



December 10, 2018

To: Franchise Tax Board
From: Lynn Freer, EA; President, Spidell Publishing Inc.®
RE: FTB Taxpayer Bill of Rights Issues

Dear Board and Staff:

Once again, we appreciate the opportunity to present issues of concern to taxpayers and tax professionals alike.

We are hearing about the following issues from our subscribers and seminar attendees.

The Larsen case

Prior to the release of the *Larsen* case (*Appeal of Larsen*, 2018-OTA-073), we had practitioners questioning whether a sole proprietor or a SMLLC must use market based sourcing if all services performed for the service business are conducted outside California.

Under 17951-4, a nonresident individual is only taxed on income from a business:

- Conducted solely within California, in which case all the income is sourced to California (e.g., a Nevada resident attorney whose only office is located in California) (Reg. 17951-4(a)); or
- If the nonresident's business is conducted [underline added] both inside and outside California, the business income apportioned to California based on the corporate apportionment rules [including market-based sourcing] (e.g., a Nevada resident attorney who has offices both in CA and Nevada). (Reg. 17951-4(c))

In *Larsen*, the OTA ruled that because the FTB could not prove that the taxpayer conducted business in California, it was not considered an apportioning business and therefore the market-based sourcing rules did not apply. The OTA ruled that simply showing a 1099 from a California business was not enough to show that the taxpayer was conducting business in California.

We believe the LLC is subject to California's annual tax if it is "doing business" in California (as defined under the R&TC 23101 nexus statute) and is subject to the LLC fee based on "income derived from or attributable to California" (using CA's apportionment statutes, including market-based sourcing). (R&TC §§17941 and 17942)

But under Reg. 17951-4(e), the nonresident individual is treated as a sole proprietor so he or she is only subject to tax on the LLC income if the business is conducted both inside and outside California, under the Reg. 17951-4 standard.

This analysis is also supported by the FTB's nonresident withholding forms and instructions, which state that a nonresident is subject to California tax based on days worked in California versus days worked everywhere.

We would like guidance on this issue based on the *Larsen* case and 18 Cal. Code Regs. §17951-4(c).

Audit time-frames

We continue to hear about audits taking more than one year to complete. In one situation, the audit began in June 2017 and the representative was told it had gone to review as a no-change in early 2018. Recently the representative contacted the auditor again and was told they were opening another year, although the first year appears to be a no-change. In this situation, the auditor is a seasoned auditor who had not taken time off, so the problem may be with the managers who review the cases.

This was an issue we raised last year and have not observed any lessening in tax professionals' complaints to us. We request the FTB find ways to shorten this time frame, which will save money and create a better agency-taxpayer relationship.

Administrative dissolutions

We applaud the FTB's efforts to get legislation enacted to provide for the voluntary and involuntary dissolutions. We look forward to guidance on policies and procedures and offer any assistance we can provide to ensure a smooth transition when implementing these policies.

Powers of Attorney

We commend the FTB staff for their responsiveness to Spidell's and other tax professionals' complaints and concerns about the two-step Power of Attorney process. We believe the addition of the check box in the initial request will streamline the process while also providing security for the taxpayer.

Conformity meeting

The FTB's annual conformity meeting was a success. The FTB's Summary of Federal Income Tax Changes was extremely well done and complete. The meeting itself was well run and we believe the attendees provided valuable information to the FTB staff for the upcoming foray into possible conformity to many – if not most – of the provisions contained in the Tax Cuts and Jobs Act and the Bipartisan Budget Act.

Thank you for your consideration of these issues.

Sincerely,



Lynn Freer, EA
President
Spidell Publishing, Inc.®