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California's Affordable Care Act subsidies and California taxes

More taxpayers may be subject to the individual shared responsibility penalty for the 2026 tax year.

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

While much of the current political news is focused on the repeal of some of the Affordable Care Act's (ACA) federal health insurance subsidies (a.k.a. Advance Premium Tax Credits), it's important for California tax practitioners to understand the interplay between the federal and state health care mandates.

Unlike federal law, unless an exemption applies California still imposes a monthly individual shared responsibility penalty against California taxpayers who fail to maintain continuous health care coverage throughout the tax year. (R&TC §61010) Should Congress fail to extend the enhanced ACA subsidies that were enacted by the American Rescue Plan Act (ARPA), economists are predicting that many taxpayers will simply choose to forego obtaining health insurance coverage, which will likely subject them to California's individual shared responsibility penalty.

In addition, if the ARPA enhanced subsidies are not extended, California will provide subsidies for certain taxpayers who are below specified income tax levels, although not at the level it did in the past.

Penalty amount

Unless exempt, taxpayers in California without continuous health care coverage are subject to a monthly individual shared responsibility penalty for the 2025 tax year equal to the lesser of:

- The sum of the monthly penalty amounts (discussed below) for the year; or
- The monthly statewide average premium for Covered California bronze plans (\$644 for 2025) multiplied by the number of months for which the failure occurred. (R&TC §61015)

The monthly penalty amount is equal to 1/12 of the greater of:

- A flat dollar amount equal to \$900 per person (\$450 for dependents) for the 2025 tax year up to 300% maximum (\$2,700). These figures are subject to annual inflation adjustments (the 2026 amounts are not currently available); or
- 2.5% of household income in excess of the state gross income filing threshold.

Example of penalty calculation: The Smith family of three (two spouses with one minor dependent) has household income of \$120,000 for the 2025 tax year and elects to forego health insurance coverage for the last six months of the year when the wife lost her job and her family's health care coverage. The gross income filing threshold for MFJ with one dependent is equal to \$73,595.

When they file their 2025 tax return, the Smiths must report an individual shared responsibility penalty equal to \$1,128.

The monthly amount is the **greater** of:

- **\$188 (\$2,250 [\$1,800 for taxpayer and spouse plus \$450 for dependent] ÷ 12); or**
- \$97 $([\$120,000 - \$73,595] \times 2.5\%) \div 12$.

The penalty amount is equal to the **lesser** of:

- **\$1,128 (\$188 × 6); or**
- \$3,864 $(\$644 \times 6)$.

A penalty estimator is available on the FTB's website at:

[www.ftb.ca.gov/file/personal/filing-situations/
healthcare/estimator](http://www.ftb.ca.gov/file/personal/filing-situations/healthcare/estimator)

The penalty must be reported on, and paid with, the responsible individual's tax return for the year that includes the month(s) of no coverage. (R&TC §61010)

Exemptions

The following individuals are exempt from California's health care coverage mandate:

- Individuals with income below the filing threshold (R&TC §61020(b) and (c));
- Individuals for whom coverage is unaffordable. An individual is entitled to an exemption for themselves or another member of their tax household for any month when the lowest cost coverage is unaffordable through an employer-sponsored plan or

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Covered California (lowest cost bronze plan). Generally, coverage is unaffordable if an individual's required contribution exceeds 7.28% for 2025 (8.05% for 2026) of the applicant's projected annual household income for the taxable year (R&TC §61020(a); 10 Cal. Code Regs. §6914(d));

- Individuals who have received a certificate of exemption from Covered California for hardship (e.g., bankruptcy, death in family, domestic violence, substantial medical expenses, etc.) or religious conscience (Gov't. Code §100705);
- A member of a health care sharing ministry (as defined by IRC §5000A(d)(2)(B));
- Incarcerated individuals (other than those awaiting trial);
- Non-U.S. citizens or nationals who are not lawfully present in the U.S.;
- Members of an Indian tribe;
- U.S. citizens who have a tax home outside the U.S.;
- Bona fide residents of another state or U.S. possession; and
- Individuals enrolled in limited or restricted scope coverage under the Medi-Cal program or similar state program.

An exemption is available for the whole month if the applicant qualifies for an exemption for at least one day of the month. (10 Cal. Code Regs. §6914)

Additional information

Additional information about exemptions and how to apply for them is available on the Covered California website at:

www.coveredca.com/learning-center/tax-penalty-details-and-exemptions/exemptions/

Subsidies

If the ARPA's enhanced subsidies are not extended, taxpayers above the 400% federal poverty level (FPL) will no longer be eligible to receive ACA subsidies from the federal government, and those at or below 400% FPL will likely receive decreased subsidies.

Prior to the passage of the ARPA's increased subsidy amounts, California offered advance subsidies to taxpayers with household incomes of 600% or less of the federal poverty level who purchased health care through Covered California.

Absent federal legislation that extends the ARPA subsidies, California will again offer advance subsidies beginning with the 2026 tax year, but eligibility will be limited to taxpayers with household income above 150% and below 166% of the federal poverty line. For these taxpayers, premiums would be capped between 3.19% and 3.91% of household income. (California Health Benefit Exchange, 2026 California Premium Subsidy Program Design)



Top 10 “must-knows” for filing 2025 Form 540

Stay on top of these California adjustments and filing tips, and tax season will be a day at the beach.

By Sandy Weiner, J.D.
California Editor

With filing season right around the corner, tax professionals need to stay on top of the biggest adjustments and filing tips that they will need to correctly file their client's Form 540. Between OBBBA, SB 711 (California's big conformity bill), and the Los Angeles wildfires,

there is a lot to stay on top of. That's why we've compiled this top 10 list of 2025 Form 540 must-knows for tax professionals.

Wildfire disaster returns

Los Angeles wildfire disasters must be noted on the 2025 tax return by following tax software disaster prompts or writing "L.A. County wildfires" on top of the return in order to avoid estimated tax underpayment penalty notices. Although the 2025 first through third quarter estimated tax payments were all postponed until October 15, 2025, underpayment penalty notices will automatically be sent if the disaster is not indicated on the 2025 return. (And yes, we know that they may still be sent out to some taxpayers incorrectly, but this will minimize the chances.)

Alimony

Alimony payments are still deductible on the 2025 return and reportable by payees. California's conformity to federal treatment of alimony deductions only applies to divorce or separation agreements entered into after 2025. (R&TC §§17091, 17201.3, 17302, 17737)

Wildfire settlement exclusions

California's wildfire settlement exclusion amounts may differ from the wildfire disaster relief payment exclusion allowed on the federal return. The California exclusion applies to both business and individual losses, whereas the federal exclusion only applies to individual losses. In addition, the federal exclusion does not apply if the losses, expenses, or damages were otherwise covered, such as through insurance. The California exclusion does not provide a similar limitation. (Federal Disaster Tax Relief Act of 2023 (P.L. 118-148) §3; R&TC §§17138.7, 24309.2)

Business interest expense limitation

Personal income taxpayers and partnerships that are subject to the business interest expense limitation on their federal return should consider extending their 2025 California return.

Due to a drafting error, California inadvertently conformed to IRC §163(j) for personal income taxpayers, but not corporate taxpayers. (R&TC §§17024.5, 17201, 24344(e), 24471.5) The author of SB 711 will introduce legislation at the beginning of 2026 that would retroactively decouple from the limitation back to the beginning of the 2025 tax year for personal income taxpayers. However, until this legislation is enacted, personal income taxpayers will be subject to the limitation.

Retired uniformed service members

Certain retired uniformed service members qualify for a new California gross income exclusion of up to \$20,000 for retirement pay from the uniformed services if their federal AGI does not exceed \$125,000, or \$250,000 for MFJ and surviving spouse filers. (R&TC §17132.9) This applies to retired members of the Army, Navy, Air Force, Marine Corps, Space Force, and Coast Guard as well as the National Guard, commissioned corps of the U.S. Public Health Services, and The National Oceanic and Atmospheric Administration (NOAA) Commissioned Officer Corps.

A similar exclusion also applies to annuity payments received by California taxpayers from a U.S. Department of Defense Survivor Benefit Plan. No similar exclusion is available on the federal return.

Personal casualty losses

Personal casualty losses can be claimed on a California return by non-disaster victims, but only if the taxpayers itemize their deductions. They are also subject to the 10% AGI limit

and \$100 per casualty thresholds. (R&TC §17024(e), 17207.14) On the federal return, only victims of Presidentially declared disasters can claim personal casualty losses, and those with qualified disaster losses can claim the loss even if they don't itemize and are not subject to the 10% AGI limit. However, they are subject to a \$500 per casualty limitation. (Uncodified §2, Federal Disaster Tax Relief Act)

§529 withdrawals

§529 account withdrawals that are used to pay for a child's K-12 tuition or related expenses or for post-secondary credential programs will continue to be included in gross income on the California return and are subject to the 2.5% early withdrawal penalty even though these amounts are excluded from gross income on the federal return. (R&TC §§17024.5, 17140, 17140.3)

Home mortgage interest deduction

California continues to allow a personal interest deduction for interest paid on up to \$1 million in acquisition debt and \$100,000 of home equity debt (even if the equity debt is not used to improve the home), whereas federal law limits the deduction to \$750,000 for mortgages incurred after December 15, 2017, and no deduction is allowed for interest paid on equity debt. (IRC §163(h)(3)(F), R&TC §17225(b))

Charitable contributions

The charitable contribution deduction cap remains 50% on the California return and 60% on the federal return. (IRC §170; R&TC §17250.1(b))

TCJA nonconformity

California continues to not conform to most of the TCJA business provisions, including 100% bonus depreciation, increased IRC §179 expenses, amortization of research expenses for foreign research, the increased business meal expense deduction limitations, the increased deduction amounts for luxury autos, the elimination of 2% miscellaneous itemized deductions, and the SALT limitation (although state income taxes are not included in the SALT deduction for California's itemized deductions). (R&TC §§1024.5, 17052.12, 17201, 17201.1, 17250, 17255, 17564(h), 23051.5, 24349, 24349.1, 24356, 24356.1, 24365, 24430, 24440)



CalSavers: household employers, employee owners, and more

See which employers must register and what to do if an exempt employer receives notices from CalSavers.

By Sandy Weiner, J.D.
California Editor

By the end of 2025, all businesses that do not offer a qualified retirement program to their employees are required to register with CalSavers if the business has at least one California employee who is 18 years of age or older. This includes part-time and seasonal employees. (Gov't. Code §100000 et seq.; 10 Cal. Code Regs. §10000 et seq.) Once registered, the business must facilitate employee contributions to the CalSavers retirement program unless the employee opts out within 30 days of being contacted by the program.

The penalties for noncompliance can be severe: up to \$250 per employee initially, increasing to \$500 per employee annually after 90 days of noncompliance. For details on the penalties, see “CalSavers reminder: Small employers must register by end of 2025” in the October 2025 issue of *Spidell's California Taxletter*®.

With the expanded mandate, we're receiving lots of questions regarding who is and isn't required to register and how to claim an exemption if an employer was erroneously contacted by CalSavers.

Household employers

The number one question we've been getting is whether household employers must register with CalSavers. Many tax professionals are questioning whether the mandate applies to household employers because an eligible employer for CalSavers is defined in the code as “a person or entity engaged in a business, industry, profession, trade, or other enterprise in the state, whether for profit or not for profit ... that has at least one eligible employee.” (Gov't. Code §100000)

According to CalSavers, household employers are considered mandated employers and must facilitate contributions for any wage-earning employees who do not opt out during the 30-day period to do so.

Household employees are counted as “employees” if they are California W-2 employees, even if the employer files a DE 38HW, Employer of Household Worker(s) Quarterly Report of Wages and Withholdings, rather than a DE 9C, Quarterly Contribution Return and Report of Wages (Continuation). All household employers reported to CalSavers by the EDD are subject to the mandate.

Practice Pointer

CalSavers has stated that if a household employer does not receive a notice informing them that they have to register, they do not need to take any compliance action.

Business owner is the only employee

If the business owner and their spouse are the only employees of the business, the business is exempt from the CalSavers mandate. This applies to S corporations whose only employee is the shareholder owner and/or their spouse.

These businesses should not receive notices from CalSavers directing them to register for the program. However, we've heard that some such businesses have received these notices. According to CalSavers, these entities should go onto the CalSavers website, register with the program, and certify their exemption by checking the following boxes on the registration form:

- “My company does not offer a qualified retirement plan”; and then
- “My company currently has no California-based employees or no employees other than the owners.” Then select the most applicable reason from there.

The box “My company does not offer a qualified retirement plan” must be checked in order for the second box to appear that deals with “no employees other than the owners.”

New businesses

Businesses created in 2025 generally have until December 31 after the year in which they hire their first California employee (and that employee is reported to CalSavers by the EDD) to register for the program.

Closed businesses

If a business receives a notice after it has closed, contact CalSavers to ensure that no penalties are erroneously imposed:

(855) 650-6916

Payroll assistance

CalSavers has partnered with a third-party vendor (Payroll Integrations) to offer automated payroll integration services for CalSavers employers. Employers can sign up for payroll integration services through their employer portal on the CalSavers website and, for a small fee, effectively automate the majority of their responsibilities to run CalSavers via payroll integration.

More information can be found at:

<https://employer.calsavers.com/home/employers/payroll-providers.html>



2026 meal and lodging values

Non-Maritime Employees: The value of meals is:		
	2025	2026
Breakfast	\$3.15	\$3.25
Lunch	\$4.75	\$4.90
Dinner	\$7.50	\$7.70
Unidentified meal	\$5.50	\$5.70
Three meals per day	\$15.40	\$15.85
Lodging value is set at 66 2/3% of the ordinary rental value to the public		
	2025	2026
Monthly maximum	\$1,946.00	\$2,038.00
Weekly maximum	\$63.15	\$66.10
Maritime employees: The value of meals and lodging is:		
	2025	2026
Licensed personnel:		
Meals	\$15.40	\$15.85
Lodging	\$13.15	\$13.75
Total per day	\$28.55	\$29.60
Unlicensed personnel:		
Meals	\$15.40	\$15.85
Lodging	\$8.95	\$9.35
Total per day	\$24.35	\$25.20
Fishermen:		
Lodging — weekly	\$63.15	\$66.10
Lodging — daily	\$8.95	\$9.35



Los Angeles' Mansion Tax upheld in court for third time

An appeals court affirms that California voters retain the power to enact special real property transaction taxes through a local initiative.

By Kathryn Zdan, EA
Contributing Editor

In another failed attempt to strike down Los Angeles' Measure ULA, a.k.a. the "Mansion Tax," the California Court of Appeal for the Second District dismissed a challenge to the measure. (*Howard Jarvis Taxpayers Association, et al. v. City of Los Angeles, et al.* (December 15, 2025) Cal.App.2d, Case No. B334071) The decision affirms that California voters have the power to enact special real property transaction taxes through local initiative, despite constitutional restrictions on local governments imposing these taxes.

The main issue in the case was whether the people revoked this power when they adopted section 450(a) of the Los Angeles City Charter. The Howard Jarvis Taxpayers Association argued that Measure ULA is invalid because it conflicts with section 450(a), which provides, in part, that:

*"[a]ny proposed ordinance **which the Council itself might adopt** may be submitted to the Council by a petition filed with the City Clerk, requesting that the ordinance be adopted by the Council or be submitted to a vote of the electors of the City [emphasis added]."*

Charter cities may impose general transaction taxes, but under the California Constitution, they are prohibited from imposing real property special transaction taxes such as Measure ULA. (Cal. Const. art. XIII A, §4) Relying on the bold language in section 450(a) above, the Howard Jarvis Taxpayers Association argued that because the City Council itself could not have enacted Measure ULA, voters cannot enact Measure ULA either.

The court concluded that the passage of Measure ULA pursuant to a majority vote was a valid exercise of the people's initiative power. The California Constitution grants the people the power to enact special real property transaction taxes by local initiative. (Cal. Const., art. II, §§1, 11; art. IV, §1)

The court noted that while the California Constitution restricts a local government's ability to impose a special transaction tax (Cal. Const. art. XIII A, §4), it does not limit the ability of voters to do so via initiative.

The court rejected the Howard Jarvis Taxpayers Association's argument that section 450(a) revokes voters' reserved initiative power with respect to special transaction taxes. The court found that the language of section 450(a) does not clearly and unambiguously revoke the people's initiative power on any municipal topic, including special transaction taxes. Nor does the language refer to a transaction tax, §4 of the California Constitution, or any limitation on the people's initiative power. The court concluded that to accept Howard Jarvis' interpretation of section 450(a) would be to effectively hold that the initiative was repealed by implication, which violates the "clear statement" rule.

Measure ULA

In November 2022, voters in Los Angeles approved Measure ULA, which imposes the Homelessness and Housing Solutions Tax on transfers of real property valued at more than \$5 million.

The tax is:

- 4% of the full consideration paid or value of the property transferred when the consideration or property value exceeds \$5 million but is less than \$10 million; and
- 5.5% if the consideration or value exceeds \$10 million.

Note: It is important to note that it's not just the incremental value over the \$5 million or \$10 million threshold that is subject to the tax.

The \$5 million and \$10 million thresholds are adjusted for inflation (\$5.3 million and \$10.6 million in 2025). (See <https://bit.ly/4jd7GfE>.)

The revenue from the Homelessness and Housing Solutions Tax is allocated to various housing and homelessness-related programs administered by the Los Angeles Housing Department.

Tax cap on the ballot?

The Howard Jarvis Taxpayers Association is currently gathering signatures to put a measure on the November 2026 ballot that would put a cap on real estate transfer taxes and would raise the electoral support needed to pass "special" tax measures to two-thirds, from a simple majority of more than 50%. Measure ULA passed with 58% support.



Initiative battles begin around the "wealth tax"

A billionaire/wealth tax initiative has been proposed as well as several other "counter" initiatives.

By Sandy Weiner, J.D.
California Editor

The November 2026 election will not only be an important election in terms of who will control Congress, but it is also shaping up to be a critical election in terms of California tax initiatives that may find their way on to the ballot.

The proposed initiatives discussed below have all been submitted to the California attorney general's office for review. If and when approved, the initiative proponents would then have 180 days to gather signatures to qualify their initiative for the November 2026 ballot. Because all of these initiatives propose to amend the California constitution, proponents must obtain over 870,000 signatures to have the initiatives placed on the ballot.

It's important to remember that proposed initiatives are frequently used as chess pawns to either get the Legislature to act on a specific issue or to pressure opponents to remove proposed initiatives from the ballot. It is still early in the process, so we will have to wait to see which, if any, of these initiatives might actually appear on next November's ballot. However, tax professionals may want to be familiar with these initiatives to be able to answer any questions that may arise from clients.

The Billionaire Tax Act

The Billionaire Tax Act initiative (AG Tracking No. 25-0024A1), if approved, would impose a one-time 5% excise tax on the worldwide net worth of California residents with net worth in excess of \$1 billion.

It is estimated that the tax would impact between 200 and 300 taxpayers in California as of January 1, 2026. The tax would be due in 2027, but taxpayers subject to the tax could elect to spread the payment over five years at an additional cost.

The tax would apply to the taxpayer's tangible and intangible property, including stocks, other business ownerships, bonds, and collectibles. Only certain personal debt liabilities

could be factored into the net worth calculation. Real estate and certain pensions and retirement accounts would be excluded from the tax base as would personal property located outside California for more than 270 days in 2026.

The primary proponent of the initiative, the Service Employees International Union, claims that this one-time tax would raise revenues to help cover a projected \$100 billion deficit in health care spending as a result of changes made by the One, Big Beautiful Bill Act (P.L. 119-21). Ninety percent of the revenue raised from the tax would be dedicated to the state's increased health care costs resulting from the federal government's cuts to Medicaid and other health care programs. The remaining 10% would be dedicated to cover administrative costs, education, and food assistance programs.

The Legislative Analyst's Office estimates that the tax would likely bring in tens of billions of dollars spread over several years but also states that there would likely be an ongoing decrease in hundreds of millions of dollars or more per year as a result of billionaires leaving the state.

Counter initiatives

It's important to note that several proposed initiatives have been submitted to the California Attorney General's Office to counter the Billionaire Tax initiative. These include:

- The Budget Stability Act of 2026 (AG Tracking No. 25-0037) would raise the voter approval threshold to a two-thirds supermajority vote for passage of any statewide initiative that creates a one-time tax, such as the proposed Billionaire Tax.
- The California Residency Rules Act (AG Tracking No. 25-0039) would establish new bright-line residency rules for income and asset taxation, and unemployment insurance and Medical eligibility, providing that individuals spending 183 or fewer days of the year in California and holding a valid driver's license and voter registration in another state are not California residents. If enacted, this rule could reduce the number of taxpayers subject to both the proposed wealth tax and state income tax.
- The Protect Schools and Taxpayers Act of 2026 (PSTA; AG Tracking No. 25-0038) would bar any new state tax from being exempt from Proposition 98 (the constitutional funding guarantee for public schools and community colleges) and Proposition 4 (a.k.a. the Gann state spending limit). The Billionaire Tax expressly exempts itself from Proposition 98 and Proposition 4; therefore, if the PSTA initiative passes, it would nullify the Billionaire Tax.
- The California Government Efficiency Improvement Act of 2026 (CGEIA; AG Tracking No. 250040) would prohibit any new special tax, defined as a tax earmarked for specific purposes, unless the new tax requires the recipient government entity to eliminate its lowest-performing programs and reinvest in higher-performing ones. The Billionaire Tax does not include such programmatic requirements and therefore would be nullified if the CGEIA initiative is passed.
- The Retirement and Personal Savings Protection Act of 2026 (RPSPA; AG Tracking No. 25-0041) would prohibit any new state tax on the ownership or accumulation of retirement assets and other personal savings, individually owned assets, including tangible and intangible personal property, business interests, etc., directly opposing the Billionaire Tax proposed tax base.



New reporting requirement for motion picture payroll services companies

The EDD releases form details for reporting payments made to a loan-out company.

By **Sandy Weiner, J.D., and Kathryn Zdan, E.A.**
Contributing Editors

Starting January 1, 2026, all motion picture payroll services companies must file Form DE 422, Report of Payments to Loan-Out Company, each quarter with the EDD.

This new reporting requirement is a result of SB 422 (Ch. 24-1011), which clarifies the responsibilities of loan-out companies and motion picture payroll services companies for the purposes of remitting unemployment insurance taxes and related obligations, including income tax withholding.

Form DE 422 is not currently available but will be available soon. The form can be filed through the EDD's e-Services for Business or by mail.

Reporting details

Under SB 422, the information that must be reported to the EDD includes:

- The total amount of payments made to the loan-out company;
- The loan-out company's:
 - Business name, address, and telephone number;
 - Federal employer identification number (FEIN), California employer account number, or other identifying number;
- The full name, address, and Social Security number of any individual whose services were provided through the loan-out company;
- The motion picture payroll services company's:
 - Name, address, and FEIN, California employer account number, or other identifying number;
 - Principal officer or member providing the service and their Social Security number; and
- Any other information as the director of the EDD requires.
(UIC §1088.9)

The information in the report will be shared with the FTB.

Penalties

Failure to comply with the reporting requirements will subject the payroll company to a fine of \$24 for each failure (\$490 for willful or fraudulent failures), unless the failure is for good cause. Good cause includes a loan-out company's refusal to provide the requested information or provision of incorrect or incomplete information to the payroll company.

SB 422

Under SB 422, the loan-out company, solely for the purpose of remitting employment taxes, is deemed to be the employer of the employee-owners or members who are engaged by the loan-out company to provide services to a motion picture production company or an allied motion picture services company. (UIC §679) The legislation states that the changes made by SB 422 regarding who is responsible for remitting the employment taxes "is declaratory of, and not a change in, existing law." (Uncodified §1, SB 422 (Ch. 24-1011))

SB 422 does not alter or modify any other laws with regard to loan-out companies or their employees, meaning that the motion picture company would likely still be treated as the employer for the purposes of wage and hour laws, etc.

Loan-out companies

For purposes of SB 422, a loan-out company is a corporation or LLC classified as a corporation whose:

- Principal activity of which is the performance of personal services for a motion picture production company or allied motion picture services company; and
 - Services provided are substantially performed by an employee of the corporation who owns, on any day during the taxable year, more than 10% of the outstanding stock of the corporation.
- (UIC §679(f))

Motion picture payroll services companies

A motion picture payroll services company is a business that directly or through its affiliated entities meets all the following criteria:

- Provides the services of motion picture production workers to a motion picture production company or to an allied motion picture services company or makes payments to a loan-out company as directed by a motion picture production company or an allied motion picture services company;
- Is a signatory to a collective bargaining agreement for one or more of its clients;
- Controls the payment of wages to the motion picture production workers and pays those wages from its own account or accounts;
- Is contractually obligated to pay wages to the motion picture production workers without regard to payment or reimbursement by the motion picture production company or allied motion picture services company; and
- At least 80% of the wages paid by the motion picture payroll services company each calendar year are paid to workers associated with contracts with motion picture production companies and motion picture payroll services companies.



Repair parts subject to use tax

The storage and use exemption from use tax is narrowly construed.

By Kathryn Zdan, EA
Contributing Editor

A taxpayer that sold medical equipment was held to not be exempt from use tax on repair parts that were incorporated into equipment that it serviced under lump-sum maintenance contracts. (*Olympus America, Inc. v. CDTFA* (September 11, 2025) Superior Ct., County of San Francisco, Case No. CGC-23-607195)

The taxpayer sold medical equipment across the United States, and some customers also purchased a maintenance contract for equipment repairs. Under the contract, the customer would ship the equipment to the taxpayer's service center in San Jose.

The taxpayer argued that the repair of medical equipment in California with ex-tax parts qualified for the use tax exemption for the storage and use of tangible personal property. (Ex-tax property is property that was purchased without paying sales tax because it was intended for resale.) The taxpayer argued that the exemption applied because the ex-tax parts were being "incorporated into" the repaired equipment that is shipped and used outside California. See "Storage and use exclusion" below.

The CDTFA argued that the exemption did not apply because while the equipment (that the ex-tax parts were being incorporated into) was in California for repairs, the parts

incorporated into the equipment were not merely in the state for storage or transit purposes. The equipment was in the state being repaired pursuant to a maintenance contract, which meant the ex-tax parts were consumed by the taxpayer during the repair.

The court found that the CDTFA's reading of the statutes was "better harmonized" with the entire statutory scheme, case law, and legislative history. For example, the court noted that "'The plain meaning of section §6009.1 is clear. There is no taxable use if the property has no function in California other than to move through the state for consumption elsewhere.' But where there is some functional purpose in California, 'other than to serve as a mere object in transit, there is a taxable use.'" (Citing *Parfums-Corday, Inc. v. State Board of Equalization* (1986) 187 Cal. App. 3d 630) The court also noted that the language the taxpayer relied in their argument did not intend to create a broad exemption from use tax for manufacturing.

The court held that the repair parts were consumed in a process that is a productive in-state use, and therefore the exemption did not apply. The court also upheld the negligence penalty.

Storage and use exclusion

The keeping or retention of property for sale in the regular course of business is not a use subject to the use tax. In addition, the keeping or retention of property for purposes of transportation outside California for use solely outside the state is not a use subject to California use tax. (R&TC §§6008, 6009, 6009.1)

This includes the keeping or retention of property for the purpose of being processed, fabricated, or manufactured into, attached to, or incorporated into, other tangible personal property to be transported and used outside California. (R&TC §6009.1)

The regulations clarify that if repair work is performed under a lump-sum maintenance contract, then the repairer is the consumer of the parts and materials. (18 Cal. Code Regs. §§1546(c)(3), 1655(c)(3))



Taxpayers obtain a rare reasonable cause win

Taxpayers were able to prove that they worked diligently to comply within a reasonable time period after their circumstances ended.

By Kathryn Zdan, EA
Contributing Editor

Taxpayers were granted reasonable cause to abate the late-payment penalty following continued medical treatments and a theft that involved their tax documents. (*Appeal of Hazard*, 2025-OTA-629)

During 2020 through mid-2022, the taxpayer-husband underwent extensive medical treatments that caused severe side-effects and increasingly frequent medical appointments. In February 2022, the taxpayer-husband's office was broken into, and his computer and a safe were stolen. The safe contained documentation that the taxpayer-husband (a CPA) had prepared to file the taxpayers' 2021 return.

The taxpayers timely filed their 2021 return after attempting to estimate their tax liability without the stolen documents. The FTB later issued a Notice of Proposed Assessment that included a late-payment penalty of \$2,025 and additional tax due of \$2,027.

The taxpayers filed a claim for refund for the late-payment penalty, arguing that they reasonably estimated the amount of tax owed using what documentation they could access after the theft. The stolen documents had included an analysis of 1,033 credit card entries (business and personal charges) that both taxpayers needed to analyze to determine which ones were business expenses. The taxpayers also lost in the theft K-1s from eight different entities that took several weeks to replace.

The taxpayer-husband credibly testified that after he recovered from his medical treatments, he worked extensively, including nights and weekends, to recreate the stolen documents and prepare the taxpayers' return.

By the April 15, 2022, payment deadline, the taxpayers had estimated they would have no additional tax liability. However, when the taxpayers filed their tax return by the October 15, 2022, extended filing deadline, their 2021 business income was three times higher than 2020, and their AGI was almost double that of 2020.

The OTA held that the taxpayers acted as an ordinary intelligent and prudent business person would have under the circumstances. The OTA found that the taxpayers worked diligently within a reasonable time period after the theft, and the taxpayer-husband recovered from his medical treatments to comply with the tax law.

The FTB argued that because the taxpayers filed a joint return, the taxpayer-wife was responsible for ensuring timely payment. However, the taxpayers provided evidence of the taxpayer-wife's role in her husband's treatments and the fact that both taxpayers needed to participate in making an accurate estimate of income. Therefore, the late-payment penalty was abated due to reasonable cause.

Practice Pointer

It's always better to file timely with your best estimate, even if it ends up being wrong. It's easier to argue for reasonable cause abatement for the late-payment penalty than for the late-filing penalty.

There are different standards for reasonable cause for the late-filing and late-payment penalties. For example, in late-filing penalty abatement cases, the OTA will consider whether the taxpayers could have filed their return with the information they had available to them at the time and later amended the return once final information was obtained.

See "Reasonable cause isn't the same for all penalties" in the August 2022 issue of *Spidell's California Taxletter*®.



Minimum wage increase reminder

Starting January 1, 2026, employers will be mandated to pay a minimum wage of at least \$16.90 per hour, up from the current \$16.50.

Fast food restaurant employers and health care facility employers have a higher minimum wage.

For more information, see:

www.dir.ca.gov/dlse/minimum_wage.htm



FTB refunds overcollected amount to taxpayer

Overcollections can be refunded if the statute of limitations has expired, but this does not apply to overpayments.

By Kathryn Zdan, EA
Contributing Editor

A taxpayer was granted a refund of amounts that had been overcollected by the FTB, despite the statute of limitations having lapsed. (*Appeal of Hibbard*, 2025-OTA-661) Unlike an overpayment, an amount that was overcollected is allowed to be refunded after the statute of limitations has expired.

The taxpayer did not timely file his 2019 return, resulting in the FTB issuing a Notice of Proposed Assessment which, combined with interest and penalties, amounted to almost \$7,000. The tax, penalties, and interest due were collected through Treasury offset payments, amounts transferred from tax year 2022, and additional amounts collected during 2023. The taxpayer filed his 2019 return in October 2024 after these amounts were collected. The FTB accepted the return as a claim for refund but denied the refund due to the four-year and one-year statute of limitations having expired. (R&TC §§18566, 19306)

At appeal, the FTB conceded that \$1,915 had been overcollected and should be refunded to the taxpayer despite the statute having expired. The taxpayer argued that the full amount of the claim for refund should be refunded to him because of extenuating personal circumstances. Unfortunately, there is no reasonable cause exception for suspending the statute of limitations.

The taxpayer further argued that only \$778 was legally owed, and any amount collected above that was technically an "overcollection" that should also be refunded to him. However, because the taxpayer failed to timely file his return, the FTB was legally permitted to estimate his income and propose tax based on that estimation. The taxpayer did not protest the NPA, so the assessment became final.

Only the amounts collected in excess of tax, penalties, and interest assessed by the FTB were treated as an overcollection.

Overcollected versus overpaid tax

Generally, the statute of limitations bars a refund of overpaid amounts when a claim for refund is not filed within the time limit provided by law. However, there is a narrow exception where the statute of limitations provisions do not apply to the return of payments that exceed what the FTB is legally allowed to collect and were the result of "overcollection." (FTB Technical Advice Memorandum 2007-1)

Interest is not allowed on the return from an overcollection of tax because the overcollection is not an overpayment of tax.

Overcollection occurs when the amount collected exceeds the amount actually due under the law as the result of a clerical or mechanical error. Amounts collected that are based on an assessment that was accurate according to the information available to the FTB at the time the assessment was made are not overcollections.

This means that if the taxpayer does not file a return and the FTB uses a method for estimating income that has been upheld by the courts, then the assessment is accurate based on the information available to the FTB at the time. (R&TC §19087(a)) The taxpayer's failure to timely file a return is what bars the FTB from refunding an overpayment.



Spidell's State Tax Directory

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www.spidell.com/spidellweb/public/editorial/cat/state-tax-directory2026.pdf

THUMB TAX

2026 EDD tax rates — For 2026, the Unemployment Insurance (UI) and Employment Training Tax (ETT) taxable wage limit is \$7,000 per employee. The ETT rate will remain at 0.1% (.001).

For current rates, go to:

https://edd.ca.gov/en/payroll_taxes/rates_and_withholding/

EDD discontinuing paper mailing of employer guides — Beginning in January 2026, the EDD will be providing the following employer guides online and will be discontinuing its automatic paper mailing service:

- DE 44, California Employer's Guide; and
- DE 8829, Household Employer's Guide.

However, paper copies can still be requested at:

<https://forms.edd.ca.gov/forms>

The guides can be accessed online at:

https://edd.ca.gov/en/payroll_taxes/Employers_Guides/

Low-Income Housing Tax Credit final regulations adopted — The California Tax Credit Allocation Committee has adopted changes to the Low-Income Housing Tax Credit regulations. The changes relate to definitions, reservations of tax credits, set-asides, eligibility requirements, application requirements, selection criteria, determination of credit amounts, appeals, fees, and compliance. (4 Cal. Code Regs. §§10300–10338)

Details are available at:

www.treasurer.ca.gov/ctcac/programreg/regulations.asp

Santa Barbara allowed to tax streaming services — Santa Barbara's 5.75% tax on video services does not violate the federal Internet Tax Freedom Act (ITFA). (*Disney Platform Distribution, Inc. et al. v. City of Santa Barbara* (December 17, 2025) Cal.App.2d Case No. B342211) The taxpayer claimed discrimination because brick-and-mortar DVD sales (of the exact same movie, for example) aren't taxed under the ordinance.

The ITFA prohibits discriminatory taxes on “electronic commerce,” meaning a tax imposed on electronic commerce that is not generally imposed at the same rate on transactions involving similar property, goods, services, or information accomplished through other means.

The court distinguished DVDs as tangible personal property already subject to 9.25% sales tax, while streaming provides a service. These aren't “similar” under ITFA, and imposing the video tax on DVDs would create double taxation.

No reasonable cause for untimely filing due to CPA's passing — Taxpayers were denied reasonable case abatement of the late-payment penalty after filing their return late following the death of their CPA. (*Appeal of Mekhtarian*, 2025-OTA-643) The taxpayers argued that they had relied on their CPA to prepare and file their return. However, they did not provide evidence that they had taken steps prior to the due date of the return to inquire about the status of their return. Instead, they waited until after the extended filing date had passed, when they were alerted to their CPA's passing by another CPA at the firm. The OTA held that the taxpayers did not exercise ordinary business care and prudence and denied penalty abatement.

Taxpayer proves duplicate 1099-R was a duplicate, not a second distribution — A taxpayer was not held liable for additional tax on what was a duplicate 1099-R showing a distribution of just over \$200,000. (*Appeal of Baumann*, 2025-OTA-644) The taxpayer received a distribution from his Roth IRA; however, two Forms 1099-R were issued: one showing the distribution as taxable, the other showing it as nontaxable. The FTB assessed additional tax due, arguing that the taxpayer had actually received two distributions of identical amounts, citing two different numbers on the documents which the FTB assumed were account numbers.

The taxpayer provided a letter from an employee of the distributor which stated that the company incorrectly coded the original Form 1099-R such that it was reported as a taxable distribution rather than a nontaxable distribution from a Roth IRA, and that an amended Form 1099-R was electronically filed with the IRS. The OTA found it likely that the amended 1099-R was erroneously labeled “original.” The OTA also found no evidence that the “account numbers” were such (rather than transaction numbers) because they didn't match the taxpayer's Roth account. Therefore, the OTA held that there was only a single qualified distribution from the taxpayer's Roth IRA, which was nontaxable.

California does not conform to federal small partnership safe harbor — The per-partner late-filing penalty was upheld against a partnership that failed to timely file its 2019 and 2020 returns but was unable to provide reasonable cause for the failure. (*Appeal of Organic Media*, 2025-OTA-628) The taxpayer argued that the reasonable cause safe harbor for small partnerships should apply.

Revenue Procedure 84-35 allows a domestic partnership consisting of 10 or fewer partners to be considered to have met the reasonable cause test if the partnership establishes that all partners have fully reported their shares of income, deductions, and credits of the partnership on their timely filed individual income tax returns.

However, California does not conform to Revenue Procedure 84-35. (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P) Further, the taxpayer did not substantiate that all its partners fully reported their shares of income, deductions, and credits of the partnership on their timely filed individual income tax returns. Therefore, the per-partner penalties were upheld.

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CDTFA can't use old data to estimate income — The CDTFA was barred from using 1099-K data from outside the audit period to estimate a taxpayer's unreported taxable sales. (*Appeal of Bazar and Hicks*, 2025-OTA-615) The taxpayer was audited in August 2020 but had ceased doing business in March 2020. The taxpayer never provided books and records to the CDTFA for the audit, so the CDTFA obtained 1099-K data for tax years 2014 through 2016 through an information sharing program with the FTB. Using this information, the CDTFA estimated the taxpayer's income and unreported taxable sales.

The CDTFA claimed that they were unable to access any 1099-K data for the taxpayer for years past 2016. When the OTA questioned whether this meant that there was no 1099-K data after 2016, the CDTFA argued that based on screenshots they had taken using the Wayback Machine, the taxpayer was still operating its website after 2016 and therefore it was more likely than not that they were still making sales and receiving credit card payments.

The OTA took issue with the CDTFA's use of credit card data from three years prior to the audit and also placed more weight on the lack of 1099-K information available after that point. The OTA denied the CDTFA's assessment of additional tax based on the use of this method to determine unreported sales.

CALIFORNIA CONTACTS

The Individual Shared Responsibility Penalty Estimator is available on the FTB's website at:	www.ftb.ca.gov/file/personal/filing-situations/healthcare/estimator
Information about health care coverage exemptions and how to apply for them is available at:	www.coveredca.com/learning-center/tax-penalty-details-and-exemptions/exemptions/
If a business receives a notice after it has closed, contact CalSavers to ensure that no penalties are erroneously imposed at:	(855) 650-6916
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Details on Low-Income Housing Tax Credit regulations are available at:	www.treasurer.ca.gov/ctcac/programreg/regulations.asp

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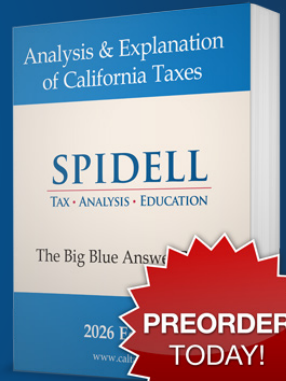
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Final Exam Questions

July 2025 Module

1. **a)** It applies only to veterans who retired after 2026
 b) It is available for AGI up to \$150,000 for all taxpayers
 c) It is limited to combat pay only
 d) It is effective for tax years 2025 through 2029
2. **a)** The transferee must move into the home within two years
 b) The property may be transferred between siblings, and the exclusion will still apply
 c) The child must move into the home within one year of the transfer
 d) There is a two-time limit to the parent-child transfer for purposes of the exclusion
3. **a)** Businesses can receive waivers of penalties for the last six years only
 b) Businesses must already be registered with the city
 c) The program ends in December 2026
 d) It applies only to payroll taxes
4. **a)** The entity must be a foreign corporation
 b) It must be a domestic corporation, and the S parent corporation must own 100% of its stock
 c) It must be owned 51% by the S corporation
 d) It must be a general partnership
5. **a)** The taxpayer's primary residence must have been destroyed or left uninhabitable in a qualifying disaster
 b) The grant must be repaid within 24 months
 c) The maximum grant is \$10,000
 d) Grants are taxable on both federal and California returns

August 2025 Module

6. **a)** The deduction for interest on qualifying passenger vehicle loans
 b) The \$500 per-casualty limit on qualified disaster losses
 c) The reinstatement of current expensing for domestic research expenses
 d) The qualified overtime deduction

7. **a)** It would reduce the elective tax rate from 9.3% to 6.5%
 b) It would eliminate the ability to carry forward unused Passthrough Entity Elective Tax Credits
 c) It would repeal the passthrough entity elective tax for tax years beginning on or after January 1 of the year in which the repeal occurs
 d) It would limit the election to general partnerships only
8. **a)** Wait to file until the K-1 is received, even if it's after the deadline
 b) File using a reasonable estimate of the K-1 income and amend the return later if necessary
 c) Report zero income from the passthrough entity and file a protective statement
 d) Rely on the passthrough entity to request an extension on the taxpayer's behalf
9. **a)** A person may be domiciled in more than one state
 b) Domicile is determined by voter registration and driver's license alone, while residency depends on real property ownership
 c) Residency determines where a taxpayer files federal taxes, while domicile determines where state taxes are owed
 d) A person can have only one domicile, which is based on intent to remain, while residency depends on whether their stay in California is more than temporary or transitory
10. **a)** Within six months of the IRS's final determination date
 b) Within 90 days of the date the taxpayer receives an IRS audit report
 c) Within six months of when the IRS issues a refund or balance due notice
 d) Within one year of a Tax Court decision regarding the federal change

September 2025 Module

11. **a)** Employers will continue paying only 0.6% FUTA tax in 2026, regardless of California's loan balance
- b)** The FUTA increase for 2026 is capped at an additional 0.3% and cannot go higher
- c)** California employers may face up to a 3.7% Benefit Cost Reduction (BCR) add-on beginning January 1, 2026, unless a federal waiver is granted
- d)** The FUTA loan balance is projected to be paid off in 2026, eliminating any future credit reductions
12. **a)** The OTA can strike down and remove invalid regulations from the California Code of Regulations
- b)** The OTA can declare regulations unconstitutional and unenforceable statewide
- c)** The OTA can rule that a regulation is invalid as applied to a particular taxpayer's case, but cannot remove the regulation from the code
- d)** The OTA must always enforce CDTFE and FTB regulations, even if they conflict with statute
13. **a)** When more than 50% of a seller's gross receipts are from food sales and more than 50% of food sales are taxable
- b)** When more than 80% of a seller's gross receipts are from food products and more than 80% of food sales are taxable as hot food, drive-in food, or food consumed on the premises
- c)** When the seller provides any seating, regardless of the percentage of taxable sales
- d)** When the seller sells both hot and cold foods together for a single price
14. **a)** Taxpayers must first claim the federal Research Credit in order to claim the California Research Credit
- b)** California allows the federal Alternative Simplified Credit (ASC) method for research expenses
- c)** The California Research Credit percentage is identical to the federal Research Credit percentage
- d)** California limits qualified research expenses to those conducted in California

15. **a)** An occasional sale occurs when tangible personal property is sold outside the course of business activities that would require a seller's permit
- b)** Any business asset sale automatically qualifies as an occasional sale
- c)** More than five sales in a 12-month period are required before a seller's permit is needed
- d)** Sales under \$400 are always taxable as non-occasional sales

October 2025 Module

16. **a)** Settlements received only if not already covered by insurance
- b)** Only class action settlements for wildfires after 2025
- c)** Settlements from both class actions and individual lawsuits related to any qualified wildfire disaster for tax years 2021 through 2029
- d)** Only settlements declared as federal disasters under the Stafford Act
17. **a)** Use the customer's billing address as the first option
- b)** Assign income to California automatically
- c)** Use reasonable approximation to determine whether receipts are attributable to California
- d)** Defer sourcing until the FTB issues a written determination
18. **a)** The business has at least one California employee age 18 or older and does not offer a qualified retirement plan
- b)** The business is domiciled outside California but pays any California employee
- c)** The business offers a qualified employer plan
- d)** The business has only the owner and spouse as employees
19. **a)** Two years from the date the credit letter is issued
- b)** Four years from the original due date or filing of the return or one year from overpayment, whichever is later
- c)** One year from the date the taxpayer discovers the credit
- d)** Six months from the end of the tax year in which the credit was withheld

20. a) 12% of gross receipts
 b) 17% of gross receipts
 c) 19% of gross receipts
 d) 15% of gross receipts

November 2025 Module

21. a) 60 and older
 b) 65 and older
 c) 70½ and older
 d) 72 and older
22. a) December 31, 2027
 b) December 31, 2029
 c) December 31, 2033
 d) December 31, 2035
23. a) 30 months
 b) 12 months
 c) 24 months
 d) 36 months
24. a) Complete one year of qualifying experience in public accounting
 b) Obtain a bachelor's degree with an accounting concentration and complete two years of qualifying experience
 c) Hold a license from any other state for more than two years
 d) Complete a master's degree in taxation or accounting
25. a) Volunteer tax preparers at nonprofit clinics
 b) Attorneys practicing in California
 c) IRS Enrolled Agents
 d) Out-of-state CPAs practicing in California under mobility laws

December 2025 Module

26. a) Only when California AGI is below \$1 million
 b) When both modified AGI and net business income are less than \$1 million
 c) Whenever federal AGI is below \$1 million
 d) Only if the taxpayer has no passive losses
27. a) When the entity prepares its return using tax preparation software
 b) Only when gross receipts exceed \$1 million
 c) Only when the entity has more than 100 employees
 d) Only if the entity filed its federal return electronically

28. a) The plan must be offered only to employees earning above the SDI wage base
 b) The plan must require employees to pay contributions greater than SDI to ensure solvency
 c) The plan may restrict eligibility to certain job classifications if approved by the employer
 d) The plan cannot cost employees more than SDI and must provide at least one benefit that is better than SDI
29. a) California conforms to the federal ARPA limit of \$10,000 (inflation-adjusted)
 b) \$3,400 adjusted for inflation
 c) \$2,200 as under pre-ARPA law
 d) California applies no investment income limitation
30. a) It determines whether an employer must withhold additional PIT for remote workers
 b) It requires cities to collect state income tax directly from unlicensed businesses
 c) It allows cities and the FTB to exchange data to identify taxpayers who may be missing required city or state business filings
 d) It authorizes the FTB to assess local business license penalties on behalf of participating cities