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## FTB is assessing mandatory e-pay penalties

### Check your software to make sure clients aren't getting vouchers to mail in payments.

By Lynn Freer, EA  
Publisher

In the rush of the filing deadline, tax professionals gave extension vouchers printed by their software to clients and closed their doors for a well-deserved break on April 18. Less than a month later, penalty notices began arriving.

It seems that many of those extension payments should have been made electronically, but the clients mailed the checks and the FTB assessed the penalty.

Although the penalty has been around since 2009, the FTB didn't start assessing it until this year. Unfortunately, software vendors, tax professionals, and taxpayers may not have realized the FTB would assess the penalty.

#### The rules

Taxpayers must make all payments electronically once one of these two triggers occurs:

- Starting with the 2009 tax year, the taxpayer makes an extension or estimate payment greater than \$20,000 (that payment can be made by check); or

- Starting with the 2009 tax year, the taxpayer files a return with a liability greater than \$80,000 (the balance due on the return may be made by check).

Once the trigger occurs, the taxpayer is subject to a penalty of 1% of any payment made by check. The FTB did not assess penalties in 2009 or 2010. However, that did not mean that the requirement went away.<sup>1</sup>

### 540ES instructions

Interestingly, the 2010 tax forms contained information that the FTB would assess a penalty for failure to pay electronically. But so did the 2009 forms. Compare the language.

#### 2009 ES form

"Any taxpayer required to remit a payment electronically who makes a payment by other means, shall pay a penalty of one percent of the amount paid, unless it is shown that the failure to make a payment as required was for a reasonable cause and was not the result of willful neglect."

#### 2010 ES form

"Individuals that do not send the payment electronically will be subject to a one percent noncompliance penalty."

See **Payments**, page 62

## Conformity train wreck headed for taxpayers

### Gridlocked legislature ignores conformity.

By Lynn Freer, EA  
Publisher

Last year we all heaved a sigh of relief when the Governor signed SB 401 (Ch. 10–14). But unfortunately, due to poor wording in Proposition 26, the provisions of SB 401 are repealed if not reenacted by a two-thirds vote of the Legislature prior to November 3, 2011.

There is no hint of a replacement bill, so it looks like taxpayers, tax professionals, and the FTB will be scrambling at the end of this year while we all wait to see if there will be a court order to force the FTB to invalidate the law. (See box on Page 62)

#### Other conformity bills

The Legislature finally enacted AB 36 (Ch. 11–17), which conforms to the federal exclusion for nondependent health care benefits enacted under the Health Care Act in 2010. This happened in March, after typical legislative bickering and well after employers had issued 2010

W-2 forms and many taxpayers had filed returns.

For more information on this bill, and on filing returns for these taxpayers, see "Two new tax bills: a little conformity, Child Care Credit, use tax, and amnesty" in the May 2011 issue of *Spidell's California Taxletter*®.

Other single-purpose conformity legislation includes:

- SB 228 currently contains conformity to the federal Mortgage Forgiveness Debt Relief Act of 2007, relating to the exclusion of the discharge of qualified principal residence indebtedness. If enacted, the provision would be

See **Conformity**, page 62

EDD, continued from page 64

### Practice Pointer

To prepare for this hearing, you should contact the EDD to request a copy of their entire file on your client's audit as well as the EDD's procedures in issuing the Notice of Assessment. This should be ordered as soon as you file your late petition.

issue a written decision as to whether to allow your late petition to be treated as a timely filed petition.

### Case in collections

Unlike the IRS, the EDD does not have a structured audit reconsideration process. If the defaulted Notice of Assessment becomes final and is turned over to the EDD's Collection Division, contact the assigned collector and request that copies of the internal files

and records regarding the assessment process be sent to you. If the collector is not familiar with your request or refuses your request, ask to speak with his or her supervisor.

If the case has not been assigned to a collector, or you are not getting the cooperation you feel you need, contact the EDD Taxpayer Advocate's office:

(866) 594-4177

Or, you can fax them at:

(916) 654-6969

<sup>1</sup> CUI §1222; 22 Cal. Code Regs. §5052

### About the author

Robert Schriebman, S.J.D. Taxation, has written over 20 books, including "IRS Tax Collection Procedures—A Manual for Practitioners" published by Commerce Clearing House, in addition to two books dealing with how the EDD operates. He can be reached at [schriebman@aol.com](mailto:schriebman@aol.com)

## A Proposition 13 Change of Ownership occurs when trust beneficiaries change

### Court rules twice that the death of a life beneficiary results in a property tax reassessment.

By Richard Malamud, J.D., LL.M., CPA  
Guest Contributor

In California, Proposition 13 provides that real estate is not reassessed until there is a "change of ownership."<sup>1</sup> When property is passed from a decedent it is revalued. It is revalued again when the later owner dies. Exceptions apply for transfers to spouses<sup>2</sup> or registered domestic partners,<sup>3</sup> or if there is a transfer of a principal residence or a transfer of up to \$1,000,000 of other real property to a child or grandchild.<sup>4</sup>

### Cases

The California Court of Appeals<sup>5</sup> has twice held that when a trust's life beneficiary dies, there is a change of ownership, even if the trust continues for the life of the next beneficiary. The

courts decided that the deceased beneficiary passed equitable title to the underlying property and therefore there was a legal change of ownership and the property could be reappraised.

**Note:** The taxpayers in the *Phelps* case appealed to the U.S. Supreme Court, but the Court recently declined to hear the case.

This is consistent with BOE tax rule 462.060(a): "The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse." Simply stated, there is a change of ownership when one life estate succeeds another.

### Unanswered questions

The courts did not decide if there is a change of ownership when a trustee has significant discretion to distribute or withhold trust income from the

**EXAMPLE 6-3:** Continuing from the previous example, Bob, the life beneficiary, dies in 2012 when the apartment is worth \$8,000,000. His three children each receive a 1/6 interest in the trust income for their lives. The property is again revalued for property tax purposes. However, in this case the reassessment is limited to the one-half interest equitably owned by Bob that passes to his children. The new property tax value is \$6,500,000 (\$2,500,000 for Jolene's continuing half interest and \$4,000,000 for the grandchildren's new interest).

beneficiary, or if a trustee's power to make distributions is limited to the support or education of a beneficiary. Similarly, it left open the question of change of ownership if the trustee has a "sprinkle power" to distribute income among a number of beneficiaries.

### Future reassessments

Now that the estate tax provides a \$5,000,000 generation skipping transfer provision, there will probably be far more multi-generational trusts. Each time one life interest ends

**EXAMPLE 6-2:** Mary Jones died in 1998 and left a \$5,000,000 apartment house in trust for her two children, Jolene and Bob. The trust will continue for the lives of Mary's grandchildren, who become life beneficiaries when their respective parent dies. The property is revalued for property tax purposes at Mary's death to its then fair market value of \$5,000,000.<sup>6</sup>

See **Prop. 13**, page 65

**Prop. 13**, continued from page 63

**EXAMPLE 6-4:** Mary Jones' 1998 trust is the same as in the previous examples, except that the trustee has complete discretion to pay out any or all of the income each year, and the trust is required to pay all educational expenses of its current beneficiaries.

When Bob dies, there is no guidance as to whether that is a taxable change of ownership. If it is, it is unclear what percentage of the property would be revalued, as the trust has the discretion to pay out all the income each year to Jolene, less any amount required to pay the educational expenses of Bob's children.

and another begins, there will be a Proposition 13 change of ownership that results in a reassessment of the trust's real estate.

If there are multiple beneficiaries, there will be a partial reassessment each time a beneficiary dies. Of course, there might not be a change of ownership if

the trust is a sprinkling trust or if the trustee has discretionary powers over the annual distributions. ☹

- <sup>1</sup> R&TC §50
- <sup>2</sup> R&TC §63
- <sup>3</sup> R&TC §63, Family Code §297
- <sup>4</sup> R&TC §63.1

- <sup>5</sup> *Phelps v. Orange County Assessment Appeals Board No. 1* (2010) 187 Cal. App. 4th 653 and *Reilly v. City and County of San Francisco* (2006) 142 Cal. App. 4th 480
- <sup>6</sup> The \$1,000,000 parent child exception may apply to a part of the property if no other commercial property is transferred at death

#### About the author

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## FTB provides payment plans and offers in compromise

### There are options for your clients who cannot pay their taxes in full.

By Debra S. Petersen, J.D., LL.M., CPA  
Sacramento Contributor

While you may be feeling relieved that you made it through the tax filing season, your clients may be feeling the stress of not being able to pay their taxes or having to deal with past due taxes from prior years.

You may be receiving calls from these clients, especially if they are listening to the ads on the radio telling them they can settle their tax debts for "cents on the dollar". While only a small percentage of taxpayers qualify for the major settlements referred to in the radio ads, there is some assistance available for your clients who are unable to pay.

Installment agreements and offers in compromise are two things that your clients can consider to help them settle their debts to the FTB. This article reviews the requirements for both options, and outlines the procedures you will need to follow for your clients to request help.

#### Installment agreements

If your client is financially unable to pay the amount owed and cannot

borrow from a private source, they can request to make monthly installment payments. The FTB would like them to pay the largest amount they possibly can. Interest and some penalties will continue to accrue until the balance is paid in full.

#### Individual installment agreement:

A \$20 (proposed to increase to \$35 under Prop. 18 Cal.Code Regs 19591) processing fee will be added to the liability. The approval or denial of the request to make installment payments is based on the client's ability to pay and compliance history and is usually made within 30 to 60 days. The FTB may still file a lien and/or request a financial statement as a condition to approval. If the request is denied, the client may request a review within 30 days and collection action will resume.

If the liability is greater than \$10,000 and the installment agreement exceeds 36 months, then the client will need to certify they have a financial hardship on the application.

Individuals may request an installment agreement without providing detailed financial information if they:

- Owe a balance of \$25,000 or less;
- Agree to pay in 60 months or less; and
- Have filed all required personal income tax returns.

Individuals can request an installment agreement online at:

[http://www.ftb.ca.gov/online/eIA/Apply\\_Online.asp](http://www.ftb.ca.gov/online/eIA/Apply_Online.asp)

This applies but only if certain conditions are met, such as not having a current wage garnishment or an existing installment agreement. They can apply online only once in a 12-month period and only newly assessed liabilities qualify for an online installment agreement. If individuals apply online, payments must be made by electronic funds withdrawal for at least \$25 per month.

If they do not meet the requirements for online filing, they can complete and mail FTB 3567 or they can make arrangements by calling the FTB at (800) 689-4776 Monday through Friday from 8 a.m. to 5 p.m. The FTB's mailing address is:

Franchise Tax Board  
P.O. Box 942867  
Sacramento, CA 94267-0011

#### Business installment agreement:

Businesses may also enter into an installment agreement if they cannot pay the total balance in 90 days due to a financial hardship. The processing fee is

See **Plans**, page 67