

California Penalty Relief Offered for 2015 on Market Sourcing Regulation

Overview

On March 29, 2017, the California Franchise Tax Board (FTB) issued FTB Notice 2017-02 providing business entities and individual taxpayers relief from late payment penalties imposed as a result of an underpayment of tax due to complying with the new amendments to California Code of Regulations, Title 18, Section (Regulation) 25136-2 that were finalized on September 15, 2016.¹ According to FTB Notice 2017-02, certain procedures must be followed, and the relief is limited only to tax liabilities shown on timely filed returns for taxable years beginning on or after January 1, 2015 and before January 1, 2016.

This Tax Alert provides background on the amendments made to Regulation 25136-2, summarizes the eligibility and procedural requirements to obtain penalty relief under FTB Notice 2017-02, and provides some taxpayer considerations.

California Amendments to Regulation 25136-2

On September 15, 2016, the FTB finalized amendments made to Regulation 25136-2, which is California's market-based sourcing regulation for the assignment of sales of services and intangible property.² The amendments generally apply to taxable years beginning on or after January 1, 2015, and provide definitions for marketable securities in general and for securities and commodities dealers; assignment rules for marketable securities; and assignment rules for interest, dividends, and goodwill.

Summary of FTB Notice 2017-02

Under California Revenue and Taxation Code (CRTC) Section 19132, the FTB imposes a penalty for late payment of tax when a taxpayer fails to pay the amount shown as tax on a return (or required to be shown) on or before the due date of the return, unless the taxpayer establishes that the late payment was due to reasonable cause and not willful neglect. In FTB Notice 2017-02, the FTB states that, for taxable years beginning on or after January 1, 2015 and before January 1, 2016 only, it will presume that reasonable cause and not willful neglect exists where the late payment resulted from applying the new amendments to Regulation 25136-2. Under this circumstance, the FTB will waive this penalty whether the request for relief from the penalty occurs prior to payment of the penalty, or is in the form of a claim for refund of amounts paid in satisfaction of the penalty. This penalty relief is available to business entities or individual taxpayers including nonresident individuals properly included in a group return under CRTC Section 18535.

This penalty relief is *not* available for delinquent filing penalties imposed as a result of failing to timely file returns such as those imposed under CRTC Sections 19131, 19172, and 19172.5. Additionally, FTB Notice 2017-02 states that properly imposed penalties for which California statutes do not provide a reasonable cause exception cannot be waived.

To request relief under FTB Notice 2017-02, taxpayers must complete the following steps:

1. Submit the form below that applies to the specific taxpayer requesting relief:
 - a. FTB 2924, Reasonable Cause – *Business Entity Claim for Refund*, or
 - b. FTB 2917, Reasonable Cause – *Individual and Fiduciary Claim for Refund*;
2. On the top of the applicable form, write "25136-2 Penalty Relief;"

¹ FTB Notice 2017-02, available [here](#).

² The amendments made to Regulation Section 25136-2 were previously discussed in our Multistate Tax Alert, dated October 9, 2016, available [here](#).

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3. On "Part 3 – Reasonable Cause Explanation and Refund Amount," compute and explain the amount of the late payment that is attributable to compliance with the new amendments to Regulation 25136-2 for only taxable year beginning on or after January 1, 2015 and before January 1, 2016; identify the amount of the late payment penalty imposed and attach a copy of the FTB notice showing the amount of the penalty imposed; and
4. If the request is a prepayment request for relief from the late payment penalty, enter "zero" for the "Refund Amount."

Considerations

Taxpayers that receive FTB notices or similar correspondence imposing the late payment penalty under CRTC Section 19132 may want to consult with their tax advisers and consider requesting relief from that penalty under FTB Notice 2017-02, if the penalty relates to a tax liability resulting from application of the new amendments to Regulation 25136-2 to the taxable year beginning on or after January 1, 2015 and before January 1, 2016. The fact that the FTB has limited relief only to calendar year 2015 in FTB Notice 2017-02 reinforces the need for taxpayers to accurately apply the new amendments to Regulation 25136-2 for all subsequent tax years. Taxpayers should also remember that penalty relief under FTB Notice 2017-02 only applies to the late payment penalty under CRTC Section 19132, and does *not* apply to delinquent filing penalties or other penalties properly imposed under California tax laws.

If you have questions regarding FTB Notice 2017-02 or other California tax matters, please contact any of the following Deloitte Tax professionals:

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