

STATE & LOCAL TAX ALERT

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October 11, 2013

Quarterly California Tax Legislation Update

July 2013 - September 2013

Dear Friends & Clients,

The purpose of this quarterly California Tax Legislative update is to provide our clients and prospective clients with timely and meaningful updates that affect both their personal income and business taxes.

The 3rd Quarter of 2013 was time for California to clarify existing law in a number of different areas including the California Enterprise Zone credit, like-kind-exchange transactions and the treatment of gain or loss on the sale of qualified small business stock. From a local perspective, the City of Los Angeles has implemented a tax amnesty program designed to give businesses the opportunity to come forward and pay existing liabilities without incurring substantial underpayment or late filing penalties.

New Legislation Provides Clarification Related to the End of the California Enterprise Zone Credit

Over the past two quarters, Green Hasson Janks has been closely following legislative changes related to the California Enterprise Zone credit ("EZ Credit"). Legislation enacted in July repealed the Enterprise Zone credit program as of January 1, 2014. On September 26, 2013, the governor signed A.B. 106 and S.B. 100, which clarify the July legislation and allow additional time for vouchering and placing qualified property into service.

A.B. 106 authorizes vouchering until January 1, 2015, so businesses have a longer period of time to document employees who were hired before the repeal of the EZ Credit program. Prior to this legislation, localities did not have authority to issue vouchers after 2013. This legislation also clarifies that the ten-year carryover of any unused EZ Credit begins with the first tax year after January 1, 2014, not when the credit first qualified. In relation to the EZ sales/use tax credit, S.B. 100 allows property purchased by December 31, 2013 to be placed in service as late as December 31, 2014. Prior to this legislation, to qualify for the credit property must have been placed in service before the end of 2013.

After the repeal of such a lucrative credit, this newly enacted legislation provides reassurance that taxpayers will be able to document qualified hires, carryover unused EZ credits for ten-years, and place property into service in 2014.

Enacted Legislation in Response to Cutler Decision Regarding QSBS Exclusions/Deferrals

In the first quarter legislation update of 2013, Green Hasson Janks discussed the Cutler decision, which found unconstitutional qualified small business stock gain exclusions and deferrals for taxpayers who invested in businesses predominately based in California. With this decision, deferrals and exclusions that were once allowed suddenly became denied by the Franchise Tax Board ("FTB"). In light of the negative response the FTB received with its decision to deny exclusions and deferrals, enacted legislation S.B. 209 and A.B. 1412 removes the in-state requirement, allowing QSBS deferrals and exclusions for certain investments.

Both bills provide deferrals and exclusions until January 1, 2016. Taxpayers who were assessed additional tax, penalties and interest after the Cutler decision should be able to ignore these assessments and the FTB is in the process of cancelling any assessments notices that were issued. The enacted legislation allows taxpayers to amend 2008 returns and onwards to claim QSBS gain exclusions/deferrals related to out-of-state investments provided that at the time the stock was acquired the business had 80% or more of its payroll and assets in California.

New Reporting Requirements for Like-Kind Exchanges Involving In-State and Out-of-State Property

For tax years beginning on or after January 1, 2014, personal and corporate taxpayers acquiring out-of-state property in a like-kind exchange of California property must file an information return with the FTB in the year of the exchange and each subsequent year gain or loss related to the exchanged property has not been recognized. Since the deferred gain originates from California property in the like-kind exchange, the gain should be reported as California income upon recognition. This information return provides the FTB with a way to track unrecognized gains connected with out-of-state property. The filing requirement will help ensure built-in gains are sourced back to California, especially those related to nonresidents or former residents.

To enforce the reporting requirement, the FTB may assess tax and impose interest and penalties on nonfilers, however it seems California filers will not be subject to penalty at this time. Nonfilers must file a standalone form, while filers will attach the information return to their tax return.

With this new requirement, it is important to properly track gains from one property to another. Although this information return creates an added burden for California filers, the additional reporting seems the most burdensome and crucial for nonfilers.

California Withholding Voluntary Compliance Program

California requires that payers of California source income in excess of \$1,500 withhold 7% for payments to nonresident payees who are not employees. Payees are defined as any person or entity that receives payment from a payer. Payees are often times referred to as the vendor in a transaction. Typical payments made include interest, dividends, prizes and winnings, rental income, royalties and compensation for personal services (e.g. payments to independent contractors).

Entities that have failed to withhold California income taxes are subject to tax exposure for the amount not withheld, plus applicable penalties and interest. The FTB recently announced a voluntary compliance program for entities not previously meeting withholding requirements. For entities that have been noncompliant for a number of years, the new Withholding Voluntary Compliance Program ("WVCP") represents an opportunity to limit exposure and provides an indication that the FTB intends to be aggressive about pursuing withholding, under the law, going forward.

Eligible taxpayers who voluntarily come forward will be given the opportunity to become current on their withholding obligations. The FTB will limit the look back period to two years, abate penalties associated with the non-filing of withholding tax returns and will refrain from pursuing withholding audits prior to the look back period. The program is available to all taxpayers who were not previously audited by the FTB for withholding and who were not assessed penalties for the failure to file withholding tax returns for prior years. Taxpayers that take advantage of the WVCP must agree to the state's withholding requirements prospectively.

The WVCP is a pilot program offered by the FTB and at this time there is no defined end date to the program. Eligible taxpayers should seriously consider the benefits of participating in the program and should speak with their tax advisors on the best course of action. Note that both profit and nonprofit entities are required to comply with the withholding tax requirements and therefore both may take advantage of the WVCP.

To participate, submit application Form FTB 4827 to the FTB along with payment.

Los Angeles Tax Amnesty Program Enacted

The City of Los Angeles recently announced a tax amnesty program that will apply to various city taxes including:

- Telephone, Electric & Gas Users Tax
- Business Tax
- Commercial Tenant's Occupancy Tax
- Transient Occupancy Tax
- Parking Occupancy Tax

The tax amnesty period runs from September 1st, 2013 – December 2nd, 2013 and the benefits of participation include the abatement of penalties, which can equal 40% of Principal Due. To qualify for the amnesty program the following requirements must be met during the amnesty period:

1. All principal, interest and fees must be paid for all open tax years
2. A taxpayer must sign and return the Tax Amnesty Billing issued by the City
3. If unregistered, a business must complete a Tax Amnesty Application

The City has announced that they will vigorously pursue a range of enforcement actions against taxpayers that have tax exposure and who choose not to participate in the amnesty program. Enforcement actions include:

- Additional 10% negligence penalty
- Expanded audit program
- Expanded on-site investigations
- Data matching with governmental agencies to identify unregistered businesses
- Whistleblower program
- Possible legal action
- Publication of tax debt
- Recording of tax lien on business real and personal property

We encourage all businesses with outstanding taxes to take advantage of this limited opportunity to save up to forty percent in penalties, clear delinquent taxes and avoid further enforcement action. Please speak with your current tax advisors to determine whether the Los Angeles tax amnesty program is the right course of action for your business. Remember, the window closes December 2 so it is pertinent to act now. &

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