

# California Update for Non-California-Based Companies

TEI Denver Chapter

**May 18, 2021**

Tim Gustafson

*Partner*

Annie Rothschild

*Associate*



**CALIFORNIA REPUBLIC**



# 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

- Identify California tax issues on the horizon for 2021
- Learn California tax agency agendas and priorities for the coming year
- Understand key issues currently being litigated in the Golden State

# Fiscal Outlook

# FISCAL OUTLOOK

What do the numbers say?

- 2020
  - Budget projections (\$54B deficit)
  - EOY revenues (\$26B windfall)
- 2021: Budget projections
  - YTD FY 2021 collections 14% ahead of projections
    - March collections 30% ahead
    - \$\_\_\_B surplus?!
  - Not looking at (COVID) deficits for FY 2021-2022
- A Golden State exodus?
  - Individuals (Elon Musk)
  - Businesses (HP, Oracle)

# Legislation

# LEGISLATION

## 2020 Hits and (Many) Misses

- 2020-2022 NOL suspension and \$5M credit cap enacted (AB 85)
- Creation of tax voucher program (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
  - No corresponding factor representation
  - May elect a 14% apportionment factor for repatriated income

### — SB 288: foreign corporate conversions

### — AB 879

- Sales/use, PIT, and corporate tax amnesty program from 2/1/2022 to 3/31/2022
- Applies to tax periods beginning before January 1, 2021
- Pay all taxes and interest and CDTFA/FTB waives all penalties for underreporting or nonreporting taxes
- 7.75% interest penalty if eligible and do not participate



# LEGISLATION

## 2021 Early Bills to Watch & Other Considerations (cont.)

- SB 792: “This bill would require a retailer whose annual sales of tangible personal property transacted online exceeded \$1,000,000 for the previous calendar year to track and report to the department the city or ZIP code where the purchaser resides for each sale within the state that is transacted online[.]”
- SB 88: tax voucher program repealed
- AB 1402: marketplace facilitators must collect fees
- Open questions
  - Another FCA push?
  - Appetite for new taxes?
  - Governor recall effort?

## POLLING QUESTION

### California Tax Agencies

Which California tax agency gives you the most headaches?

- A. FTB
- B. CDTFA
- C. OTA
- D. BOE

# 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
  - FTB Tax News Chief Counsel Corner

# FTB

## 2021 Agenda?

- More/continued regulation projects?
  - Informal: FTB Reg. 25136-2 and another IPM?
  - Formal
    - FTB Reg. 25137 to Office of Administrative Law
    - Board voted to begin formal regulatory process at March 4 hearing
- 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 2020)

# 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

## POLLING QUESTION

### California OTA Decisions

What issue would you like to see OTA address in a precedential opinion?

- A. Business vs. nonbusiness income
- B. Use tax collection
- C. Market sourcing
- D. Who goes to the OTA anyway?

# OTA

## 2020 Decisions

- Precedential research credit cases
  - *Appeal of Swat-Fame Inc.*, 2020-OTA-046P (followed federal law with regard to “process of experimentation”)
  - *Appeal of C.R. Pino and C. Pino*, 2020-OTA-376P (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
- *Appeal of IMAGE 2000*, 2020-OTA-272P (Precedential) (reliance on prior written CDTFA advice/CRTC 6596 relief)

# OTA

## 2021 Decisions and Developments

- *Appeal of Thomas Conglomerate, 2021-OTA-030P* (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)
- *Appeal of S. Krown, 2021-OTA-078* (Nonprecedential) (benefit of consulting services non-resident provided to UCLA for AIDS clinical trials group reasonably approximated to be at location of site work)

# OTA

## 2021 Decisions and Developments (cont.)

- *Appeal of R. Jones, 2021-OTA-144P* (Pending Precedential)
  - Numerous nonprecedential OTA decisions came to opposite conclusion on FTB demand penalty
  - Split panel rules for FTB's interpretation of penalty
- Revised Rules for Tax Appeals (eff. 3/1/2021)
  - 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

## POLLING QUESTION

### Movies

What movie sequel are you most looking forward to in 2021?

- A. Fast and Furious 9
- B. Matrix 4
- C. Mission Impossible 7
- D. Top Gun 2

# LITIGATION

## 2020 Cases

- *Bekkerman v. CDTFA*, Case No. 34-2015-80002242 (Sacramento trial court held CDTFA Reg. 1585 invalid)
- *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
  - South Coast Air Quality Management District “mitigation fee” imposed on warehouses located in Los Angeles, Orange, Riverside and San Bernardino counties



# QUESTIONS



EVERSHEDS  
SUTHERLAND

*Contact us*

**Tim Gustafson**

Partner

Eversheds Sutherland (US) LLP

916.844.2826

TimGustafson@eversheds-  
sutherland.us

**Annie Rothschild**

Associate

Eversheds Sutherland (US) LLP

916.302.9351

AnnieRothschild@eversheds-  
sutherland.us

**eversheds-sutherland.com**

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

*PRIVILEGED AND CONFIDENTIAL*

*This communication cannot be used for the purpose of avoiding any penalties that may be imposed under federal, state or local tax law.*