



US Multistate Tax Alert

California FTB Grants Automatic Consent for California-Only Accounting Method Changes

Overview

On December 30, 2020, the California Franchise Tax Board (“FTB”) issued Notice 2020-04, which supersedes its prior Notice 2000-8 relating to changes in accounting methods or periods. Notice 2020-04 provides additional guidance to taxpayers when making changes in accounting methods or periods (collectively referred herein as “Accounting Method Change”) – most notably, the FTB now grants automatic consent when a taxpayer makes an Accounting Method Change for California tax purposes only (“California-Only Change”), provided that the change would be eligible for automatic consent by the Internal Revenue Service (“IRS”) and California has conformed to the applicable Internal Revenue Code (“I.R.C.”) sections that are being relied upon to make the change. Notice 2020-04 also provides additional guidance to taxpayers with respect to the manner in which to implement an Accounting Method Change, as well as the deadlines that apply when a taxpayer must secure the FTB’s prior consent to make the change and when prior FTB consent is not required.

This Tax Alert summarizes the more notable changes made in Notice 2020-04 and provides some taxpayer considerations.

Background of California Revenue and Taxation Code (“CRTC”) Sections Underlying Notice 2020-04

Notice 2020-04 relies upon CRTC sections 23051.5 (applicable to the Corporation Tax Law) and 17024.5 (applicable to the Personal Income Tax Law). CRTC sections 23051.5(e) and 17024.5(e) generally apply when a taxpayer makes an election for California tax purposes. However, pursuant to CRTC sections 23051.5(f) and 17024.5(f), those rules also apply when a taxpayer makes an Accounting Method Change.¹

Generally, pursuant to CRTC sections 23051.5(e)(1) and (f) and 17024.5(e)(1) and (f), when a taxpayer properly files a request for an Accounting Method Change for federal income tax purposes with the IRS in accordance with the I.R.C. or regulations thereunder, that Accounting Method Change applies for

California tax purposes, unless otherwise expressly provided under California's tax laws or in FTB regulations.²

However, if that taxpayer wants to obtain a treatment other than the one elected for federal purposes (e.g., make a California-only Accounting Method Change, or stay on the historical method that it was using for California tax purposes), a separate application or request for consent "shall be filed with the [FTB] at the time and in the manner that may be required by the [FTB]."³

In 2000, the FTB issued Notice 2000-8 which provided guidance to taxpayers on how the above-stated CRTC provisions should be applied, including the time and manner required by the FTB to secure the FTB's consent to make an Accounting Method Change. Notice 2020-04 supersedes Notice 2000-8 and thus, Notice 2000-8 no longer applies in California to Accounting Method Changes.

Overview of FTB Notice 2020-04

The most notable change in Notice 2020-04 is the grant of automatic consent for California-Only Changes, provided that "the change would be eligible for automatic consent by the [IRS] and California has conformed to the applicable [I.R.C.] sections which provide for the underlying accounting period or method being applied for or relied upon."⁴ Historically, the FTB did not grant automatic consent for California-Only Changes and instead required a taxpayer to secure the FTB's consent prior to implementing the change on its California tax return.⁵ To implement the change, Notice 2020-04 states that the "Federal Form 3115 should be filed with the FTB along with the original California tax return for the taxable year in which the election is to take effect."⁶ Notice 2020-04 further provides that "[f]or elections not requiring FTB consent [such as when automatic consent is granted for a California-Only Change], Form 3115 should be filed at any time prior to or along with the filing of an original tax return on which the change or election is sought to be applied."⁷

Additionally, where a taxpayer makes the same Accounting Method Change for both federal and California tax purposes, Notice 2020-04 generally retains the same treatment as stated under Notice 2000-8 – that if a taxpayer submits a request for an Accounting Method Change for federal tax purposes and the IRS approves that request, the change will apply for California tax purposes without any action by the taxpayer (referred therein as "deemed California consent"), "as long as California has conformed to the underlying law which is being applied."⁸ To implement the change, Notice 2020-04 provides that "[t]axpayers shall submit a copy of the approved federal election along with the original California tax return for the taxable year in which the change is in effect."⁹ Notice 2020-04 further provides that "[f]or elections not requiring FTB consent [such as when there is deemed California consent], Form 3115 should be filed at any time prior to or along with the filing of an original tax return on which the change or election is sought to be applied."¹⁰

Moreover, when a taxpayer "(i) cannot rely on a federally-approved request to change an accounting period or method, (ii) desires to obtain a change different from the federal change, or (iii) desires a change for California tax purposes only," similar to Notice 2000-8, Notice 2020-04 states that a federal Form 3115 (Application for Change in Accounting Method), or federal Form 1128 (Application to Adopt, Change, or Retain a Tax Year), "should be submitted to the FTB by the due date specified below in this notice[,] using the appropriate California tax information (and not the federal tax information) and taking into account differences in federal and California law."¹¹ Notice 2020-04 also sets a formal 60-day deadline that applies when a request for Accounting Method Change requires prior FTB consent.¹² Specifically, Notice 2020-04 states that "[f]or elections requiring FTB consent [such as when automatic consent or deemed California consent is not granted], the request should be submitted at least sixty (60) days prior to the taxpayer's return due date, including

permissible extensions, to allow the FTB time to review the request and issue a determination letter.”¹³ Importantly, Notice 2020-04 notes that “[i]f consent is required and the return is filed before receiving the consent of the FTB, the request will be denied.”¹⁴

Similar to Notice 2000-8, Notice 2020-04 also states that a “cover letter should be attached to the front of the federal Form 3115 or Form 1128, clearly indicating that a ‘Change in Accounting Period’ or a ‘Change in Accounting Method’ is being requested” and that the “name of the taxpayer requesting the change and the taxpayer’s CCN must be included in the cover letter.”¹⁵ Furthermore, Notice 2020-04 specifies an additional requirement that “[t]axpayers should attach their federal Form 3115 to their California return, as well as a California-specific pro forma Form 3115 showing adjustments to the impact of the accounting method change to reflect, for example, federal-to-state differences in depreciable basis, useful life, or applicable method of depreciation.”¹⁶ Notice 2020-04 still requires the cover letter and Form 3115 to be mailed to the FTB’s Change in Accounting Periods and Methods Coordinator at the address listed therein. However, it is unclear from the language of Notice 2020-04 whether a cover letter and/or separate submission to the FTB’s Change in Accounting Periods and Methods Coordinator is required under all circumstances, or if it is only required when the taxpayer must secure the FTB’s prior consent to make an Accounting Method Change.

Considerations

Notice 2020-04’s grant of automatic consent for California-Only Changes will streamline the process surrounding California-Only Changes, as taxpayers will no longer be required to secure the FTB’s prior consent for these changes. However, ambiguities exist in the language of Notice 2020-04, including the exact procedures required to implement various Accounting Method Changes. For example, for changes where there is deemed California consent, or when automatic consent is granted, it is unclear whether a taxpayer is required to include a cover letter with the Form 3115 and/or separately submit a copy of the Form 3115 to the FTB’s Change in Accounting Periods and Methods Coordinator, or whether attaching the Form 3115 to its California tax return is sufficient to effectuate the Accounting Method Change. Additionally, it is unclear whether prior FTB consent is required, or if automatic consent is granted, where, for example, a taxpayer changes to Method A for federal tax purposes, but opts out of that federal method change for California tax purposes and instead changes to Method B for California tax purposes only. Given the ambiguities in Notice 2020-04, taxpayers should consult with their tax advisers before implementing Accounting Method Changes to ensure that all necessary requirements have been satisfied. Failure to adhere to Notice 2020-04’s requirements could result in the Accounting Method Change being denied and/or the imposition of California tax penalties and interest.

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¹ Cal. Rev. & Tax Code §§ 17024.51(f); 23051.5(f). Note that, for purposes of the Corporation Tax Law, CRTC section 24651 generally governs changes in accounting methods. Notably, CRTC section 24651(e) states that "[e]xcept as otherwise expressly provided under [the Corporation Tax Law], a taxpayer who changes the method of accounting on the basis of which it regularly computes its income in keeping its books shall, before computing its income under the new method, secure the consent of the Franchise Tax Board." CRTC section 23051.5(e) and (f) provide further guidance on how to secure the FTB's consent for an Accounting Method Change. Although the corresponding CRTC section under the Personal Tax Law contains more general language (e.g., generally conforming to "subchapter E of Chapter 1 of Subtitle A of the [I.R.C.], relating to accounting periods and method of accounting...except as otherwise provided," both the Corporation Tax Law and the Personal Income Tax contain the same language under CRTC sections 23051.5(e) and (f) and 17024.5(e) and (f) which explains how to secure the FTB's consent to make an Accounting Method Change.

² Cal. Rev. & Tax Code §§ 17024.51(e)(1); 23051.5(e)(1).

³ Cal. Rev. & Tax Code §§ 17024.51(e)(3)(A); 23051.5(e)(3)(A).

⁴ FTB Notice 2020-04, p. 2.

⁵ See e.g., FTB Notice 2000-8; FTB Notice 2017-03.

⁶ FTB Notice 2020-04, p. 2.

⁷ FTB Notice 2020-04, p. 3.

⁸ FTB Notice 2020-04, p. 2. Note that the prior FTB Notice 2000-8 had provided additional statements qualifying when deemed California consent was granted – namely, in addition to stating that the federal change would apply for California tax purposes "as long as California has conformed to the underlying law which is being applied," Notice 2000-8 also stated – "the authority for granting the request is within the [FTB's] authority, and the [FTB] has not announced that it will not follow the federal procedure being relied upon." See Notice 2000-8, p. 1. Notice 2020-04 deletes the latter statements.

⁹ FTB Notice 2020-04, p. 2.

¹⁰ FTB Notice 2020-04, p. 3.

¹¹ See FTB Notice 2020-04, p. 2 (providing additional explanation).

¹² With respect to deadlines, the prior FTB Notice 2000-8 stated that such federal Form 3115 or federal Form 1128 "should be completed and submitted to the [FTB] by the due date specified in California law or, if none is specified, by the due date for a federal change request if a federal change request had been submitted to the [IRS] for that change." See FTB Notice 2000-8, p. 1.

¹³ FTB Notice 2020-04, p. 3.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* Prior FTB Notice 2000-8 did not explicitly state this requirement.