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Storm-related extension further expanded

A third postponement announcement muddies the waters further for California counties affected by storms.

By Sandy Weiner, J.D.
California Editor

On March 17, 2023, the IRS issued yet another storm-related disaster postponement announcement for California taxpayers.[1] This means we now have three different disaster relief notices for storms in California (CA-2023-01, CA-2023-02, and CA-2023-03). Unfortunately, the notices apply to different counties, have different applicable periods, and postpone different filing and payment deadlines.

The most recent announcement extends the available October 16 postponement deadline (see "Storm-related disaster extensions extended to October 16, 2023" in the March issue of *Spidell's California Taxletter®* for discussion of earlier relief) to cover taxpayers in the following counties not previously included:

- Imperial;
- Kern;
- Plumas; and
- Sierra.

The only counties that are not currently included in the filing/payment October 16 postponement relief (for now) are Lassen, Modoc, and Shasta.

However, for taxpayers in Imperial, Kern, Plumas, and Sierra counties, the relief only applies to deadlines that fall on or after March 9, 2023.

California conforms to this extended relief.

The announcement does provide additional payroll deposit relief for taxpayers listed in the most recent notice. Penalties on payroll and excise tax deposits due on or after March 9, 2023, and before March 24, 2023, will be abated as long as the tax deposits were made by March 24, 2023, for taxpayers in all counties except the following:

- Alameda;
- Colusa;
- Contra Costa;
- Lassen;
- Marin;
- Modoc;
- Riverside;
- San Diego;
- Shasta;
- Siskiyou;
- Solano;
- Sutter;
- Tehama;
- Ventura; and
- Yolo.

The text of the IRS's latest announcement is available at:

https://bit.ly/irs-provides-tax-relief-for-victims-of-severe-winter-storms

Also, see the article "October 16 disaster postponement FAQs" in this issue for answers to common questions that have been raised.

Webinar on disaster extensions

We created a one-hour webinar, "Understanding Extensions for California Storms," that breaks down all of the differences between the available relief provided in the IRS announcements so you will know what to do in your practice. Receive a free client letter when you register for the on-demand version of this webinar at:

https://bit.ly/understanding-extensions-for-california-storms

[1] CA-2023-03, available at: www.irs.gov/newsroom/irs-provides-tax-relief-for-victims-of-severe-winter-storms-flooding-landslides-and-mudslides-in-california

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October 16 disaster postponement FAQs

Here are answers to common questions tax pros are asking about the disaster-related filing postponements.

By Sandy Weiner, J.D.
California Editor

As we discussed last month, most tax filing and payment deadlines have been postponed for the vast majority of California taxpayers until October 16, 2023 (see "Storm-related disaster extensions extended to October 16, 2023" in the March 2023 issue of *Spidell's California Taxletter®*).

Below are answers to some frequently asked questions we are receiving.

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Can taxpayers outside the listed counties qualify for relief?

Relief from federal and California tax and payment deadlines is available to taxpayers outside the listed counties if their tax preparer is located in one of the listed counties[1] (see upcoming box regarding listed counties). The postponement also applies to partners and S corporation shareholders if the partnership or S corporation is located in a listed county and is unable to provide the records necessary to file the partner's/shareholder's return.

For taxpayers located outside California whose tax records are in one of the listed counties or California resident taxpayers who must file a tax return in another state, we recommend that you contact the applicable state tax department to determine whether postponement relief is available for the other state's tax return.

How do you request relief for taxpayers outside the listed counties?

Taxpayers located outside the listed counties who want to request an IRS postponement must:[2]

- Call the IRS's Disaster Hotline at (866) 562-5227;
- Explain that the necessary records are located in a covered disaster area; and
- Provide the FEMA Disaster Number or IRS announcement (CA-2023-01, CA-2023-02, or CA-2023-03) of the area where the tax preparer is located.

Alternatively, we have heard from many tax professionals that they have successfully submitted bulk requests to the IRS for postponement of their clients' federal tax and payment deadlines by preparing an Excel spreadsheet for 10 or more taxpayers and mailing it to:

Internal Revenue Service
Planning & Analysis Staff
4800 Buford Highway, Stop 96C
Chamblee, GA 30341

For more information, refer to:

www.irs.gov/tax-professionals/bulk-requests-from-practitioners-for-disaster-relief

The FTB has not established a similar approach to obtain an extension for taxpayers located outside the listed counties. Rather, the FTB FAQs state that in this scenario, "It is recommended taxpayers and tax practitioners retain records to substantiate they qualify for disaster relief (e.g., utility bill, bank statement, etc.)."[3]

When filing both the taxpayers' California and federal returns, we also recommend that you:

- Write "Disaster extension" and the applicable IRS announcement (CA-2023-01, CA-2023-02, or CA-2023-03) on the returns for these taxpayers; and
- Consider filing extensions anyway to avoid having to deal with late-filing/payment penalty notices.

Which payment deadlines are extended?

All payments scheduled for or payments due with tax returns that were originally due on or after January 8, 2023, (December 27, 2022,[4] or March 9[5] for some counties) and before October 16, 2023, are postponed until October 16, 2023. This includes, but is not limited to, the following payments:

- The balance of the 2022 passthrough entity elective tax due on March 15, 2023, for calendar-year taxpayers and the 2023 prepayment of the passthrough entity elective tax due on June 15;
- The 2023 estimated tax LLC fee due on June 15, 2023;

- Individual and entity estimated tax payments; and
- Any installment payments that would otherwise be due during the postponement period.

Practice Pointer

Taxpayers can file the returns now and pay the tax later. Just make sure to send a payment reminder in early October to your clients who chose this option to avoid having interest and penalties imposed.

Are withholding taxes and returns postponed?

The postponement does not apply to payroll deposits nor to California real estate or nonresident withholding payments. However, it does apply to IRS Form 8804, Annual Return for Partnership Withholding,[6] as well as FTB Form 592, Resident and Nonresident Withholding Statement, and 592-PTE, Pass-Through Entity Annual Withholding Return.

Does the extension apply to extended returns?

Yes, if a fiscal-year taxpayer had an extended due date that fell within the January 8 through October 15 postponement period, then the original extended due date is automatically extended to October 16, 2023.[7]

Note: Taxpayers are not eligible for an additional "automatic" extension beyond the October 16 postponed due date.

Resources

The IRS press releases/announcements are available at:

www.irs.gov/newsroom/tax-relief-in-disaster-situations

The IRS FAQs are available at:

www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims#affectedtaxpayersandrecords

The FTB's extension-related FAQs are available at:

www.ftb.ca.gov/file/when-to-file/help-with-disaster-relief.html

Listed counties

Any taxpayer who resides in, or whose principal place of business is located in, any of the affected California counties is granted an automatic postponement of time to file and pay most types of federal and California tax obligations until October 16, 2023. These taxpayers do not have to be directly affected by the storms.

All counties in California are listed as affected counties except:

- Lassen;
- Modoc; and
- Shasta.

It does not matter that a county is not listed in all of the IRS announcements (CA-2023-01, CA-2023-02, CA-2023-03) as long as they are listed in at least one announcement.

1 IRS FAQs for Disaster Victims, Q1 under "Taxpayers Affected by Disasters" at: www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims#affectedtaxpayersandrecords

2 Id.; IR-2023-33, available at: www.irs.gov/newsroom/irs-may-15-tax-deadline-extended-to-oct-16-for-disaster-area-taxpayers-in-california-alabama-and-georgia

3 FTB, Help with disaster relief, FAQ #3, available at: www.ftb.ca.gov/file/when-to-file/help-with-disaster-relief.html

4 This applies to the following counties listed in CA-2023-01 that are not listed in CA-2023-02: Kings, Lake, Mono, Orange, Riverside, San Bernardino, San Diego, San Francisco, and Yuba counties

5 This applies to the following counties listed in CA -2023-03 that are not listed in CA-2023-01 or CA-2023-02: Imperial, Kern, Plumas, and Sierra counties

6 Rev. Proc. 2018-58

7 IRS FAQs for Disaster Victims, "Filing of Extensions/Extensions of Time to File" FAQ #3

FTB Survey

In an effort to better serve taxpayers and tax professionals throughout this extended filing season, the FTB is conducting an anonymous survey requesting information about when practitioners expect to file returns. If you would like to participate, the survey can be found at:

www.research.net/r/TaxProDisaster

Passthrough entity elective tax calculation clarified

IRC §179 recapture is included in the qualified net income calculation.

By Sandy Weiner, J.D., and Mike Giangrande, J.D., LL.M.
Contributing Editors

Recently we've received numerous inquiries on our Message Board asking whether IRC §179 recapture is included in the qualified net income calculation for purposes of determining the amount of an entity's passthrough entity elective tax.

The issue arose because the FTB has indicated that for an S corporation, the qualified net income for a consenting shareholder can generally be computed by taking the sum of Schedule K-1 (100S) lines 1–10 minus lines 11 and 12, and for partnerships it is computed by totaling K-1 (565) lines 1–3, plus lines 4c–11, minus lines 12 and 13.[1] However, IRC §179 recapture is not included in these lines on the K-1. Rather, it is only reflected in box 17 or box 20 (Other information).

The FTB has informed us that even though it is not included in the K-1 lines listed above, IRC §179 recapture amounts should be included in qualified net income for purposes of the passthrough entity elective tax. According to the FTB, gain from the disposition of §179-expensed property should be included in qualified net income with gain computed at the passthrough entity level despite that adjustments to the gain are made at the entity-owner level.

Example of reporting §179 recapture: GreenCo, an S corporation, purchased computer equipment in 2020 at a cost of $20,000 and claimed the IRC §179 deduction for the full cost of the property, which was reported on its sole shareholder's Schedule K-1, box 11.

In 2022, more than 50% of the computer equipment's use was for the shareholder's personal purposes, which triggered IRC §179 recapture.

GreenCo will report the information necessary for its shareholder to calculate the deduction recapture on Schedule K-1, box 17 (Other information). However, GreenCo must also calculate the recapture at the entity level for purposes of calculating its California passthrough entity elective tax.

The additional income that must be included as qualified net income for purposes of calculating the passthrough entity elective tax because of the recapture is calculated as follows:

IRC §179 expense claimed for property subject to recapture	$20,000
Allowable regular depreciation for the property subject to recapture (in this case, five-year MACRS property)	(10,400)
Depreciation recapture (added to qualified net income for the passthrough entity elective tax calculation)	$9,600

Interest paid on debt-financed distributions

Another common issue raised related to the calculation of qualified net income relates to the treatment of interest paid on debt-financed distributions.

The FTB has confirmed that the expense for interest on partnership debt that is used to finance distributions is a deduction item included in the qualified taxpayer's distributive share of partnership income. This is factored in when computing qualified net income for the passthrough entity elective tax.

As stated above, the distributive share of a qualified taxpayer–owner's qualified net income is the sum of lines 1–3, plus lines 4c–11, minus lines 12 and 13 on the Schedule K-1 (Forms 565 and 568), and the partnership reports the interest from the debt-financed distributions in box 13.

Several tax professionals questioned whether the interest payments should be counted in the qualified net income calculation because it is not a partnership expense; rather, it is paid by the partnership on behalf of the partners. Because the partnership does not know how the partners will utilize the distributions, it's unclear whether the interest will ultimately be deductible.[2] The FTB's position is that the interest should be included in the calculation.

What is qualified net income?

The passthrough entity elective tax is 9.3% of the entity's qualified net income, which is the sum of the *pro rata* or distributive share and guaranteed payments of each consenting qualified taxpayer shareholder's/partner's income subject to California personal income tax.[3] Only partners and shareholders that are individuals, estates, trusts, or SMLLCs owned by an individual, estate, or trust are qualified taxpayers.[4] The tax cannot be paid on behalf of a passthrough entity's corporate or partner shareholders or partners.

For a California resident, all of a qualified taxpayer's share of the entity's income and guaranteed payments are included in qualified net income. For nonresident qualified taxpayers, only their share of the entity's California-source income is included in the qualified net income calculation.

1 FTB, Help with pass-through entity elective tax FAQs available at: www.ftb.ca.gov/file/business/credits/pass-through-entity-elective-tax/help.html#What-is-included-in-the-qualified-entity-s-qualified-net-income

2 IRS Notice 89-5

3 R&TC §19900(a)(2)

4 R&TC §17052.10(b)(3)

Estimated tax underpayment interplay with tax overpayment

The FTB does not automatically reduce tax overpayments by estimated tax underpayment penalties.

By Sandy Weiner, J.D.
California Editor

We received a number of questions on our Message Board recently regarding the FTB's procedure for reducing overpayment credits from prior years when the FTB assesses estimated tax underpayment penalties and interest. Many tax professionals questioned whether the FTB has changed their procedure, claiming that the FTB had historically offset overpayment credits by the amount of penalties and interest assessed and then applied a reduced overpayment credit toward the subsequent year's estimated tax payments.

We reached out to the FTB to ask whether there has been a change in their procedures. Below is their response:

> *Taxpayers receive Notice of Tax Return Changes (NTRC) when errors are identified on the return during the return validation process. When there are miscalculated estimated tax and extension payments, it reduces the transfer of estimate tax payment applied. This may result in the taxpayer receiving notification of an assessed penalty from FTB. When the taxpayer receives notification, they can pay or dispute the assessed penalty.*
>
> …
>
> *FTB does not automatically apply the taxpayer estimate tax payment transfer to pay off the penalty since the taxpayer may dispute the penalty and potential interest. There is one exception to this. FTB will apply any available credits, including taxpayer estimate tax payment transfer, if the taxpayer has made a mathematical error on the return in their calculation of tax and owes additional tax. Additionally, FTB's procedures for this workload have not changed within the past ten years.*

Bottom line, the FTB does not generally reduce the amount of the overpayment credits designated by a taxpayer to be applied to the subsequent year's estimated tax payments by the amount of penalties and interest assessed. This can actually work in the taxpayer's favor, as many taxpayers may neglect to inform their tax professional that they received a notice reducing their overpayment credit, which will result in another estimated tax underpayment penalty for the subsequent year because the overpayment credit applied was incorrect.

As stated in the FTB's response, the only exception to the FTB's general rule to not apply the overpayment credit to offset tax liabilities involves situations of mathematical errors involving the calculation of tax.

Example of interplay: George and Georgette each filed 2021 tax returns with overpayments of $10,000 that they requested be applied to their 2022 estimated tax payments. They were both assessed estimated tax underpayment penalties.

George underpaid his estimated taxes because he did not account for a $20,000 capital gain when he sold some property in 2021 and did not tell his tax preparer until the end of the tax year. Georgette underpaid her estimated taxes because she transposed the numbers when making out her check, and instead of paying $21,000, she paid $12,000. When the tax preparer prepared her return, they applied the $21,000 in estimated tax payments they believed Georgette had paid in calculating her tax liability reported on the return.

The FTB will not reduce George's $10,000 overpayment credit to cover the amount of the assessed estimated tax underpayment penalties and interest. Rather, the FTB will apply the full $10,000 2021 overpayment to George's 2022 estimated taxes and will send George a notice for the estimated tax underpayment penalty.

In contrast, because Georgette's estimated tax underpayment penalty stemmed from a mathematical error, the FTB will automatically reduce her $10,000 2021 overpayment credit by the amount of the $9,000 mathematical error and will send her a notice for the estimated tax underpayment penalty associated with the underpayment.

Hopefully, Georgette will tell her tax preparer that her overpayment credit was reduced by the $9,000 so her preparer doesn't underestimate her 2022 estimated tax payment calculations.

Understanding California's partial conformity to CPAR rules

Although the FTB will not audit and assess tax, partnerships must report federal changes.

By Sandy Weiner, J.D.
California Editor

We have had numerous questions on our Message Board recently regarding how to report a federal adjustment stemming from an IRS centralized partnership audit or from the partnership's administrative adjustment request (AAR). Below is a brief summary of the rules.

Partial conformity

California law allows the FTB to assess tax resulting from a federal determination assessed against a partnership as a result of a partnership audit.[1] Like federal law, California will assess the tax against the partnership unless the partnership elects out of the centralized partnership audit regime (CPAR) or makes a push-out election.

If the FTB audits a partnership, the FTB can only assess tax against the partners and not against the partnership. However, following an IRS audit or a taxpayer's filing of an AAR, similar to federal law, California tax will be assessed against the partnership at the highest rates for individuals and partnerships subject to any change due to a push-out election or modification.

Reporting the changes from federal adjustment

Taxpayers must notify the FTB whenever there is a final federal determination, which is the date the IRS adjustment or resolution (assessment, refund, or no change) is assessed under IRC §6203 (aka the 23C date), even if the taxpayer has filed a protest. Each federal partnership item change or correction must be reported to the FTB within six months of the date of each final federal determination if the partnership is issued an adjustment or makes a push-out election as part of an IRS partnership level audit.[2] The change must be reported whether the adjustment is made following a federal audit or because of the partnership filing an AAR.

Changes should be reported on an amended return (although a letter detailing the adjustments would also be sufficient). Note that there is no Form 565X or Form 568X. The mandate applies to any partnership item change or correction, even if there is no change in tax liability, and encompasses any change to:

- Gross income;
- Deductions;
- Penalties;
- Credits;
- Tax; or
- Partnership distributions or allocations.

If the change is not reported within six months, the FTB can issue a Notice of Deficiency resulting from the federal determination at any time.[3]

Which year's return is amended?

For California purposes, adjustments and resulting tax are reported on amended returns for the taxable year that is adjusted (the reviewed year). This is different than federal adjustments on the federal return, which are reported on the return for the year the adjustment is made.

Example of federal and California reporting: In 2023, Partnership A's 2020 return is audited by the IRS. On August 1, 2023, the IRS assesses tax against the partnership due to various adjustments related to the 2020 tax year. The assessment becomes "final" in 2023, the adjustment year, and the partnership must pay the increased federal tax with its 2023 federal return. For California purposes, the partnership must file an amended 2020 return and pay the tax by February 1, 2024 (six months from the August 1, 2023, assessment date).

When to report an adjustment stemming from an AAR adjustment

A taxpayer that files an AAR on the federal level must also file a California amended return for the reviewed year to report the adjustment.

Elections

For purposes of California's partial conformity to the CPAR rules, the general rule is that any federal election made related to the partnership audit is binding for California purposes, and a separate election is not allowed.[4] So, if a push-out election is made at the federal level, the push-out election applies at the state level as well.

However, there are two major exceptions to the prohibition against separate California elections:

- Reviewed-year unitary partners must file an amended California return to separately report their share of the adjustments. A unitary partner is a partner whose distributive share of the partnership income and apportionment factors are included in the partner's business income computation; and
- A partnership may file a request with the FTB to make a separate election. The FTB must approve the request if the partnership can show that the FTB's ability to collect any California franchise or income taxes due will not be impeded.

Tiered and indirect partners

The rules are a little more complicated for partnerships with partnership owners, aka "a tiered partnership." First, it's important to understand some terminology:

- A "direct partner" is a partner of the partnership being audited; and
- An "indirect partner" is a partner in a partnership or passthrough entity that itself holds an interest directly, or through another indirect partner, in the partnership or passthrough entity being audited.

Each tiered partner and each indirect partner of an audited partnership are bound by the same election, reporting, and payment requirements for audited partnerships and their direct partners.

Under federal law, a partnership must make a push-out election within 45 days of the final partnership adjustment (FPA) and must issue statements to the partners and the IRS within 60 days of the FPA.[5]

California provides an additional 90 days from these deadlines to make a push-out election and issue the push-out statements for California purposes.[6]

The partnership tax

If a push-out election is not made, the partnership-level tax is reported on line 6 of Form 568, Limited Liability Company Return of Income, or line 26 of Form 565, Partnership Return of Income. The FTB has included this line to report partnership-level (CPAR) tax when there is a federal audit or an AAR. This line should only be used when filing an amended return. There should never be an amount entered for partnership-level tax on a timely filed original California return.

Computing the tax

The tax is calculated as follows:[7]

- First, removing from the calculation:
  - The share of the adjustments made to a tax-exempt partner that are not unrelated business taxable income; and
  - The share of the adjustments made to a partner that has previously filed an amended return reporting their share of the adjustments and paid any additional state tax liability due.
- Second, adding:
  - The total share of all adjustments and positive reallocation adjustments for any corporate partner or tax-exempt partner after apportionment and allocation to California, multiplied by the highest marginal corporation tax rate for the reviewed year (presently, 8.84%);
  - The total share of all adjustments and positive reallocation adjustments for all tiered partners, nonresident individual partners, or nonresident fiduciary partners that is California-source income, multiplied by the highest marginal applicable personal income tax rate for the reviewed year (presently, 13.3%); and
  - The total share of all adjustments and positive reallocations for resident partners, resident fiduciary partners, or any other partners, multiplied by the highest marginal tax rate applicable to individuals for the reviewed year (also, 13.3%).

Reallocation adjustments

A "reallocation adjustment" means a federal adjustment that changes the shares of items of partnership income, gain, loss, expense, or credit allocated to direct partners. A positive reallocation adjustment means a reallocation adjustment that would increase state taxable income for direct partners, and a negative reallocation adjustment means a reallocation adjustment that would decrease state taxable income for direct partners.

Like federal law, California only requires the partnership to take into account the positive reallocation adjustments that would result in an increase in a partnership's tax liability. If the partner has negative reallocation adjustments that would decrease the state taxable income for a direct partner, these should be reported by having the partner file an amended return.

Example of partnership-level tax calculation: ABC Partnership, a multistate partnership, has three partners with equal shares in the partnership:

- Partner A is a unitary corporate partner;
- Partner B is a nonunitary corporate partner; and
- Partner C is a California nonresident individual.

On May 31, 2021, the IRS completed a CPAR audit and found that ABC underreported a $30,000 gain in 2019. ABC did not make a push-out election. By November 30, 2021, ABC must file an amended Form 565 and report any additional tax on line 25. The tax will be computed as follows:

ABC will disregard partner A's $10,000 share of gain because as a unitary partner, A was required to and did report its $10,000 distribution from the gain on its amended corporate return.

$5,000 of partner B's $10,000 share of the gain is apportioned to California and is subject to an 8.84% tax, for a total of $442.

The $10,000 share of gain to partner C is California-source income and is taxed at 13.3%, for a total of $1,330.

ABC will report a partnership-level tax of $1,772 ($442 + $1,330) on line 25 of its amended 2019 partnership return.

Partner liability

If an audited partnership or tiered partner fails to timely make any report or payment, the FTB may assess direct partners or indirect partners for taxes they owe.[8]

Alternative agreements

If approved by the FTB, an audited partnership or tiered partner may enter into an alternative agreement with the FTB regarding reporting and paying the tax, the time requirements, or any other provision stemming from any issue resulting from a federal audit adjustment, amended federal return, or administrative adjustment.[9]

1 R&TC §18622.5
2 R&TC §18622.5(a)
3 R&TC §18622.5(f)(3)
4 R&TC §18622.5(c)
5 IRC §6226
6 R&TC §18662.5(c)(4)
7 R&TC §18622.5(d)
8 R&TC §18622.5(g)(1)
9 R&TC §18662.5(e)

Some gig workers can continue to be independent contractors

The court upholds Proposition 22, but an appeal is likely.

By Kathryn Zdan, EA
Contributing Editor

On March 13, 2023, the Court of Appeals for the First District issued a ruling in ***Castellanos v. California***, reversing a lower court's decision and upholding Proposition 22, which was approved by the voters in November 2020.[1] This means drivers for certain app-based companies like Uber and Lyft are exempt from AB 5's ABC worker classification test and will continue to be treated as independent contractors for purposes of California's worker compensation, unemployment, and personal income tax laws, at least for now. However, the court ruled that the companies could not stop their drivers from joining a labor union and collectively bargaining for better working conditions.

The Service Employees International Union (one of the plaintiffs in this case, along with three drivers) may appeal the decision to the California Supreme Court, which could decide to hear the case. However, Proposition 22 will continue to be the law of the land in California unless the California Supreme Court reverses the appellate court's decision.

Case background

In August 2021, a California superior court in ***Castellanos v. California*** struck down Proposition 22 as unconstitutional because it:[2]

- Limited the Legislature's ability to enact future legislation concerning the app-based drivers' workers' compensation in violation of the California Constitution; and
- Violated the single subject rule because it dealt with both the drivers' worker classification and the Legislature's ability to legislate concerning the workers' collective bargaining rights.

This decision was stayed pending appeal.

In September 2021, the U.S. Ninth Circuit Court of Appeals ruled that Proposition 22 only applied prospectively, and therefore the law did not abate a driver's wage and hours claim filed prior to Proposition 22's effective date.[3]

Uber lawsuit revived

On March 17, 2023, a three-judge panel of the Ninth Circuit Court of Appeals revived the Uber and Postmates lawsuit[4] because AB 5 improperly singles out app-based drivers, but exempts (through subsequent legislation) many other industries. This means the Uber and Postmates case will be sent back to the U.S. District Court for the Central District of California.

Proposition 22 history lesson

After the enactment of AB 5 (Ch. 19-269), companies like Uber, Lyft, and DoorDash lobbied hard to have the law revised so that their drivers would be treated as independent contractors. However, Sacramento refused to budge, and the state and several cities filed a lawsuit against Uber and Lyft seeking an injunction to force them to start treating their drivers as employees, as well as seeking millions in damages. In response to the Legislature's refusal to compromise, Uber, Lyft, and other companies spent an unprecedented $205 million to ensure the passage of Proposition 22.

Proposition 22 allows app-based drivers, such as Uber and Lyft drivers, to be treated as independent contractors but requires the network companies that employ them to provide them with certain benefits. These benefits include compensation equal to 120% of the state minimum wage, no terminations without cause, and health insurance stipends.

Proposition 22 only applies to app-based transportation (rideshare) and delivery companies (collectively referred to as "network companies") and only if these network companies do not:[5]

- Unilaterally prescribe specific dates, times of day, or a minimum number of hours during which the app-based driver must be logged in to the network company's online app or platform;
- Require the app-based driver to accept any specific rideshare service or delivery service request as a condition of maintaining access to the network company's online-enabled application or platform;
- Restrict the app-based driver from performing rideshare services or delivery services through other network companies except during engaged time; and
- Restrict the app-based driver from working in any other lawful occupation or business.

What's important to note is that Proposition 22 does not apply to all app-based companies that use gig workers. Companies such as Rover or TaskEasy that hire these app-workers will have to see if they qualify under the AB 5/AB 2257 exemptions and the ***Borello*** tests to determine if the workers qualify as independent contractors.[6]

[1] ***Castellanos, et al. v. State of California*** (March 13, 2023) Court of Appeals, First District, Case No. A163655

[2] ***Castellanos, et al. v. State of California*** (August 20, 2021) Cal. Superior Ct., County of Alameda, Case No. RG21088725

[3] ***Lawson v. Grubhub, Inc.*** (September 20, 2021) U.S. Court of Appeal, Ninth Circuit, Case No. 18-15386

[4] ***Olsen, et al. v. State of California*** (December 19, 2019) U.S. Dist. Ct., Central Dist. of Calif., Case No. 2:19-cv-10956; ***Olsen, et al. v. State of California*** (March 17, 2023) U.S. Court of Appeals, Ninth District, Case No. 21-55757

[5] B&PC §7451

[6] See ***S.G. Borello & Sons, Inc. v. Dept. of Ind. Rel.*** (1989) 48 Cal.3rd 342

Verifying estimated tax payments with the FTB

This year the FTB has tightened up its security procedures for obtaining estimated tax payment information from the Tax Practitioner Hotline. The FTB has confirmed that tax professionals can still obtain their clients' estimated tax payment information from the hotline without a power of attorney (POA) or a tax information authorization (TIA). However, tax professionals may have to provide "additional" information for their individual or trust clients beyond what has been required in prior years.

The FTB has stated that they are changing their policies because of potential identity theft issues, so they will not specifically state what information they will be requesting aside from client account information or current tax records. However, we have been assured that the additional information is information that tax professionals should have on hand.

The FTB will not require any additional information to obtain estimated tax information for businesses.

For more information, see the FTB's news release at:

www.ftb.ca.gov/about-ftb/newsroom/news-releases/2023-04-establishing-and-renewing-tia-and-poa-relationships.html

Use tax applies to counterfeit goods

We're used to thinking about products in terms of markup, but counterfeit goods deal in markdowns.

By Kathryn Zdan, EA
Contributing Editor

A taxpayer who was in the business of selling counterfeit handbags, belts, wallets, and sunglasses in Los Angeles was liable for use tax on the total estimated street value of the goods confiscated but not yet sold.[1]

The taxpayer sold two counterfeit items to an investigator, and based on those purchases, the CDTFA was able to determine the approximate markdown percentage of the counterfeit items as compared to what the items would have cost if they were legitimate. The two counterfeit items totaled $1,280, but the manufacturer's suggested retail price (MSRP) if they had not been counterfeit would have been $165,510. This resulted in a markdown percentage of 12,830.47%.

The CDTFA then applied the markdown percentage to the $13,059,470 MSRP of all of the confiscated goods and determined that the taxpayer could have sold all of those goods for $100,998.

The taxpayer was convicted of two counts of counterfeiting.[2] Therefore, because he is a "convicted purchaser," his purchases of counterfeit items for resale were subject to use tax. Specifically, any purchase of counterfeit items the taxpayer made prior to being convicted constitutes a taxable storage or use of those items.[3] The taxpayer was liable for use tax on the purchase price of those items, unless he was able to provide a valid receipt from an authorized retailer showing the tax was paid to the retailer.

The taxpayer did not provide a receipt for his purchases, so even though he likely paid less than the estimated street value of $100,998, there was no other evidence to prove what amount he may have paid (other than the taxpayer's unsubstantiated testimony that he paid $31,147 for the items). Because there are no industry standards for valuing purchases of counterfeit goods, the CDTFA's measure of use tax based on $100,998 was reasonable.

1 *Appeal of Qu*, 2023-OTA-142

2 Penal Code §350

3 R&TC §6009.2(a)

How to minimize the impending SDI tax increase

Employers may want to consider offering a voluntary plan to reduce increased tax on employees.

By Sandy Weiner, J.D.
California Editor

Effective January 1, 2024, the state disability insurance (SDI) tax (currently set at 0.9% for 2023) will apply to an employee's total wages rather than being capped at a specified amount.[1] For 2023, the maximum wage base that the tax could be applied to was set at $153,164.

Elimination of the wage base essentially amounts to a 1% tax increase on wages above the current $153,164 wage base. **Note:** Revenues raised with the increased tax base will fund increased benefits for lower-income workers but will not provide additional benefits to higher wage earners.

However, there are ways that employers may be able to minimize this tax increase on their employees while potentially offering greater benefits to their employees.

We covered the options available to corporate shareholders in our "SDI wage base cap eliminated; benefit amounts increased" in the December 2022 issue of *Spidell's California Taxletter®*. In this article, we discuss how an employer can set up a voluntary plan as an alternative to the state's disability insurance program.

What is a voluntary plan?

California allows employers to offer a voluntary plan in lieu of participating in the state's disability insurance program; however, any such plan must be pre-approved by the California Employment Development Department (EDD).[2] The plan can still be funded by employee contributions (which must be placed in a separate trust fund), but certain requirements must be met, including providing coverage that is better than what is offered by the SDI program. The voluntary plan must be offered to all of an employer's California employees or to all employees at any of the employer's distinct, separate California establishments.[3] So, a California employer with only one location cannot simply offer this option to only their highly compensated employees.

This option could be beneficial for businesses that have lots of highly compensated employees and/or large numbers of employees and very few disability claims. Although the SDI tax is funded solely through employee withholding and will not result in an employer's costs being directly increased, offering a voluntary plan will enable employees to keep more of their wages (happy employees make for a happy and productive workplace) and may indirectly lower an employer's costs because they would not have to offer increased wages to counter the reduced take-home pay and stay competitive in the labor market.

The voluntary plan can be self-administered, but most employers contract with a third-party administrator to administer the plan.

Benefits paid through a voluntary plan are treated as nontaxable unemployment insurance benefits. For more information on this, see our article "Employer paid family leave benefits: taxable or not?" in the December 2021 issue of *Spidell's California Taxletter®*.

Explore options now

While the increased SDI rate will not go into effect until 2024, employers that are considering offering a voluntary plan should start the process now so they have time to review voluntary plan options, evaluate potential third-party administrators and insurers, educate their employees about the program, and administer the "election" procedure (as is discussed below, 51% of employees must elect to participate in the program). There are insurance companies that specialize in voluntary plans, but employers may want to check with their current insurance brokers to see if they offer this plan.

It will also take the EDD approximately 30 days to review any application.

Voluntary plan requirements

California law requires that a voluntary plan be one that:

- Obtains written approval from the majority of employees eligible for coverage;
- Cannot cost employees more than SDI;
- Provides all the same benefits as SDI plus at least one benefit that is better;
- Allows employees to reject the voluntary plan and choose SDI coverage (in which case the employer will still be required to collect and remit SDI taxes on behalf of any employees electing SDI coverage);
- Must be offered to all eligible California employees of the employer; and
- Must be updated to match any statutory or regulatory increase in SDI benefits.

Application process

An employer must apply for approval from the EDD prior to offering a voluntary plan to its employees. Applications are made by submitting to the EDD a Form DE 2520BV, Application for Approval of Voluntary Plan Self-Insured Disability Benefits, as well as the proposed tax of the plan provisions to the EDD.

Additional information

For additional information, employers can contact the EDD's Voluntary Plan Group by e-mail, phone, or mail:

- E-mail:

VPProgram@edd.ca.gov

- Call or TTY users, dial the California Relay Service at 711:

(916) 653-6839

- Mail to:

Employment Development Department
Disability Insurance Branch
Voluntary Plan Group, MIC 29VP
P.O. Box 826880
Sacramento, CA 94280-0001

Current SDI coverage

California's SDI program provides partial wage replacement for California workers under two short-term benefit programs available to eligible workers:

- Disability Insurance (DI): provides a maximum of 52 times the weekly benefit amount to eligible workers who lose wages due to a non-work–related disability; and
- Paid family leave (PFL): provides up to eight times the weekly benefit amount in a 12-month period to care for specified family members.

Generally speaking, weekly benefit amounts currently range between 60–70% of an employee's wages (scheduled to increase to 90% for lower-income workers beginning in 2025).[4]

1 SB 951 (Ch. 22-878); UIC §985

2 UIC §3251, et seq.

3 UIC §3254

4 SB 951 (Ch. 22-878); UIC §§2655, 3301

THUMB TAX

EDD provides relief to Silicon Valley Bank customers — In response to the appointment of the Federal Deposit Insurance Corporation (FDIC) as receiver of Silicon Valley Bank to help insured depositors, the EDD will waive any penalty for late payroll tax for companies that did business with the bank.[1]

The EDD has determined that the Silicon Valley Bank situation could make it difficult for some employers to timely pay payroll taxes. The EDD is exercising its authority under state law to waive any penalty against any employer who is unable to pay the tax when due.

Employers may submit a waiver request through e-Services for Business or in writing.

1 EDD News Release 23-10 (March 10, 2023)

Soundstage Filming Tax Credit regulations made permanent — On February 15, 2023, the California Film Commission made permanent regulations that were originally adopted as emergency regulations concerning the Soundstage Filming Tax Credit program.[2] The regulations implement the tax credit for qualified expenditures paid or incurred during a taxable year by a qualified motion picture produced in California at a certified studio construction project.[3]

2 10 Cal. Code Regs. §§5530–5541

3 R&TC §§17053.98(k), 23698(k)

District tax rates changing — District tax rates approved in the November 2022 election will go into effect on April 1, 2023, in various cities, counties, and unincorporated areas. For a full list of affected districts, go to:

www.cdtfa.ca.gov/formspubs/l892.pdf

A dividend is a dividend is a dividend for California purposes — A taxpayer was not allowed an adjustment to the additional tax owed for unreported dividend income.[4] The FTB has increased the taxpayer's taxable income to account for $36,364 in unreported dividends. However, while the IRS ultimately made an adjustment to take a portion of the dividends at the more favorable qualified dividend rate rather that at the higher ordinary dividend rate,[5] California does not allow for a preferential treatment of qualified dividends. All dividends are taxed as ordinary income for California purposes.

4 *Appeal of Choi*, 2023-OTA-054SCP

5 IRC §§1(h)(11)(A), 61(a)(7); R&TC §17071

Nonresident indirect partner taxed on gain from sale of partnership interest — In a precedential decision, the OTA ruled that an indirect partner in a partnership holding company was subject to California tax on the partner's distributive share of the gain the holding company received from its sale of its interest in a timeshare partnership (the operating company).[6]

The operating company had timeshares in California and for the year at issue apportioned over 40% of its income to California. Because the holding and operating companies were unitary (the holding company's only holding was the operating company), the OTA determined that the gain from the sale of the operating company was apportionable business income, the character of which flowed through to the nonresident partner. The OTA rejected the taxpayer's argument that the holding company's sale of its operating company interest was the sale of an intangible and therefore should be sourced to the partner's state of residence.

For further details concerning this opinion, see the upcoming April 2023 issue of *Spidell's Strategic Tax Advisor®*.

6 *Appeal of Smith*, 2023-OTA-069P

Impact of imminent domain on tax treatment from sale — A partnership's sale of real property to a school district under the threat of imminent domain was not a "bargain sale" for which the partner could claim a charitable deduction.[7]

The evidence showed that the price paid by the school district was reflective of appraisals undertaken at the time for both the partnership and the school district, was negotiated in good faith, and represented the property's fair market value at the time of the sale. In addition, even though the partnership was able to defer the gain from the sale under the IRC §1033 involuntary conversion rules, the partner-taxpayer was required to recognize gain resulting from his relief of liability when the mortgage from the relinquished property was paid off.

California follows IRS Revenue Ruling 81-242, which treats the sale of the relinquished property and the purchase of the replacement property as two separate transactions. If the deemed distribution from the payment of the mortgage exceeds the partner's basis, the taxpayer has a taxable distribution. Partners are not able to offset decreases in mortgage liability of the relinquished property with increases in the mortgage liability of the replacement property.

[7] *Appeal of MacLeod*, 2023-OTA-098

California Contacts

The IRS's disaster relief notices for storms in California are available at:	https://bit.ly/irs-provides-tax-relief-for-victims-of-severe-winter-storms
To submit bulk requests to the IRS for postponement due to the winter storms, go to:	www.irs.gov/tax-professionals/bulk-requests-from-practitioners-for-disaster-relief
The IRS press releases/announcements regarding the October 16 disaster postponement are available at:	www.irs.gov/newsroom/tax-relief-in-disaster-situations
The IRS October 16 disaster postponement FAQs are available at:	www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims#affectedtaxpayersandrecords
California press releases regarding the October 16 disaster postponement are available at:	www.gov.ca.gov/2023/03/02/more-time-to-file-state-taxes-for-californians-impacted-by-december-and-january-winter-storms/
The FTB's extension-related FAQs are available at:	www.ftb.ca.gov/file/when-to-file/help-with-disaster-relief.html
For more information on the FTB not requiring additional information to obtain estimated tax information, see the FTB's news release at:	www.ftb.ca.gov/about-ftb/newsroom/news-releases/2023-04-establishing-and-renewing-tia-and-poa-relationships.html
For additional information on voluntary plans, contact the EDD's Voluntary Plan Group at:	VPProgram@edd.ca.gov • (916) 653-6839 • Employment Development Department • Disability Insurance Branch • Voluntary Plan Group, MIC 29VP • P.O. Box 826880 • Sacramento, CA 94280-0001
For a full list of districts affected by the change in district tax rates, go to:	www.cdtfa.ca.gov/formspubs/l892.pdf

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