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**2015 State Income Tax Rate Schedules Adjusted**

We released the 2015 state tax brackets. Brackets are “indexed” each year by adjusting them to reflect changes in the California Consumer Price Index (CPI).

Filing requirement thresholds, standard deductions, and certain credits were adjusted along with income tax brackets based on the inflation rate of 1.3 percent, as measured by the California CPI for all urban consumers from June 2014 to June 2015. Last year, California had an inflation rate that measured 2.2 percent.

Below are some of the tax rate changes:

<table>
<thead>
<tr>
<th>Adjustments</th>
<th>2015 Amounts</th>
<th>2014 Amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard deduction for single or married filing separate taxpayers</td>
<td>$4,044</td>
<td>$3,992</td>
</tr>
<tr>
<td>Standard deduction for joint, surviving spouse, or head of household taxpayers</td>
<td>$8,088</td>
<td>$7,984</td>
</tr>
<tr>
<td>Personal exemption credit amount for single, separate, and head of household taxpayers</td>
<td>$109</td>
<td>$108</td>
</tr>
<tr>
<td>Personal exemption credit amount for joint filers or surviving spouses</td>
<td>$218</td>
<td>$216</td>
</tr>
<tr>
<td>Dependent exemption credit</td>
<td>$337</td>
<td>$333</td>
</tr>
<tr>
<td>Renter’s Credit is available for single filers with adjusted gross incomes of $38,259 or less</td>
<td>$38,259 or less</td>
<td>$37,768 or less</td>
</tr>
<tr>
<td>Renter’s Credit is available for joint filers with adjusted gross incomes of $76,518 or less</td>
<td>$76,518 or less</td>
<td>$75,536 or less</td>
</tr>
</tbody>
</table>

In addition, we provide minimum filing requirement thresholds to ensure that most taxpayers who will not owe taxes are not required to file a state tax return. We adjust these each year to include the added senior exemption and the dependent exemption credits. For example, most single people under age 65 with no dependents would not need to file a tax return until they have adjusted gross income of $13,005 or more compared to last year’s threshold of $12,838 or more.

Other tax credits affected by indexing include the Joint Custody Head of Household Credit, Dependent Parent Credit, and Qualified Senior Head of Household Credit.

Go to [ftb.ca.gov](http://ftb.ca.gov) and search **2015 tax rates**.
Interest Computation Adjustments Update

Earlier this year, we became aware that a limited number of individuals or business entities meeting a set of specific criteria may be subject to interest computation adjustments as a result of the following rulings:

- *May Department Stores v. United States* (IRS Revenue Ruling 99-40)
- Corporate Interest Netting (IRS Revenue Procedure 94-60)

Regarding *May Department Stores* interest calculations, the criteria are centered on individuals or business entities that have *all* of the following:

1. 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
2. On the original return, taxpayer elected an overpayment transfer to the subsequent year's estimate tax; AND
3. On the subsequent year, the required first quarter estimate payment was less than the requested overpayment transfer amount.

Regarding Corporate Interest Netting adjustments, the criteria are centered on corporations with all of the following:

1. Previous refund or payment transfer; AND
2. Subsequent deficiency or amended return for additional tax with interest for the same tax year.

We now trained our staff to proactively identify cases meeting these criteria and revised our procedures to ensure that these cases receive proper treatment. We also publicized the issue to reach out to taxpayers that may be impacted by the new rulings. To date, we have received very few requests for interest adjustments.

At the July 21, 2015 meeting of the Franchise Tax Board, we shared that the estimated universe of these taxpayers is approximately:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Computation</th>
<th>Taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>May Dept Store</td>
<td>24,000</td>
</tr>
<tr>
<td>Business Entities</td>
<td>May Dept Store</td>
<td>2,000</td>
</tr>
<tr>
<td>Business Entities</td>
<td>Corporate Interest</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>27,000</strong></td>
</tr>
</tbody>
</table>
We committed to providing an update in September 2015 regarding the fiscal impacts to the various groups. We now estimate those impacts to be approximately:

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Computation</th>
<th>Maximum Fiscal Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>May Dept Store</td>
<td>$1.5 million</td>
</tr>
<tr>
<td>Business Entities</td>
<td>May Dept Store</td>
<td>$14.5 million</td>
</tr>
<tr>
<td>Business Entities</td>
<td>Corporate Interest Netting</td>
<td>To Be Determined</td>
</tr>
</tbody>
</table>

The calculations involved in determining the potential interest adjustments are both complex and time-consuming. We are still in the process of determining the fiscal impact of Corporate Interest Netting and will provide an update to include these figures once they are available. We will also begin issuing refunds/credits on in-statute years and sending letters of explanation to impacted taxpayers in Fall 2015. If you have questions or need additional information, go to ftb.ca.gov and search interest adjustments.

State Tax Relief for Victims of the Wildfires in Amador, Calaveras, Lake, and Napa Counties

Taxpayers affected by wildfires in Amador, Calaveras, Lake, and Napa Counties are automatically eligible for qualifying disaster loss treatment under the terms of a new law covering areas where the Governor declares a State of Emergency. Governor Brown made these declarations for 2015 on September 11 for Amador and Calaveras Counties, and September 13 for Lake and Napa Counties.

Special tax rules apply to disaster losses. Victims can claim a loss in either the year the disaster occurred or in the prior year. Those who choose the latter can reduce their tax liability for the prior year, allowing us to quickly issue a refund.

Disaster victims who have not yet filed 2014 tax returns can claim disaster losses on their original tax returns. Those who have already filed 2014 tax returns can claim losses against that year’s income by filing a Form 540X, Amended Individual Income Tax Return. Taxpayers should write, “DISASTER – 2015 BUTTE AND VALLEY WILDFIRES” in red ink at the top of the tax return.

Taxpayers who need copies of lost or damaged state tax returns should complete Form FTB 3516, Request for Copy of Personal Income or Fiduciary Tax Return, which can be downloaded online. Disaster victims can get copies of tax returns at no charge by writing, “DISASTER – 2015 BUTTE AND VALLEY WILDFIRES” in red ink at the top of the tax return.
The new law also applies to taxpayers affected by the 2014 and 2015 State of Emergency declarations on the Governor’s website at [gov.ca.gov](http://gov.ca.gov).

For more information, get [FTB Publication 1034, Disaster Loss: How to Claim a State Tax Deduction](http://ftb.ca.gov) at [ftb.ca.gov](http://ftb.ca.gov).

### California’s Earned Income Tax Credit – Additional Information

As we shared [earlier this year](#), California (CA) will offer an Earned Income Tax Credit (EITC) for Form W-2 wage earners for the 2015 tax year. California’s EITC will be similar to the federal credit, but includes some different qualifying rules and a separate form.

<table>
<thead>
<tr>
<th>Number of qualifying children</th>
<th>CA earned income upper limit, if single, HOH, widowed, or married filing jointly</th>
<th>Federal earned income upper limit, if single, HOH, widowed</th>
<th>Federal earned income upper limit, if married filing jointly</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>$6,580</td>
<td>$14,820</td>
<td>$20,330</td>
</tr>
<tr>
<td>1</td>
<td>$9,880</td>
<td>$39,131</td>
<td>$44,651</td>
</tr>
<tr>
<td>2</td>
<td>$13,870</td>
<td>$44,454</td>
<td>$49,974</td>
</tr>
<tr>
<td>3 or more</td>
<td>$13,870</td>
<td>$47,747</td>
<td>$53,267</td>
</tr>
</tbody>
</table>

Since you may be assisting clients in claiming this credit, we want to provide you with the latest information on how we plan to implement this credit, some of the differences and similarities between the CA EITC and the federal credit, and what we need from you and your clients.

- The CA EITC excludes self-employment income from the definition of earned income.
- Taxpayers filing “Married Filing Separately” are not eligible for the federal or CA EITC.
- The CA EITC can be claimed on forms 540, 5402EZ, and 540NR (short or long).
- To claim the CA EITC, complete and attach the new form FTB 3514, California Earned Income Tax Credit, to the tax return, regardless if your client can claim qualifying children or not.
- As a paid preparer, you must complete and attach the new form FTB 3596, Paid Preparer's California Earned Income Tax Credit Checklist, with all returns claiming the CA EITC. This form is very similar to the related federal Form 8867, Paid Preparer’s Earned Income Credit Checklist.
• Forms FTB 3514 and FTB 3596 will be available in late 2015 at ftb.ca.gov.
• Taxpayers can generally expect to receive their refund in 7 to 10 days for e-filed returns and 8 to 12 weeks if they mail their tax return.
• If we suspect identity theft or credit ineligibility, we may need to take extra steps to validate the CA EITC claim. We will send FTB 4502, Additional Documentation Required — Refund Pending, to verify eligibility. Representatives may respond to us using their MyFTB accounts. Once completed and returned with the required documentation, we ask you to allow an additional 6 to 8 weeks for processing.

We are very excited to offer the lowest-income California households the opportunity to claim the CA EITC. This credit will assist in increasing the standard of living for hundreds of thousands of Californians by offering an average estimated household benefit of $460, with a maximum benefit of $2,618.

FTB Audit Roundtable Update - Second in a Series

Earlier this year, we conducted two Audit Roundtable Sessions with representatives from large accounting and law firms, a sampling of large corporate taxpayers, and other interested parties. Attendees asked for timeliness, better communication, and enhanced collaboration during the audit and claim processes. Over the next several months, we will be publishing quarterly articles that focus on our progress as we address many of the items discussed at the Audit Roundtable Sessions. This quarterly article focuses on the claim for refund process.

• **New screening procedures**
  In July of 2015, we implemented new procedures to streamline the screening process. We changed our processes from paper to electronic and refined our audit referral criteria. Under our new process, more claims will be refunded prior to Audit consideration. While a claim may be refunded sooner, your client’s return remains subject to audit.

• **Supervisor and manager contact information added to frequently used audit documents**
  Roundtable attendees shared that they did not always know who to call to resolve procedural issues in the claim audit process. We have updated some of our most frequently used audit documents to include supervisor and manager contact information, so you and your clients will easily know who to contact with questions. We modified the Audit Issue Presentation Sheet Cover Letter, Information Document Request Cover Sheet Letter, Demand Letter, and the Cover Letter for Request for State Waiver to include supervisor and manager contact information.
• **Flowchart for claims for refund process**
  During the roundtable discussions we shared a flowchart of the corporate claim process. Attendees were unaware of the steps involved, so we published the flowchart on our website: [Flow Chart of Claim for Refund Process](#)

**Coming Soon- claim for refund acknowledgment letter for business entities**
Roundtable attendees asked us to communicate as the claim progressed through our processes so taxpayers could better estimate when to expect their refund. We are developing an acknowledgment letter for business entity claims that file an amended Form 100X. This letter will notify taxpayers whether a corporation claim was referred to audit or will be refunded prior to audit consideration. We plan to start mailing these acknowledgment letters next month.

We thank all Tax News subscribers who participated in the roundtable discussions. The ideas we received were very helpful to us in moving forward in streamlining our processes and enhancing our communications.

**Public Law 86-272: Let’s Be Clear**

Public Law 86-272 (15 USC Section 381) prevents the state from asserting its right to impose a tax based on net income, such as the corporate income tax or franchise tax. Public Law 86-272 protection is available to out-of-state business entities that sell tangible personal property in this state and whose in-state activities are limited to the solicitation of orders for their goods. As a result, if a taxpayer is protected by Public Law 86-272, it will not be required to pay the franchise tax or the corporate income tax, as both are measured by net income.

However, even if protected by Public Law 86-272, an out-of-state entity is still obligated to file a tax return and pay taxes that are not measured upon net income, such as the minimum franchise tax, annual Limited Liability Company (LLC) tax, and the Limited Liability Company (LLC) fee, unless certain exceptions apply.

For further details in regards to what activities are protected by Public Law 86-272, see [FTB 1050](#), Application and Interpretation of Public Law 86-272. In addition, for more information on the minimum franchise tax, annual LLC tax, and LLC fee, as well as their exceptions, please reference Revenue and Tax Code Sections 23151, 17941, and 17942, respectively.

**For example:** Corporation C, an out-of-state corporation that does not file a combined return, sells tangible goods over the internet and qualifies for protection under Public Law 86-272. For the 2013 taxable year, Corporation C has $1,000,000 of California sales but no property or payroll in California. Corporation C, though considered doing
business in California because it has $1,000,000 in California sales, will not be subject to California’s franchise tax as it is protected under Public Law 86-272. However, Corporation C must still file a California return and pay the minimum franchise tax of $800.

Another example: LLC Z, an out-of-state LLC that engaged in activities that are protected under Public Law 86-272 and considered to be doing business in California for the tax year 2013. LLC Z’s total income from sources derived from or attributable to the state of California was $300,000. Therefore, LLC Z must file a California tax return, pay the annual LLC tax of $800, and pay the LLC fee of $900.\footnote{The LLC fee amount can be determined from the LLC fee table. Go to \texttt{ftb.ca.gov} and search \texttt{FTB 3556}.} Public Law 86-272 does not protect qualified out-of-state business entities from the annual LLC tax or the LLC fee.

Real Estate Withholding Process Improvements Continue

In our May article, Real Estate Withholding Process Improvements, we outlined many of the improvements made by the Withholding Services and Compliance Section to improve customer service and accuracy of real estate withholding. Since we continue to receive questions about real estate withholding, we want to again share this article and all we are doing to make the real estate withholding program a success in this year, and in the years to come:

Have you or your clients experienced real estate withholding problems? If so, we are here to help. We listened to your comments and share the desire to improve the process and availability of real estate withholding credits for our taxpayers. Our goal is to ensure that every real estate withholding credit is available for our taxpayers at the time they file their tax return. In October 2014, we conducted a study on our California Form 593, Real Estate Withholding Tax Statement, to determine the frequency of processing problems and to target specific areas for improvement. We found that we process 70 percent of the filed forms through our automated system successfully. However, 30 percent of the forms do not process successfully, primarily due to inaccurate information or incomplete forms. Since March 2015, we have been actively working on short-term processing improvements that match available real estate withholding credits to the correct taxpayers for this tax season. We are also working on long-term solutions that will improve the efficiency of the real estate withholding process for taxpayers. The following provides a brief overview of what is happening behind the scenes at FTB:
Our Short-Term Solutions

- Manually review the Forms 593 that do not process successfully through the automated system. We review each account, and work with the Real Estate Escrow Person (REEP) to make necessary corrections to a completed Form 593 and/or manually apply the credit before taxpayers file their tax return.
- Validate the accuracy of the Notice of Tax Change prior to mailing it to the taxpayer. This notice is generated when the credit claimed on the tax return does not match the credit available in our system. We review our records to determine if there is an unapplied credit or if the discrepancy is correct. In many cases, we found we are able to resolve the discrepancy prior to issuing the Notice of Tax Change.

Our Long-Term Solutions

- Educate the escrow community regarding Form 593 completion.
- Provide personal income tax real estate withholding credit information on MyFTB, so taxpayers can view their credits prior to filing their return. (Scheduled to launch in January 2016.)
- Revise FTB Publication 1016, Real Estate Withholding Guidelines, based on input from our stakeholders to clarify the real estate withholding process and instructions.
- Revise Form 593 based on input from taxpayers and practitioners. We want to make this form as user-friendly as possible and stay consistent with our real estate withholding regulations. Our goal is to gather the appropriate information so that we can accurately apply the credits in a timely manner.

If you or your clients experienced real estate withholding problems in the past, we are excited to share these future enhancements with you. If you notice an error in your client’s name and/or identification number on the FTB Form 593 or a difference between withholding on the escrow statement and the FTB Form 593, call us at 888.792.4900.
Withholding and Transfers

When your client wants to know if withholding is required when there is a transfer of California real property, the answer is yes. Withholding is required on any disposition of a California real property interest by a transferor.

Withholding is required unless any of the following apply:

- The total sales price is $100,000 or less.
- The seller is a bank acting as a fiduciary for a trust.
- The property is being foreclosed.
- The seller meets a full exemption on a certified FTB Form 593-C, Real Estate Withholding Certificate.

In real estate, deeds are legal documents that transfer property ownership from one party to another. There are many different types of deeds: property deeds, grant deeds, warranty deeds, fiduciary deeds, gift deeds, and quitclaim deeds. Each type of deed is used for a specific situation.

Grant and warranty deeds guarantee (warrant) that the grantor has full title to the property or the interest the deed states is being conveyed. A warranty deed is used in most real property sales and makes a guarantee that the grantor owns clear and complete interest in the title and the property is free of all liens.

The two deeds that we receive questions about the most in terms of withholding are the gift and quitclaim deeds.

A gift deed is a simple, notarized document that transfers ownership of a property to another person. Gift deeds are often used between relatives and friends. The person gifting the property is referred to as the donor, and the person receiving the property is referred to as the recipient. Gift deeds can be used only when there is no payment or compensation given to the donor in exchange for gifting the property.

A quitclaim deed contains no warranties of title. A quitclaim deed is used to transfer property interest from the grantor to the grantee. It is most often used to:

- Add a spouse's name to a property title.
- Transfer property to a child, sibling, or other family member.
- Transfer property interest to a business partner.
- Remove a spouse's name from a property title after divorce.
- Bequeath property to someone in a will.

A quitclaim deed is considered one of the easiest ways to legally transfer property. Quitclaim deeds carry no guarantee that the grantor possesses ownership of the property; rather it is a relinquishment of the grantor's rights, if any, to the property.
Quitclaim deeds are also used to clear up questions of full title when a person has a possible but unknown interest in the property.

Thus for each transfer the transferor must certify an exemption on Form 593-C if the real property interest is more than $100,000. For example:

- A grandmother uses a quitclaim deed to transfer the grandmother’s personal residence, a California real property interest, to her granddaughter. Withholding is required unless the grandmother meets an exemption. In this example the grandmother may qualify for check box 1 or 2 under Part II, Certifications which fully exempt the sale from withholding, on Form 593-C. The grandmother may check all boxes that apply and certify a completed certificate.

- Mr. Right uses a quitclaim deed to transfer an office building he owns to a new corporation in exchange for 100 percent of the corporate common stock. Withholding is required unless Mr. Right meets an exemption. In this example Mr. Right may qualify for check box 5 under Part II, Certifications which fully exempt the sale from withholding, on Form 593-C. Mr. Right may check all boxes that apply and certify a completed certificate.

- Ms. Aunty uses a gift deed to transfer her personal residence to her favorite and only niece before moving to a care home. Withholding is required unless Ms. Aunty meets an exemption. In this example, Ms. Aunty may qualify for check box 1, 2, or 3 under Part II, Certifications, which fully exempt the sale from withholding, on Form 593-C. Ms. Aunty may check all boxes that apply and certify a completed certificate.

Remember, we highly recommend that the seller contact a tax professional to help them with their withholding forms.
California Real Estate Withholding Installment Sales Webinar

Learn about California's real estate withholding installment sale process. This live webinar will cover:

- Real estate withholding requirements.
- The definition of an installment sale.
- How to calculate the withholding on installment payments during and after escrow.
- How to complete installment sale withholding forms.
- How to elect-out of withholding on payments following the close of escrow.
- Resources and contact information.

Join us Wednesday, **October 07, 2015, at 10 a.m.** Also, tune in for a question and answer session following the live webinar.

Register now!

Do You Have a Nonconsenting Nonresident (NCNR) Members’ Tax Credit to Claim?

All multiple member Limited Liability Companies (LLCs) who have nonresident members are required to file form FTB 3832, Limited Liability Company's Nonresident Members’ Consent, with their FTB Form 568, Limited Liability Company Return of Income. A single member LLC with a nonresident member signs its consent on Form 568, Side 3. This consent is required to be filed in the first tax year that a nonresident member has California source income and is due by the extended due date of the tax return. The consent provides us with a list of names, taxpayer identification numbers, and the signature of each nonresident member. The consent is an agreement by the member to file a California income tax return, pay all taxes imposed on the nonresident member's share of income from the LLC on time, and be subject to jurisdiction in California for the collection of income taxes, interest, and penalties.

However, if a nonresident member fails to sign its consent or if the LLC fails to file the Form FTB 3832, the LLC is required to pay tax on the member's distributive share of California source income at the member's highest marginal tax rate. The LLC uses the Schedule T in Form 568 to compute the nonconsenting nonresident (NCNR) members' tax liability to be paid by the LLC. This payment made by the LLC will be considered a payment made on behalf of the nonconsenting member. If your client is a nonconsenting member of an LLC and needs to claim the NCNR credit from their LLC, you must remember to follow the instructions which are also included in the tax forms identified below:
• Nonresident Individual Member – on Line 82 of Form 540NR, California Nonresident or Part-Year Resident Income Tax Return, write “LLC” on the dotted line to the left of the amount on line 82, and attach Schedule K-1 (568) with the amount of the NCNR tax claimed.

• Corporation Member – on Line 32 of Form 100S, California S Corporation Franchise or Income Tax Return, or on Line 33 of the Form 100, California Corporation Franchise or Income Tax Return, write “LLC” on the dotted line to the left of the amount on line 32 or 33, and attach Schedule K-1 (568) to the California income tax return to claim the tax paid by the LLC on the corporation’s behalf.

• Partnership Member – on Schedule K, Line 15e of Form 565, Partnership Return of Income, and attach Schedule K-1 (568) with the amount of NCNR tax claimed. Also allocate the amount to the partners on each Schedule K-1(565) based on distributive share. Partners must attach a copy of the Schedule K-1(568) and their Schedule K-1(565) to their tax returns.

• LLC Member – on Line 6 of the Form 568, Limited Liability Company Return of Income, but do not exceed the amount on Line 4. Enter any remaining amount on Line 15e of Schedule K (568). Also allocate any remaining amount to the members on each Schedule K-1 (568) based on distributive share. Attach Schedule K-1 (568) from the LLC that paid the amount of NCNR tax claimed. Members must attach a copy of the Schedule K-1(568) from the LLC that paid the amount and their Schedule K-1(568) to their tax returns.

It is important to note that if a nonconsenting member files their tax return before the LLC files its tax return, we will be unable to apply the NCNR payment until the LLC files its return and makes the NCNR payment. This may result in delayed processing of your tax return, issuance of a balance due notice, and delayed refunds. If you have claimed an NCNR payment on your tax return and you either received a notice or have not received your full refund, check with your LLC to see if the LLC has filed its tax return and paid the NCNR tax liability before contacting us. To avoid the potential issues listed above it is beneficial for the nonresident member to sign Form FTB 3832, Limited Liability Company’s Nonresident Member’s Consent. However, understand that completion of this form does not satisfy the requirements for filing a California income tax return. Nonresident members are required to file the appropriate California tax returns, in addition to signing for FTB 3832.
Ask the Advocate

It is a Busy Fall!

One of the things I enjoy most about being the Taxpayers' Rights Advocate is that it provides me and my staff with the opportunity to be involved in many different ways that can have a positive impact for practitioners and taxpayers, including meeting with many of you during the year. While we have a pretty full calendar throughout the year, fall is an especially busy time for us due to the end of the current legislative session, several annual meetings, and the upcoming filing season.

As I write this, there are several tax related bills on the Governor’s desk, awaiting his signature or veto. Probably the most talked about of these is Assembly Bill (AB) 154 (Ting). If signed into law, California’s general conformity date to federal income tax laws would change from January 1, 2009, to January 1, 2015, for taxable years beginning on or after January 1, 2015. Generally, the bill also conforms California law to the federal net operating loss (NOL) rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year. Finally, AB 154 would modify the large corporate understatement penalty to provide certain exceptions to the penalty. Another bill, and one that impacts my office directly, is Senate Bill 540 (Hertzberg). This bill would extend and make permanent the Taxpayers’ Rights Advocate’s penalty, interest, and fee relief provisions. Our public website provides detailed analyses of these and many other tax related bills. I encourage you to read the bill analysis for AB 154 and other bills of interest so that you can better understand the potential impacts to your clients from any new legislation.

The fall is also a time when we coordinate meetings with different industry groups, including the California Society of Certified Public Accountants (CalCPA) and the California Society of Enrolled Agents (CSEA). At both meetings, we present the projects and issues that our Audit, Collections, Filing, and Legal programs plans to work on in the coming year and answer questions submitted in advance by members of both groups. The CSEA State Tax Agencies Liaison Meeting (STALM) includes representatives from the Board of Equalization, the Employment Development Department, and FTB to allow all three agencies to hear practitioners’ concerns and meet with many of you. This year’s STALM will be hosted here on our campus and include a tour of our processing facilities.

Gearing up for filing season is an annual ritual here at FTB and we expect the upcoming filing season to be a busy one for many reasons, including the roll out of the enhanced MyFTB and the first-ever California Earned Income Tax Credit (CA EITC). The planned rollout date for the enhanced MyFTB is the first week of January 2016. I'm recommending that practitioners sign up as soon as possible after the first of the year because the new registration verification process will not allow access on the same day that you sign up – don't wait until April 15!
The new CA EITC is expected to benefit over 800,000 hardworking California families, including 60,000 new filers. We are in the final stages of creating the necessary forms and updating our public website content to provide the information necessary to ensure that qualifying taxpayers receive the credit they are entitled to. We will keep you updated about both MyFTB and the CA EITC in upcoming issues of Tax News.

Susan Maples, CPA
Taxpayers’ Rights Advocate
Follow me on Twitter at twitter.com/FTBAdvocate

Event Calendar

As part of education and outreach to our tax professional community, we participate in many different presentations and fairs. We now provide a calendar that shows the events we attend, as well as other events happening with us, such as interested party and board meetings.

EDR in the News

Coming Soon to EDR – the Final Major Release!

On January 4, 2016, we will implement Release 3.2, our final major Release of the EDR Project. In this Release, we are very excited to launch the enhanced MyFTB, which will improve the way individual taxpayers, business entities, and tax preparers conduct their online business with us. We will provide more information about the enhanced MyFTB in a future Tax News article. There are also enhanced MyFTB FAQs on our website.

This Release will also bring even more functionality to the Taxpayer Folder (TPF), Case Management, Personal Income Tax (PIT) and Business Entity (BE) Return Analysis (RA).

By the end of September, as part of EDR’s Crawl, Walk, Run approach, we will process additional PIT tax return types and payments through the new RA. We will also
incorporate the [Earned Income Tax Credit](#) in PIT RA. At the end of this year we will begin to process BE tax returns through RA, which will allow us to validate BE tax returns and payments in real-time.

This Release also expands our Notification process by generating several notices, including the Notice of Tax Return Change and Notice of State Income Tax Due, from our Enterprise Noticing Service. The Notification improvements will also generate additional outbound correspondence from the TPF, and email notifications to Power of Attorney representatives, if registered on MyFTB with an email address, informing the POA representatives that their client received a notice.

As always, these changes will improve our customer service while expanding and simplifying your self-service options.

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**All About Business**

**S Corporations or Limited Liability Companies (LLCs)?**

Back in 2013, we did a three-part series of articles ([June](#), [July](#), and [August](#)) on the differences between S corporations and LLCs. We provided a chart showing some of the different forms each of the entities would file. We also discussed the effects on taxation as they can both qualify for pass-through treatment.

We continue to hear the same question, “What are the differences between S corporations and LLCs?” Since it’s been a couple of years, we thought it would be a good time to share the information once again.

An LLC is a legal business entity formed under state corporate law. In contrast, the term "S corporation" refers to the tax treatment accorded to an entity that is classified as a corporation for federal and state income tax purposes. The term does not refer to a particular form of entity under state corporate law. S corporation status comes about by filing an election with the Internal Revenue Service. The S election is made when the federal [Form 2553](#), Election by a Small Business Corporation, is filed and processed by the IRS. Therefore, a business entity that is an S corporation for federal income tax purposes is also an S corporation for California income and franchise tax purposes, and the entity cannot make a separate election for California purposes to be taxable as a C corporation. (Note: some tax rules of Subchapter C still apply to an entity taxable as an S corporation.)

The existing or newly created business entity that elects to be an S corporation for income tax purposes is most commonly incorporated as a corporation under state corporate law, e.g., the California Corporations Code, by filing articles of incorporation with the California Secretary of State (SOS). However, an "eligible entity" may also file
an election with the IRS to be classified as an S corporation for federal income tax purposes if it also meets the income tax law requirements for an S corporation, such as restrictions on ownership. An "eligible entity" is defined by the federal entity tax classification regulations as a business entity that is not incorporated under state law or otherwise treated by the regulations as a per se corporation. Examples of "eligible entities" are a state law general partnership, limited partnership, or LLC. The reason these non-incorporated entities can elect to be taxed as an S corporation is that an "eligible entity" may elect under the federal regulations to be classified either: (1) as a partnership (if it has more than one owner) or disregarded as separate from the owner (if it has a single owner); or, (2) as a corporation. If an eligible entity elects to be classified as a corporation for income tax purposes, it can then elect to be taxable as an S corporation, or it will by default be taxable as a C corporation. (Note: a sole proprietorship under state law is not a separate entity from its owner, and, therefore, cannot be classified as a corporation for income tax purposes.)

However, for state corporate law purposes, an eligible entity is treated according to its business form under the California Corporations Code, e.g., as either an (incorporated) corporation, a general or limited partnership, or an LLC, and it will need to continue to meet the requirements of the law relating to those particular state corporate law business forms. So, while an entity classification election affects the income taxation of the business entity, it does not change the business entity's legal form. For example, while both a state law corporation and an LLC may be classified for income tax purposes as a corporation, corporations formed under the California General Corporations Law are required to hold annual meetings, and maintain corporate minutes; LLCs are not. Such corporations are also required to file a Statement of Information with the SOS every year, while LLCs are required to file the Statement of Information biannually (every two years) with the SOS. Classification as a corporation does not change these requirements. Similarly, whether an entity is taxable as an S corporation or as a C corporation will not affect the state corporate law requirements, which are the same for both.

(Note: The owners of an eligible entity that is taxable as an S corporation are generally referred to as "shareholders" for income tax purposes, even though they do not own "stock" under state corporate law.)

A taxpayer who has a valid federal S corporation election must file in California as an S corporation using our Form 100S, California S Corporation Franchise or Income Tax Return.
This chart shows some of the differences between an S corporation and an LLC for California franchise and income tax purposes:

<table>
<thead>
<tr>
<th></th>
<th>LLC</th>
<th>S Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax forms</td>
<td>568</td>
<td>100S</td>
</tr>
<tr>
<td>Business entity tax</td>
<td>Yes</td>
<td>Yes, franchise or income tax measured by or on net income at the rate of 1.5% on general S corporations and 3.5% on financial corporations. However, corporations incorporated as such under state law and LLCs classified as corporations for income purposes are subject to the minimum franchise tax of $800, except for their first taxable year. An S corporation is also subject to tax on built-in gains and tax on excess net passive investment income at the regular corporate rates, e.g., 8.84% for nonfinancial corporations, if the S corporation entity was previously taxable as a C corporation.</td>
</tr>
<tr>
<td>and fee</td>
<td>Annual *tax $800 (due and payable on or before the 15th day of the 4th month of the taxable year) LLC fee of: $0, $900, $2,500, $6,000, or $11,790 based on total income from all sources derived from or attributable to CA (gross income plus cost of goods sold)</td>
<td>FTB 3536, Estimated Fee for LLCs Estimated LLC fee is due and payable on or before the 15th day of the 6th month of the current taxable year. Any additional fee amount is payable by the original due date of the LLC return. FTB 3522, LLC Tax Voucher Annual LLC Tax is due and payable by the 15th day of the 4th month after the beginning of the LLC’s taxable year.</td>
</tr>
<tr>
<td>Estimated fee or tax</td>
<td>Estimated tax of S corporation is due on the 15th day of 4th, 6th, 9th, and 12th month of its taxable year. For S corporations subject to franchise tax, the first estimated tax payment may not be less than $800 minimum franchise</td>
<td></td>
</tr>
<tr>
<td>form</td>
<td>Form 100-ES, Corporation Estimated Tax</td>
<td>FTB 3522, LLC Tax Voucher Annual LLC Tax is due and payable by the 15th day of the 4th month after the beginning of the LLC’s taxable year.</td>
</tr>
<tr>
<td>Tax return date due</td>
<td>The LLC tax return (Form 568) is due on or before the 15th day of 4th month following the close of its taxable year.</td>
<td>The S corporation tax return (Form 100S) is due on the 15th day of the 3rd month after close of its tax year (e.g., March 15 if the S corporation's taxable year is the calendar year.)</td>
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<tr>
<td>Extension form</td>
<td>The LLC Extension form is FTB 3537 (LLC) Payment for Automatic Extension for LLCs</td>
<td>FTB 3539, Payment for Automatic Extension for Corporations or Exempt Organizations, or FTB 3586, Payment Voucher for Corporations and Exempt Organizations (e-filed) Returns</td>
</tr>
<tr>
<td>First year annual tax/minimum franchise tax exception</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Business entity estimated payments</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Estimated due dates</td>
<td>Estimated LLC fee (on or before the 15th day of the 6th month of the current taxable year)</td>
<td>Estimated tax is due on the 15th day of 4th, 6th, 9th, and 12th month of the S corporation's taxable year. (See instructions for Form 100-ES for amounts required for each installment payment of estimated tax.)</td>
</tr>
</tbody>
</table>
Form to report owner's share of entity's income | Schedule K-1 (568), Member’s Share of Income, Deductions, Credits, etc. | Schedule K-1 (100S), Shareholder’s Share of Income, Deductions, Credits, etc.
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Late filing penalty based on partners/shareholders | Single member LLC – No | Yes
Multiple member LLC - Yes

When it comes to the effects of taxation there are several significant state and federal differences.

Under the Corporations Code, LLCs are neither partnerships nor corporations, but they generally provide limited liability to their owners for obligations of the business. An LLC with one owner (single member LLC or SMLLC), by default, is disregarded (i.e., treated as not separate from its owner) for federal and California income tax purposes. Thus, if the single member is an individual, the disregarded SMLLC is treated as a sole proprietorship. If the single member is a corporation, the disregarded SMLLC is treated as a division or branch of the corporation. The SMLLC doing business in California is required to file a tax return and is subject to California’s annual tax and fee. In addition, California limits the amount of any credit or credit carry forward attributable to a disregarded business entity to the amount of tax being reported by its owner attributable to the entity.

LLCs with two or more owners under the federal default rules are treated as partnerships, unless an election is made to be treated as a corporation. Therefore, an LLC with two or more members is generally treated as a pass-through entity. For federal income tax purposes, the LLC is not subject to tax at the entity level. However, an LLC classified as a partnership for California purposes doing business in California is required to file a tax return and is subject to California's annual tax and fee. Since an LLC with two or more members is treated as a partnership, an out of state LLC that is not doing business, but has California sourced income is required to file a partnership tax return. A multiple member LLC follows the federal partner and partnerships rules, Subchapter K (IRC Sections 701-777). This gives the LLC a significant amount of flexibility to vary their respective shares of partnership income. Unlike an S corporation, a partnership may allocate items of income, gain, loss, deduction, and credit among the members/partners, provided the allocations have substantial economic effect. In general, an allocation is permitted to the extent the member/partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation, and the allocation substantially affects the dollar amounts to be received by the members/partners from the partnership, independent of tax consequences.

An S corporation also provides the federal income tax advantage of pass-through treatment, unlike a C corporation. Thus, an S corporation and its shareholders are generally treated more like a partnership and its partners than like a C corporation and its shareholders. But an S corporation can only have one class of stock/ownership
interest and does not offer the same flexibility as a partnership to allocate income and losses among investors. Each shareholder is allocated his or her pro rata share of S corporation taxable income. California law provides for modified conformity to federal provisions relating to the tax treatment of S corporations and their shareholders. For federal income tax purposes, an S corporation is not subject to income tax. However, an S corporation is subject to California’s income/franchise tax, but at a reduced rate (1.5 percent for general business S corporations or 3.5 percent for S corporations that are financial corporations).

Both partnerships and S corporations that conduct business both within and outside of California are required to determine California sourced income using apportionment rules. Unlike a C corporation, an S corporation may not be included in a combined report. California like federal does allow for qualified subchapter S subsidiaries (QSubs), with certain exceptions. See Form 100S, S Corporation Tax Booklet, General Information DD, Qualified Subchapter S Subsidiary (QSub), for more information.

A change in the number of owners of an LLC that is classified as a partnership or disregarded can affect the LLC’s taxable year and the requirements for filing tax returns and paying taxes and fees. For more information, see past articles, LLC Federal Tax Classification Change from Multiple-Member Partnership to Disregarded Single-Member and LLC Federal Tax Classification Change from Disregarded Single-Member to Multiple-Member Partnership. On the other hand, a change in the number of shareholders of an S corporation will not generally affect the S corporation's taxable year or entity-level taxes except with respect to certain circumstances where the income tax law relating to S corporations allows the shareholders to elect to terminate the taxable year of the S corporation. Of course, in any transaction, a business entity must continue to meet the requirements for S corporation tax status or the S election will automatically terminate and the entity will become taxable as a C corporation.