D, and in many cases, the return will be processed as filed.

What to do

To request additional time, if the taxpayer can't gather the information needed in time, call:

916-845-7088

This is the number of the unit handling these letters, and the wait time should be much less than calling the Practitioner Hotline. Also, as many of the notices may pertain to known problems, if you have verified that the information on the return is correct, you can call the Practitioner Hotline or the number above, and the employee may be able to resolve the issue.

If your client receives one of these notices, do not use the MyFTB secure message function, as it will take longer than a phone call. We also recommend that you do not fax the information until calling the number listed above, as phone calls are resolved more quickly than faxes.

The FTB has stated they will follow up on these mismatches in 45 to 90 days.

Reduced refunds

The FTB has told us they have identified 3,000 taxpayers where the FTB denied the difference in withholding credits claimed by the taxpayers and FTB records. The FTB will send a letter to each of these taxpayers after they have made adjustments to the accounts. They

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anticipate the problem will be fixed by early May. There do not appear to be discrepancies in estimated tax payments.

Interestingly, we have been told in some cases that the withholding in the taxpayer's MyFTB account is correct but the notice from the FTB is incorrect.

More bad news

Unfortunately, if the taxpayer's refund is adjusted, the electronic refund will be converted to a paper check.

What's Spidell doing?

We have been actively working with the FTB to get information on why this is happening. We are still not sure we have information on all the problems. We find it interesting that the FTB says they will send 3,000 notices to taxpayers whose refunds have been denied, but 60,000 Forms 4734D were mailed to taxpayers.

We have suggested that the FTB:

- Do another match when the technical issue with withholding is resolved and process the refunds for all remaining taxpayers who received a Form 4734D and whose refunds were erroneously denied but who have not yet sent requested information;
- Escalate discussion with the EDD about these issues as well as the problems where the withholding doesn't match EDD/FTB records; and
- Allow a longer period of time to respond to the Form 4734D before sending a denial.



Watch for fraudulent MyFTB activity in your account

If your client receives a notice informing them that they have been added to the account of a practitioner they (or you) don't know, contact the FTB immediately.

By Renée Rodda, J.D.
Editor

We have recently been informed that some taxpayers are receiving notices indicating that they have been added to a practitioner account that they did not authorize. If this happens to you, or your clients, immediately contact the FTB Tax Practitioner Hotline at (916) 845-7057, and request that they remove the taxpayer from the unauthorized account.

When a practitioner adds a client to their MyFTB account, the FTB mails the taxpayer Form FTB 4099, Access Granted to Your MyFTB Account, alerting them that the practitioner now has the ability to see their tax information. This is done to help prevent identity theft.

Client information at risk of being stolen

It is important to stop the unauthorized access as soon as possible because even without a POA, a practitioner with MyFTB access can view the client's:

Individual Clients

Account information
Contact information such as name, address, and IDs (including SSNs)
Estimated payments, real estate withholding, recent payments, liabilities, and penalties
Prior year balances, including zero balance years
Summary return information, including status
State W-2 information (wage and withholding)
If the taxpayer is subject to mandatory e-pay
FTB-issued Form 1099-G and Form 1099-INT information
Business Clients
Contact information such as name, address, and taxpayer IDs
Estimated payments, real estate withholding, and recent payments
Prior years, including zero-balance years
Account information
Summary return information, including status
Exact entity name to use when filing a return



Changes to California's minimum wage and Paid Family Leave

SB 3 and AB 908 provide extra benefits for California employees.

By Kathryn Zdan, EA
Contributing Editor

The Governor has signed SB 3 (Ch. 16-4), which raises the minimum wage in California and AB 908 (Ch. 16-5), which increases Paid Family Leave benefits.

Make sure your clients with employees are aware of these changes, so they can comply with the new laws.

Minimum wage increase

California's minimum wage will rise to \$10.50 per hour on January 1, 2017. The minimum wage will then rise each year until it reaches \$15 per hour. However, the timeline for phasing in the increases depends on the number of employees that a business has.

For businesses with 26 or more employees, the \$15/hour wage will be fully phased in by 2022, as follows:¹

- January 1, 2017–December 31, 2017: \$10.50 per hour;
- January 1, 2018–December 31, 2018: \$11 per hour;
- January 1, 2019–December 31, 2019: \$12 per hour;
- January 1, 2020–December 31, 2020: \$13 per hour;
- January 1, 2021–December 31, 2021: \$14 per hour; and
- January 1, 2022, until adjusted according to the CPI: \$15 per hour.

Smaller employers

The bill allows additional time for employers with 25 or fewer employees to phase in the increases as follows:

- January 1, 2018–December 31, 2018: \$10.50 per hour;
- January 1, 2019–December 31, 2019: \$11 per hour;
- January 1, 2020–December 31, 2020: \$12 per hour;
- January 1, 2021–December 31, 2021: \$13 per hour;
- January 1, 2022–December 31, 2022: \$14 per hour; and
- January 1, 2023, until adjusted according to the CPI: \$15 per hour.

Note: The law is silent as to how and when the 26 or more employees is determined.

After January 1, 2023, the minimum wage will be increased annually, but no more than 3.5% in a year. The resulting increase will be rounded to the nearest \$0.10. The increase will be calculated on August 1 to take effect on January 1 of the following year.

There is a provision that allows the Governor to suspend the incremental wage increases in certain situations, such as in the event of decreased nonfarm and retail employment over certain time periods, or if an increase would put the state budget into a deficit. The Governor may only suspend increases due to a budget deficit twice.

IHSS

Existing law excludes In-Home Supportive Services (IHSS) employers from the requirement to provide at least three days of paid sick time to their employees.²

SB 3 phases in sick leave for IHSS workers as follows:³

- 8 hours or one paid sick day in each year of employment beginning July 1, 2018;
- 16 hours or 2 paid sick days in each year of employment beginning when the minimum wage reaches \$13/hour; and
- 24 hours or 3 paid sick days in each year of employment beginning when the minimum wage reaches \$15/hour.

For this purpose, “year of employment” means either a calendar year or 12-month period.

For more information on SB 3, go to:

http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB3

Paid Family Leave benefits increased

With the passage of AB 908, the maximum amount of Paid Family Leave (PFL) benefits recipients can receive from the Employment Development Department is increased from 55% to 70% of his or her wages. AB 908 also establishes a minimum \$50 per week benefit level and eliminates the one-week waiting period previously required for all claims. The increased benefits apply to periods of disability beginning on or after January 1, 2018, and before January 1, 2022.

California's PFL program provides up to six weeks of benefits for individuals who take time off of work to care for a seriously ill child, parent, parent-in-law, grandparent, grandchild, sibling, spouse, or registered domestic partner, or to bond with a new child.

The program is administered by the State Disability Insurance (SDI) program for California workers covered by SDI, and the premiums are paid as a part of the SDI payment.

For more information on AB 908, go to:

http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB908



¹ Labor Code §1182.12

² Labor Code §245.5

³ Labor Code §246(e)

Paid sick leave for employees working nontraditional shifts

Some employers must offer more than 24 hours per year of paid sick time.

By **Rénee Rodda, J.D.**
Editor

The California Labor Code requires most employers to offer a minimum of "24 hours or 3 days" of paid sick time per year.¹ However, not all employees work a traditional eight-hour day.

The Department of Industrial Relations has determined that the Labor Code specifies a minimum labor standard, and "in order to give effect to this minimum standard for all employees, including those that may work more or less than eight hours per day, the language must necessarily be interpreted as requiring "24 hours or three days" of paid sick leave, *whichever is more for an employee*. [emphasis added]"²

This means that if an employee's regular work day is 10 hours, a paid sick day would be 10 hours. The paid sick time offered to that employee must be at least 30 hours per year.

However, if an employee's normal shift is less than eight hours, they must still be offered at least 24 hours of paid sick leave each year.

These minimum requirements apply to employers who offer accrued sick pay benefits and employers who offer upfront sick pay benefits.

Mandatory paid sick leave

Effective July 1, 2015, most employers must provide at least 24 hours or three days of annual paid sick leave to California employees who work for them at least 90 days.³

Exemptions

The mandate does not apply to:

- Employees, including construction workers, covered by certain collective bargaining agreements;
- Certain flight deck and cabin crew employees of air carriers; and
- CalPERS retired annuitants.

(See page 51 for IHSS workers.)

Accrual of benefits

Benefits generally accrue at the rate of one hour per every 30 hours worked. However, employers may use a different accrual method, as long as the accrual is on a regular basis so that an employee has no less than 24 hours or 3 days of accrued sick leave or paid time off by the 120th calendar day of employment, or each calendar year or 12-month period.⁴

An employer may limit an employee's use of paid sick days to 24 hours or three days in each year of employment. Employees can start using the sick time beginning on the 90th day of employment.

Upfront benefits

An employer can avoid having to compute and carry over unused sick days on its books by making 24 hours or three days of sick pay available up front at the beginning of the year. The "year" for this purpose can begin at the beginning of the calendar year, anniversary date, or other 12-month basis.⁵

For more information on the 2015 sick pay legislation, see "Legislation mandates employers provide sick pay benefits" and "Mandatory sick pay accrual and reporting requirements eased" in the January and September 2015 issues of *Spidell's California Taxletter*®.



¹ Labor Code §246

² See Department of Industrial Relations Request for Opinion Re: Paid Sick Leave (August 7, 2015) Available at: www.dir.ca.gov/dlse/opinions/2015.08.07.pdf

³ Labor Code §245 et seq.

⁴ Labor Code §246(a)(3)

⁵ Labor Code §246(d)

FTB scores a big win in the *Hyatt* case

A recent U.S. Supreme Court decision may mean one part of this saga may be coming to an end soon.

By Renée Rodda, J.D.

Editor

The FTB just gained an advantage in their battle with Gilbert Hyatt when the U.S. Supreme Court held that Mr. Hyatt can sue the FTB in a Nevada court, but his damages will be limited to \$50,000.¹ This is substantially less than the \$250 million in punitive damages and \$139 million in compensatory damages he was originally awarded by a Nevada court.

The case will still go back to Nevada, but the limitations the Court placed on the damages means this chapter of the saga between Mr. Hyatt and the FTB should be coming to an end shortly.

The original audit

In 1993, the FTB began a residency audit questioning Gilbert Hyatt's 1991 change of residence and domicile from California to Nevada.

Hyatt (not of the hotel chain, but of microchip invention fame) was a longtime resident of California. He alleges he sold his home and relocated to Nevada, abandoning his California residence and domicile, thus avoiding California tax on \$40 million of patent licensing income.

When the FTB began its expected audit, the auditor used extremely aggressive tactics, including sending letters to and speaking with Hyatt's neighbors, going through his trash, and using other methods of discovering Hyatt's true residence and domicile.

The lawsuit

The result was Hyatt filing a lawsuit against the FTB, alleging fraud, intentional infliction of emotional distress, abuse of process, breach of confidential relationship, and invasions of privacy. After the U.S. Supreme Court found in favor of Hyatt in 2003,² allowing him to sue the FTB for tortuous acts in a Nevada court, Hyatt was awarded the \$389 million judgment.

The appeals have continued since then, with the case finally making it back to the U.S. Supreme Court again. But this recent decision should help to bring the civil suit to an end.

To view the full U.S. Supreme Court decision, go to:

www.caltax.com/spidellweb/public/editorial/HyattSC.pdf

The residency issue still not settled

Even if the civil case gets settled, there is still the question of Mr. Hyatt's residency in 1991 and 1992. The residency case continues, with both the taxpayer and the FTB accusing each other of foot-dragging and many other indiscretions.

Briefs have been submitted to the Board of Equalization in the residency case, and both sides have gone public with facts contained in the briefs, but the case has never been heard by the Board.

This case has given years of fodder to the tax publishing community and is already part of California's tax lore. There have been allegations of anti-Semitism, scandalous allegations of a fired FTB employee, and destroyed documentation. Whatever the result, we will probably never know the whole truth, but we will continue to report the details as they develop.



¹ *FTB v. Hyatt* (April 19, 2016) U.S. Supreme Court, Case No. 14-1175

² *FTB v. Hyatt* (2003) 538 U.S. 488

Understand the legal implications of domicile

Remember, residency and domicile are not the same thing.

By Lynn Freer, EA
Publisher

In some situations, a taxpayer may be domiciled in California but not be considered a resident. In this case, the individual is taxed only on income from California sources.

This frequently arises in situations involving military personnel or long-term employment contracts.

Community property: Whether an individual's income is subject to community property is based on the individual's domicile.¹

Voting: California's Elections Code defines "residence" for voting purposes as a person's domicile. The FTB considers voting in California proof of residency. However, voting in another state does not automatically mean the taxpayer is a resident there.

EXAMPLE 5-1: Joseph and Jodie marry and agree to each continue to live in the state in which they are currently employed. Joseph works and lives in California. He is a resident and domiciled in California. Jodie lives and works in Utah. She is a resident and domiciled in Utah. California is a community property state so Joseph's wages are community income, and unless they have a separate property agreement, 50% of Joseph's wages are taxable to Jodie. Utah is a separate property state, so Jodie's wages are not community income and are not taxable to Joseph.

Military: A military member is domiciled in the state of his/her home of record. The military income may only be taxed by the domiciliary state, not by the state in which the member is stationed.²

EXAMPLE 5-2: Tex, a Marine, is a resident of Alaska. He has been stationed on permanent orders in California for 15 years. Tex is domiciled in Alaska. California may not tax his military income, and he is treated as a nonresident.

Practitioner pointer

Some states tax the military member's military pay if the individual is domiciled in that state. Some do not.

California military

California treats a military member who is domiciled in California as a nonresident if the member is stationed outside California on permanent orders. In this case, the member is a nonresident of California but still domiciled in California.

EXAMPLE 5-3: Fred is in the Marine Corps stationed in California. He is domiciled in Florida. He has a part-time job working at a 24 Minute Fitness gym. His military income is not taxable to California, but his income from the gym is taxable. (See Publication 1032 — Tax Information for Military Personnel — for information on filing military member returns.)

The 546-day rule

A taxpayer is a nonresident but still domiciled in California if that taxpayer:

- Is outside of California for at least 546 days under a written employment-related contract;
- Spends no more than 45 days in California (business or personal); and
- Has less than \$200,000 in investment income.³

The spouse who accompanies the taxpayer also qualifies as a nonresident if that spouse meets the three previous requirements.

However, if a resident is working outside the state and does not meet the 546-day rule, residency status will be determined under the general "temporary or transitory purpose" rules that have evolved through numerous BOE appeals.

In *Springer*, the taxpayer left California in January of 1996 to fulfill a one-year teaching contract in South Korea. He excluded the income he earned in South Korea from his 1996 resident income tax return and excluded it on his federal return as foreign-earned income. Because the taxpayer was not working outside of the state for the required 546 days, the Board was forced to look to the facts and circumstances to determine whether his absence was for a "temporary or transitory" purpose.⁴

The taxpayer argued that his intent was to stay in South Korea indefinitely, but that he was forced to return to California at the end of his initial contract because he was losing

too much money. The Board stated that even in situations where employment assignments are indefinite but the taxpayer does not establish a new residence, the assignment will be considered for temporary or transitory purposes. In this case, not only was the employment contract for a definite period of time (less than 546 days), but also the taxpayer did not establish a new residence in South Korea, and he maintained some ties with California. Based on these facts, the Board held that the taxpayer had not established that he changed his domicile or residence from California to South Korea in 1996.

But what if?

Instead, assume Mr. Springer continued to stay and work in South Korea for a total of three years, severed his ties with California, and when he left Korea, he moved to Georgia. He would most likely be considered a nonresident from the time he left California.



¹ *Appeal of Bailey* (March 8, 1976) 76-SEB-016; FTB Publication 1051A, Guidelines for Married/RDP filing Separate Tax Returns

² Section 511 of the Servicemembers Civil Relief Act (50 U.S.C. Appen. Sec. 571); R&TC §17140.5

³ R&TC §17014(d)

⁴ *Appeal of Rodney Springer* (2002) Cal. St. Bd. of Equal., Case No. 157784

San Francisco imposes additional tax on Airbnb-type hosts

So just how much did that fork cost?

By Sandy Weiner, J.D.

California Editor

San Francisco is once again on the cutting edge. The San Francisco Assessor's Office has now launched a campaign to have Airbnb/VRBO-type short-term rental hosts file a business personal property tax statement (Form 571-R) and pay the 1.182% personal property tax on the property reported.

The Assessor's Office has contacted all of the short-term rental owners who have registered as a business with the city and county of San Francisco or other short-term lessors whom the Assessor is aware of to inform them of their reporting/payment requirements.

This is a fairly aggressive position, as under R&TC §441(a), business owners with personal property of less than \$100,000 in value are only required to file a business property statement upon the assessor's request. All businesses with property valued at \$100,000 and up must file the annual statement.

We are unaware of any other California county making such requests of Airbnb-type hosts.

What must be reported

According to the San Francisco County Assessor's Office, the lessors are responsible to pay tax on all furniture, appliances, equipment, and supplies used in the rental activity.¹ Taxpayers must report the cost and acquisition year of all physical assets used in the rental activity (regardless of when purchased), "including kitchen appliances, laundry machines, entertainment units, linens, dishes, utensils, artwork, and any other property that you provide to your renters as part of the rental activity." And don't forget the "cleaning supplies, computer equipment, and office equipment such as desks, chairs, and file cabinets."²

Many are questioning just how much revenue this is really going to generate. The assessor has stated that the business personal property tax will only bring in \$118 annually for each

host with business personal property with an assessed value of \$10,000; although many hosts may have property valued at higher amounts. A 2015 San Francisco Chronicle study "showed that two-thirds of about 5,500 Airbnb listings in San Francisco are for entire homes. All 1,400 listings on HomeAway/VRBO and FlipKey are for entire homes."³ For these hosts, potentially all furniture, linens, cutlery, etc., located in the home would have to be reported.

Other "items" of interest that the Assessor's Office has addressed:

- All property used in the rental activity must be reported and tax paid on the assessed value even if the residence is only rented out for a few weeks out of the year;
- The requirement applies even if the host only rents out one room; and
- Hosts who sublet all or a portion of a unit that they rent (rather than own) are also required to file the statement and pay the tax.

Penalties imposed

If a host fails to file the return and pay the tax by the May 7 deadline, a 10% penalty will be imposed.⁴ This would bring a host's liability up substantially (from \$118 to \$1,118 for a host with \$10,000 in assessed personal property).

Other developments

Legislation has been introduced in the California Senate (SB 1102) that would allow hosting platforms such as Airbnb, VRBO, Flipkey, and Homeaway to elect to voluntarily collect and remit transient occupancy taxes (TOTs) on behalf of all local California cities and counties (other than those localities that elect not to participate). Currently, there is no statewide requirement that these hosting platforms collect and remit TOTs; however, Airbnb and some other hosting platforms have entered into agreements to collect these taxes in some cities (e.g., San Francisco and San Diego).



¹ "Short-Term Rental Business Personal Property Taxation Frequently Asked Questions," San Francisco Office of the Assessor-Recorder. Available at: www.sfassessor.org/sites/default/files/2016%20FAQ%20for%20Short%20Term%20Rentals__FINAL%20%282016.3.17%29.pdf

² *Id.*

³ Said, Carolyn, (March 17, 2016) "SF wants Airbnb hosts to pay taxes on beds, stoves and cutlery," *SF Gate*

⁴ R&TC §441(b)

What is California-source income?

"California-source income" has a whole other meaning for nonresident withholding purposes.

By Sandy Weiner, J.D.
California Editor

A recent inquiry from our Message Board highlighted what is likely a source of confusion for many tax practitioners and taxpayers when it comes to what "California-source income" actually means. The confusion arises because the use of California-source income for apportionment purposes is different than California-source income for withholding-at-source purposes.

For apportionment purposes, service revenues of a trade or business are sourced according to where the benefit is received under 18 Cal. Code Regs. §25136-2.

However for withholding-at-source for nonresidents, the focus is on where revenues for personal services performed by an individual should be sourced. Under 18 Cal. Code Regs. §17951-5, personal service revenues are sourced where the service is performed. So if a nonresident performs personal services in California for a business, then the business must withhold 7% from the payments made to the nonresident for those services performed in California.

EXAMPLE 5-4: MySource, Inc. provides online, personalized meditation services for tax practitioners over the Internet. From its billing records, it is able to tell where its customers receive the benefit of its services. Let's say for the month of April, 200 customers from five states (for simplicity, 40 customers in each state) subscribed to these services. For California apportionment purposes, MySource, Inc. would source 20% of its revenues to each of those states.

MySource, Inc. hired Sally Nirvana, a Hawaii resident, as an independent contractor to perform some of these meditations and to train other meditation leaders. In April, she came to MySource, Inc.'s headquarters in Santa Cruz, California, to conduct a seminar. She was paid \$10,000 for the personal services she performed in Santa Cruz and \$5,000 for work she performed in Hawaii, putting together the reports and doing telephone follow-ups for MySource. MySource must withhold \$700 from this payment ($\$10,000 \times 7\%$).



Taxpayer returns to California too soon, owing tax on capital gain

The Board issues a written summary decision due to the amount of tax involved.

By Lynn Freer, EA
Publisher

In a fairly straightforward case, the California State Board of Equalization ruled that a taxpayer who previously had resided in China was a California resident and domiciliary when he sold stock for a \$6,731,242 gain.¹ The case is a published decision under R&TC §40 (see page 56).

Hexu Zhao was a California resident for approximately 11 years prior to moving to China to work as the CFO for JA Solar in July of 2006. While he was working for JA Solar, his wife and two children remained in their home in California. In April 2008, he left his employment and on May 11, 2008, returned to California to work for Legend Silicon.

On May 16, 2008, the taxpayer sold JA Solar stock, which resulted in the capital gain at issue.

The taxpayer's attorney unsuccessfully argued that while he was working for Legend Silicon in 2008, he traveled between California and Asia for both business and personal reasons and was a nonresident. For 2008, Zhao filed a California Form 540NR as married filing separately. He did not include the capital gain for the JA stock sold on May 16, 2008. **Note:** There were also wages in dispute.

Although the FTB determined he was a nonresident for 2006 through May 11, 2008, he became a resident of California beginning on May 12, 2008, when he returned. As a result, his income taxable to California included all of the income he earned after May 11, 2008, including

the \$6,731,242 gain on the sale of stock. The FTB proposed an assessment of \$676,073 in additional tax, plus interest.

Published opinion

Under R&TC §40, when the Board rules on a case in which the tax is \$500,000 or more, the Board must publish the case on its website within 120 days of the date upon which the Board renders its decision.

The case can be published as a:

- Written formal opinion;
- Written memorandum opinion; or
- Written summary decision for each decision.

This case was published as a written summary decision, meaning the case cannot be used as authority.



¹ *Appeal of Hexu Zhao* (March 29, 2016) Cal. St. Bd. of Equal., Case No. 849110

Limited *Lucent*-type sales and use tax refunds to be issued

The BOE will hold interested parties meetings on embedded software and other unresolved issues.

By Sandy Weiner, J.D.

California Editor

At its March 26, 2016, meeting, the California Board of Equalization directed staff to begin issuing sales and use tax refunds involving sales of software under a technology transfer agreement (TTA) to taxpayers with near identical fact patterns to those involved in *Lucent Technologies, Inc. v. State Board of Equalization*.¹ Remember that the *Lucent* case involved the sale to various telephone companies of telephone equipment and the software needed to operate the equipment. For further background, see our December 2015 article, "Update on software sales and use tax exemption" in *Spidell's California Taxletter*.®

According to statements made at the Board meeting, refunds will be issued to taxpayers if the BOE can verify the existence of a software TTA that meets the following conditions:

- It is between a seller who is an exclusive copyright/patent holder and a purchaser-licensee; and
- The software was transmitted on tangible storage media that was collateral to the subsequent use of the licenses regarding that software.

Staff has been directed to issue a notice to this effect.

The Board referred the discussion as to how to resolve other implementation issues raised by *Lucent*, such as the taxability of embedded or preloaded noncustom software, to its Business Taxes Committee. The committee will hold interested parties meetings to develop proposed regulations as to how to address these issues.

For more information concerning the case and the various implementation issues raised, see the Chief Counsel Memorandum prepared for the Board (March 18, 2016) available at:

www.boe.ca.gov/meetings/pdf/2016/032916_M1_Lucent_Technologies_Inc.pdf

Action point

A claim for refund for all open periods (under the three-year statute) should be filed for all software products that meet the *Lucent* criteria and on which California use tax was paid. If the purchase was from a California vendor with sales tax added, contact the vendor to file a claim for refund on your behalf.



¹ *Lucent Technologies, Inc. v. State Board of Equalization* (2015) 241 Cal.App.4th 19

Missing refund — was it used to pay another bill?

The refund your client is expecting could have been taken to pay another debt.

By Kathryn Zdan, EA
Contributing Editor

There is a state interagency refund intercept program that requires the FTB to:

- Determine whether a taxpayer has a balance due with another government agency; and
- Redirect part (or all) of the taxpayer's state tax refund to pay the debt.

In addition, the FTB participates in the Treasury Offset Program and may intercept a federal refund to pay a state tax debt.¹

FTB intercepting state refund

If the FTB takes part of a taxpayer's refund to satisfy another agency's debt, they will send the taxpayer a notice explaining how much was taken and sent to which agency. If your client disputes the other agency's liability, he or she must contact that agency.

Refunds are available for intercept after all existing tax debts have been satisfied. Any FTB tax refund will be used first to pay use tax on the FTB return, then any prior year's FTB taxes. If a taxpayer owes more than one agency, there is an order of priority that determines who gets paid first. Any leftover amount will be refunded to the taxpayer. This is the priority:²

- Delinquent child or family support cases enforced by a local child support agency;
- Delinquent child or family support cases enforced by someone other than a local child support agency;
- Delinquent spousal support cases enforced by a local child support agency;
- Delinquent spousal support cases enforced by someone other than a local child support agency;
- Unpaid restitution fines;
- Unemployment benefits overpayment cases;
- All other California state agencies;
- California cities and counties;
- California colleges; and
- IRS debts.

The processing time may take three to four months. If the refund is intercepted and the taxpayer had already paid the debt to the other agency, the overpayment will be refunded.³

FTB intercepting federal refund

Taxpayers will receive a notice if the FTB will intercept their federal tax refund, and they have 60 days to pay their state tax liability in order to avoid the offset. Payments can be made online via the FTB's Web Pay.

Even if a taxpayer has an offer in compromise plan in place or is making installment payments, the FTB may still offset the federal refund, in addition to any state tax refund, until the outstanding tax debt is paid.⁵

Taxpayers who have their federal income tax refunds intercepted by the FTB to pay all or a portion of any delinquent state income or franchise taxes are charged a \$22 collection fee.⁶ The FTB imposes the fee for every offset; therefore, a taxpayer may have more than one fee imposed.⁷



¹ IRC §6402(e)

² Gov't Code §§12419.3, 12419.4–13

³ www.ftb.ca.gov/individuals/faq/ivr/301.shtml

⁴ R&TC §6452.1

⁵ FTB Treasury Offset Program FAQs, Question 6, <https://ftb.ca.gov/individuals/faq/treasuryOffsetFAQ.shtml>

⁶ Govt. Code §16583.1; www.ftb.ca.gov/aboutFTB/Common_Fees.shtml

⁷ *Id.*

Craigslist required to “throw out” ad revenues from sales factor

The Board refuses to apply the economic presence standard prior to the 2011 taxable year.

By Sandy Weiner, J.D.

California Editor

For purposes of apportioning Craigslist's advertising revenues from the 2007–2010 taxable years, the Board of Equalization refused to apply an economic presence test to determine whether Craigslist was taxable in other states prior to the 2011 taxable year.¹

As a result, Craigslist was required under the alternative apportionment method approved by the FTB to “throw out” the receipts from the apportionment formula's sales factor that were sourced to the states in which it did not have some form of physical presence.

By throwing out these receipts rather than including them in the sales factor denominator, a greater portion of the revenues was taxable by California.

Background

Craigslist had revenues from fees charged for classified advertisements placed on its website by various users. Under the sales factor apportionment rules in effect during 2007–2010, Craigslist was required to use the cost-of-performance method to source these revenues to California. (**Note:** Market-based sourcing was not allowed until the 2011 taxable year.)

Because most of the work in designing and placing the advertising work on the website was performed in California, using the cost-of-performance method resulted in all of Craigslist's advertising revenues being sourced to and taxed by California.

Craigslist petitioned the FTB to use an alternative apportionment method under R&TC §25137, which allows taxpayers to use an alternative apportionment method if they can show that using the standard apportionment method results in an outcome that does not accurately reflect their business activity in the state.

Craigslist felt that sourcing all of its revenues to California did not reflect its business activity in the state, because the advertising markets the advertisers were trying to reach were located throughout the country and not just in California.

The FTB granted the taxpayer's petition. Per the terms outlined in the FTB's determination letter granting the petition, Craigslist was allowed to source its advertising gross receipts on a "market basis."

So for the 2007–2010 taxable years, Craigslist sourced its advertising gross receipts to the state where the advertisement income was generated rather than where the advertising work was performed.

However, as part of the agreement, the FTB required Craigslist to throw out receipts from those states in which Craigslist was not taxable, as defined in R&TC §25122.

When receipts are thrown out, they are removed from both the sales factor numerator and denominator. This prevents California's sales from being diluted by "nowhere" income.



¹ *Appeal of Craigslist, Inc.* (March 29, 2016) Cal. St. Bd. of Equal., Case Nos. 725838, 843070

Don't forget — LLC annual fees are due June 15

LLCs must estimate their 2016 gross receipts now and pay the fee based on that number.

By Renée Rodda, J.D.

Editor

The LLC annual fee is due on the 15th day of the sixth month of the current taxable year — June 15, 2016, for calendar-year LLCs.¹ Although taxpayers are less than halfway through the year, they must estimate their total annual income based on the first six months of the year. Use Form FTB 3536, Estimated Fee for LLCs, or Web Pay to remit the estimated fee.

Estimating the fee

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

There is a prior-year exception if the timely paid estimated fee is equal to or greater than the prior year's fee.

The underpayment penalty is 10% of the difference between the fee paid and the fee owed, and there is no reasonable cause exception for this penalty.

Unlike the corporation's estimated tax prior-year exception, there is no requirement that the prior tax year be a full 12 months. Also, there is no penalty for the LLC's first-year filing in California.

2016 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

EXAMPLE 5-5: Tryin' to Plan, LLC, owed a fee of \$6,000 for 2015, based on \$1,200,000 of income. If Tryin' pays \$6,000 on June 15, 2016, they will not be subject to an underpayment penalty regardless of their final 2016 income.

However, in 2016, Tryin' projects their income will be less than \$1,000,000. As a result, they pay \$2,500, the fee they expect to owe.

Unfortunately, Tryin's 2016 income is actually \$1,000,001. Because Tryin' is over the \$1,000,000 income level, they will owe a balance of \$3,500 (\$6,000 - \$2,500) and a penalty of \$350.



¹ R&TC §17942(d)(11)

THUMB TAX

Limitations period applies to refunds of failure to withhold liability — The standard four-year limitations period for refunds of corporate franchise and personal income taxes applies to refunds of overpayments of the failure to withhold liability imposed against withholding agents.¹

Frequently, a withholding agent who fails to file a return and pay the withholding will be held liable for the amount of withholding that should have been withheld.²

After paying the liability, the taxpayer who should have been originally withheld will then file a return and pay the tax due. In such situations, the withholding agent may then file for a refund as long as it files within four years from the original due date of the withholding agent's return (FTB Form 592, Resident and Nonresident Withholding Statement, or FTB Form 593, Real Estate Withholding Statement), not the ultimate taxpayer's return.

¹ FTB Technical Advice Memorandum 2016-02 (February 24, 2016)

² R&TC §18668(a); 18 Cal. Code Regs. §18662-8(d)(2)(C)

New sales tax on services bill — SB 1445 (Hertzberg) would impose a sales tax on services. There are no exact details yet except that the following would be exempt:

- Health care services;
 - Education services;
 - Child care;
 - Rent;
 - Interest; and
 - "Services represented by very small businesses."
- Revenue would be used for tax relief to middle and low-income families and:
- Lower the corporate income tax on small businesses; and
 - "Significantly" reduce the minimum franchise tax.

The bill contains no details and can be passed by a majority of the Legislature, because as of now, there are no tax consequences.

See the full bill text at:

http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201520160SB1445

Business trusts not subject to minimum franchise tax — The FTB issued two separate Chief Counsel Rulings holding that regulated investment companies organized as business trusts were not "corporations" for purposes of the minimum franchise tax and were therefore not liable for the tax.¹

For both California corporation franchise tax and California corporation income tax purposes, the term "corporation" includes every corporation except those that are exempted by statute or state constitution.² However, for corporation income tax purposes but not for corporation franchise tax purposes, the definition includes business trusts.³

¹ Chief Counsel Ruling 2016-01; Chief Counsel Ruling 2016-02

² R&TC §§23038, 24871

³ R&TC §23083(b)(2)(A)

CFC credit application dates — The California Film Commission (CFC) has announced new application windows for the California Film and Television Tax Credit Program 2.0.

The TV application window for nontransferable tax credits will be open from May 18 through May 27, 2016, only for:

- Relocating TV series (\$33 million in tax credits available); and
- Recurring TV projects (TV series, relocating TV series in their second season in California, or series from pilots that have previously received a credit allocation letter).

The CFC will not be accepting applications for any new TV series, TV pilots, movies of the week, or mini-series during the May application window.

The application dates for independent projects (transferable film credits) and nonindependent feature films (nontransferable tax credits) will be open from June 27 through July 8, 2016.

For more information, go to:

www.film.ca.gov/Incentives.htm

FTB updates Top 500 Delinquent Taxpayers list — The FTB has updated its list of the Top 500 Delinquent Taxpayers. The FTB started sending letters to the taxpayers scheduled to appear on the list in February 2016. Of the taxpayers on the list, 101 made arrangements to pay and another 316 individuals and 83 businesses did not, resulting in their inclusion on the list.

The FTB has collected more than \$507 million in state taxes since the first list was created in October 2007.

To view the Top 500 Delinquent Taxpayers list, or to find out how to remove a taxpayer's name from the list, go to:

[www.ftb.ca.gov/aboutFTB/
Delinquent_Taxpayers.shtml](http://www.ftb.ca.gov/aboutFTB/Delinquent_Taxpayers.shtml)

Change to payment processor may affect some EDD payments — Effective June 30, 2016, Union Bank, with First Data Government Solutions as the data collector, will process EFT payments on behalf of the EDD.⁴

The process of making ACH debit payments will not change. However, if employers make payments by ACH credit or Fedwire, they will need to update the EDD bank account number to reflect the change to Union Bank. The EDD will provide more detailed information regarding this change on its website in May 2016.

⁴ EDD California Employer Newsletter (April 4, 2016)



CALIFORNIA CONTACTS

To request additional time to respond to Form 4734D, call:	916-845-7088
For more information on SB 3, go to:	http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB3
For more information on AB 908, go to:	http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160AB908
To view the full U.S. Supreme Court <i>Hyatt</i> case decision, go to:	www.caltax.com/spidellweb/public/editorial/HyattSC.pdf
See the Chief Counsel Memorandum for more information on the <i>Lucent</i> case, available at:	www.boe.ca.gov/meetings/pdf/2016/032916_M1_Lucent_Technologies_Inc.pdf
See the full SB 1445 bill text at:	http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201520160SB1445
To view the Top 500 Delinquent Taxpayers list, or to find out how to remove a taxpayer's name from the list, go to:	www.ftb.ca.gov/aboutFTB/Delinquent_Taxpayers.shtml
For more information on the California Film and Television Tax Credit Program 2.0, go to:	www.film.ca.gov/Incentives.htm

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CPAs and CFPs**	8 Tax
EAs and CRTPs	8 Federal Tax
CA Attorney	6.75 General MCLE

About the presenter:

Larry A. Conway, CPA, Esq.



Larry Conway is a 1976 graduate of the University of Iowa, and practiced as a CPA for 26 years before obtaining his J.D. from California Western School

of Law (magna cum laude) in 2003. While at California Western he served on the Law Review editorial board and received numerous scholarship awards in Taxation.

He is the founder and Senior Attorney in Conway Law Group, Inc., where his practice focuses on Tax, Estate Planning, Probate, and General Business Counsel. He lectures frequently on estate planning, tax, FATCA, and issues affecting same sex couples. He has been a guest on San Diego radio KCBQ, and has been an adjunct professor at California Western School of Law.

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City	Day	Date	Location
San Jose	Monday	May 23, 2016	Holiday Inn San Jose-Silicon Valley
Sacramento	Tuesday	May 24, 2016	Crowne Plaza Sacramento Northeast
Orange	Thursday	May 26, 2016	DoubleTree by Hilton Anaheim-Orange County
Burbank	Friday	May 27, 2016	Pickwick Gardens Conference Center
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San Diego	Monday	July 18, 2016	Scottish Rite Event Center
Orange	Tuesday	July 19, 2016	DoubleTree by Hilton Anaheim-Orange County
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Monday	Nov. 28	Burbank	Pickwick Gardens Conference Center	Wednesday	Jan. 4	Stockton	Hilton Stockton
Monday	Nov. 28	Concord	Hilton Concord	Thursday	Jan. 5	Milpitas	Embassy Suites by Hilton Milpitas Silicon Valley
Tuesday	Nov. 29	Modesto	DoubleTree by Hilton Modesto	Thursday	Jan. 5	Pasadena	Hilton Pasadena
Tuesday	Nov. 29	Oxnard	Residence Inn Oxnard River Ridge	Friday	Jan. 6	Berkeley	DoubleTree by Hilton Berkeley Marina
Wednesday	Nov. 30	San Luis Obispo	Alex Madonna Expo Center	Friday	Jan. 6	Westlake Village	Hyatt Regency Westlake
Wednesday	Nov. 30	San Rafael	Embassy Suites San Rafael Marin County	Monday	Jan. 9	Sacramento	DoubleTree by Hilton Sacramento
Thursday	Dec. 1	Bakersfield	DoubleTree by Hilton Bakersfield	Wednesday	Jan. 11	Burbank	Pickwick Gardens Conference Center
Dec. TBA	Fresno	TBA		Thursday	Jan. 12	Culver City	DoubleTree by Hilton Los Angeles — Westside
Monday	Dec. 5	Escondido	California Center for the Arts Escondido	Thursday	Jan. 12	Pleasanton	DoubleTree by Hilton Pleasanton at The Club
Wednesday	Dec. 7	Ontario	DoubleTree by Hilton Ontario Airport	Friday	Jan. 13	Monterey	Embassy Suites Monterey Bay Seaside
Thursday	Dec. 8	Culver City	DoubleTree by Hilton Los Angeles — Westside	Tuesday	Jan. 17	Riverside	Riverside Convention Center
Monday	Dec. 12	Sacramento	Crowne Plaza Sacramento Northeast	Tuesday	Jan. 17	Santa Rosa	Hyatt Vineyard Creek Sonoma County
Monday	Dec. 12	Santa Barbara	The Fess Parker — A DoubleTree Resort by Hilton	Wednesday	Jan. 18	Long Beach	Long Beach Marriott
Tuesday	Dec. 13	Rohnert Park	DoubleTree by Hilton Sonoma Wine Country	Wednesday	Jan. 18	So. San Francisco	South San Francisco Conference Center
Tuesday	Dec. 13	Woodland Hills	Warner Center Marriott Woodland Hills	Thursday	Jan. 19	San Ramon	San Ramon Marriott
Wednesday	Dec. 14	So. San Francisco	South San Francisco Conference Center	Monday	Jan. 23	Sacramento	Crowne Plaza Sacramento Northeast
Wednesday	Dec. 14	Torrance	Torrance Marriott Redondo Beach	Monday	Jan. 23	San Diego	Scottish Rite Event Center
Thursday	Dec. 15	San Jose	DoubleTree by Hilton San Jose	Tuesday	Jan. 24	San Jose	DoubleTree by Hilton San Jose
Friday	Dec. 16	Anaheim	Hilton Anaheim	Wednesday	Jan. 25	Burbank	Pickwick Gardens Conference Center
Monday	Dec. 19	Burbank	Pickwick Gardens Conference Center	Friday	Jan. 27	Temecula	South Coast Winery Resort & Spa
Monday	Dec. 19	San Diego	Scottish Rite Event Center	Monday	Jan. 30	Woodland Hills	Warner Center Marriott Woodland Hills
Tuesday	Jan. 3	Del Mar	Hilton San Diego/Del Mar	Tuesday	Jan. 31	Anaheim	Anaheim Marriott
Tuesday	Jan. 3	Valencia	Hyatt Regency Valencia	FREE parking, lunch, continental breakfast, soda break, and printed manual!			
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Webinar 1				Webinar 2			
Dec. 6 and Dec. 7				Jan. 10 and Jan. 11			
				Print (Available 12/1/16)			
				Online (Available 2/3/17)			

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