

Aftershocks, or Warning Signs?

How the California Tax Landscape Looks
Heading into the New Year

February 16, 2021

Tim Gustafson

Partner

Eric Coffill

Senior Counsel



AGENDA

- Fiscal Outlook
- Legislation
- State Tax Agencies
 - Franchise Tax Board
 - Office of Tax Appeals
 - Department of Tax and Fee Administration
 - Board of Equalization
- Litigation
- Local Taxes

LEARNING OBJECTIVES

- Discuss key California tax events of 2020 and how they affect the state's outlook for 2021.
- Identify significant California tax legislative and regulatory activity already underway in 2021.
- Understand the current hot-button issues at California's various tax agencies.

FISCAL OUTLOOK

FISCAL OUTLOOK

What do the numbers say?

- 2020
 - Budget projections (\$54B deficit)
 - EOY revenues (\$26B windfall)
- 2021: Budget projections
- A Golden State exodus?
 - Individuals
 - Businesses

Legislation

LEGISLATION

2020 Hits and (Many) Misses

- 2020-2022 NOL suspension and \$5M credit cap enacted (AB 85)
- Tax voucher program enacted (AB 107)
- FCA applied to taxes failed (AB 2570)
- Corporate taxpayer confidential information disclosure requirement failed (SB 972)
- Corporate tax rate increase failed (SB 37)
- Net worth tax failed (AB 2088)
- Additional tax on high-income earners failed (AB 1253)

LEGISLATION

2021 Early Bills to Watch & Other Considerations

- AB 71
 - Corporate tax rate increase
 - Tax on GILTI and IRC 965 repatriated income for water's-edge taxpayers (without corresponding factor representation)
- SB 288: foreign corporate conversions
- SB 104: SALT cap work-around for pass-through entities
- Open questions
 - Another FCA push?
 - Appetite for new taxes?
 - Governor recall effort?

State Tax Agencies: FTB

FTB

2020 Activity

- Ongoing regulation projects
 - Market sourcing regulation: FTB Reg. 25136-2 (held fifth IPM in July)
 - Alternative apportionment petition regulation: FTB Reg. 25137 (held fourth IPM in August)
- Administrative guidance
 - Chief Counsel Rulings 2020-01, 2020-02
 - FAQs on teleworking nexus
 - Chief Counsel discussion of carried interest

FTB

2021 Agenda?

- More/continued regulation projects?
 - Informal: FTB Reg. 25136-2 and another IPM?
 - Formal: amendments to FTB Reg. 25137 to Office of Administrative Law (20-day notice given on Dec. 29, 2020)
- More cases resolved at audit/protest?
- Settlement program changes?
 - FTB Notice 2020-03 (Dec. 22, 2020)
 - Raise all issues/arguments in request for consideration (“complete and full analysis”)?
 - Prohibited from providing additional facts?

State Tax Agencies: CDTFA

CDTFA

2020 Activity

— Annual Report to Legislature

- For FY 2018-2019 (released June 2020)
- Three highest areas of taxpayer noncompliance:
 - Unsupported sales for resale (disallowed “due to lack of supporting information”)
 - Unreported sales (sales on books not on tax return)
 - Out-of-state vendor purchases (failure to collect use tax)
- Appeals volume up slightly (close to 1,000 in FY 2018-2019)

— Regulatory activity

- Emergency marketplace regulation promulgated:
CDTFA Reg. 1684.5
- Proposed amendments to drop shipment regulation:
CDTFA Reg. 1706 (IPM held in September)

CDTFA

2021 Agenda?

- Movement on technology transfer agreements?
 - Stalled regulation project: CDTFA Reg. 1507
 - Activity in CDTFA Settlement Bureau
- More regulation projects?

State Tax Agencies: OTA

OTA

2020 Decisions

- *Appeal of Swat-Fame Inc.*, 2020-OTA-046P
(Precedential)
 - Research credit
 - Followed federal law with regard to “process of experimentation”
- *Appeal of C.R. Pino and C. Pino*, 2020-OTA-376P
(Precedential)
 - Research credit
 - Uncorroborated study insufficient to show qualified research
- *Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P
(Precedential)
 - Establishing price of tangible assets upon sale of business
 - CDTFA must follow its regulation (CDTFA Reg. 1595), not audit manual

OTA

2020 Decisions (cont.)

- *Appeal of IMAGE 2000*, 2020-OTA-272P
(Precedential)
 - Reliance on prior written CDTFA advice/CRTC 6596 relief
- *Appeal of L. Mazer and M. Mazer*, 2020-OTA-263P
(Precedential)
 - California domicile/residence under CRTC 17041
- *Appeal of L. Conacher and J. Dea*, 2020-OTA-365
(Nonprecedential)
 - Which jurisdiction's law applies?

OTA

2021 Decisions and Developments

- *Appeal of Thomas Conglomerate*, 2021-OTA-030P
(Pending precedential)
 - Prenatal imaging services (i.e., ultrasounds)
 - Applied “true object” test to determine taxability
- *Appeal of Q-Mobile, Inc.*, 2021-OTA-011
(Nonprecedential)
 - CDTFA applied “safe harbor” in Reg. 1585 to establish sales price of unbundled sales of cell phones
- Revising Rules for Tax Appeals
 - Clarifying grounds for petitions for rehearing
 - Process and requirements for closed hearing requests
- More weighty business tax decisions?

State Tax Agencies: BOE

BOE

2020 Property Tax Activity

- Prop 15 (split roll initiative)
 - Would have required reassessment of commercial property at FMV at least once every three years
 - Defeated at polls 52% to 48%
- Prop 19 (Constitutional amendment)
 - Allows primary residence base year value transfer for certain individuals
 - Changes provisions governing family transfer exclusions
- COVID-related working groups
 - Assessment appeals relief
 - CRTC 170 disaster relief claims
 - Proposition 8 decline in value claims

BOE

2021 Agenda?

- Implement Prop 19
 - BOE backing county assessors' draft legislation
- Prop 8 decline in value claims
 - Temporary reduction when market value falls below base value as of January 1 lien date
 - Owner provides data to support a lower value

Litigation

LITIGATION

2020 Cases

- *Bekkerman v. CDTFA*, Case No. 34-2015-80002242 (Sacramento trial court held CDTFA Reg. 1585 invalid as applied to carrier-retailers)
- *CDTFA v. Superior Court* (2020) 48 Cal.App.5th 922 (taxpayer must pay tax before seeking a declaration that the regulation underlying assessment is invalid)
- *Zolly v. City of Oakland* (2020) 47 Cal.App.5th 73 (Oakland's waste management franchise fees are "taxes")

LITIGATION

2020 Cases (cont.)

- *731 Mkt. St. Owner, LLC v. City & Cty. of San Francisco* (2020) 50 Cal.App.5th 937
(San Francisco cannot impose documentary transfer tax on existing leasehold interest with 35-year remaining term)
- *Prang v. Amen* (2020) 56 Cal.App.5th 246
(change of ownership exception where proportional ownership interests as represented by stock remain the same considers all classes of stock, not just voting stock)

LITIGATION

2021 Docket

- FTB
 - *2009 Metropolous Family Trust v. FTB* (sourcing sale of goodwill)
 - *Handelman-CEG v. FTB* (research credit case)
 - Residency cases
 - Penalty cases
- CDTFA: *EMA Design Automation v. CDTFA* (reliance on prior written advice)

Local Taxes

LOCAL TAXES

2020 Activity

- Majority vs. super-majority vote requirement cases
 - 0-3 at Court of Appeal
 - Supreme Court has declined review thus far
- New San Francisco taxes
 - Repeal Payroll Expense Tax and increase GRT (Prop F)
 - Real property transfer tax (Prop I)
 - Parcel tax (Prop J)
 - CEO pay ratio tax (Prop L)

LOCAL TAXES

2021 Forecast

- Last chance in majority vs. super-majority vote dispute – *Jobs & Housing Coalition, et al., v. City of Oakland*
 - Pending before First Appellate District
 - Different facts, additional legal argument

- Aggressive localities
 - Budget issues
 - Expand tax base
 - Apply current taxes to new businesses/industries
 - Example: apply communications users tax definition of “telecommunications service” to software, streaming/OTT, and other services



EVERSHEDS
SUTHERLAND

[eversheds-sutherland.com](https://www.eversheds-sutherland.com)

© 2021 Eversheds Sutherland (US) LLP
All rights reserved.

Contact us

Tim Gustafson

Partner

Eversheds Sutherland (US) LLP

916.844.2826

TimGustafson@Eversheds-
Sutherland.us

Eric Coffill

Senior Counsel

Eversheds Sutherland (US) LLP

916.844.2821

EricCoffill@eversheds-
sutherland.us