

# 2009 California Update Follow-Up

This is the first year for a follow-up to the California Update presentation, but there were a few items that would benefit from clarification or additional emphasis:

## **Disaster Losses**

A disaster loss is a type of casualty loss that receives special tax treatment. Disaster loss treatment is allowed for federal purposes after a presidential declaration. Disaster loss treatment is allowed for California purposes after a governor declaration and subsequent state legislation. If the disaster receives both a federal declaration and a California declaration accompanied by legislation, special tax loss treatment is allowed for both federal and California purposes.

**Note:** There were 4 presidentially-declared disasters in 2009, qualifying for special federal tax treatment:

- September tsunami that occurred in American Samoa;
- September storms and floods in the state of Georgia;
- August storms and floods in the state of New York; and
- August storms and floods in the state of Kentucky.

## **Recent Changes in Federal Disaster Treatment**

It is important to mention that the following federal disaster and casualty loss tax changes resulted from the National Disaster Relief Act of 2008:

- All taxpayers, not just those who itemize, can claim a disaster loss deduction regardless of AGI;
- For years beginning after 12/31/08, the amount by which individual taxpayers must reduce their personal casualty and disaster losses increases from \$ 100 to \$ 500. (The reduction returns to \$ 100 for taxable years beginning after 12/31/09);
- Elimination of the previous requirement that only allowed a net disaster loss deduction if the disaster loss exceeded 10% of AGI; and
- Provision of a 5-year NOL carryback for qualified disaster losses.

**Federal Form Change:** The Internal Revenue Service has recently released new *Schedule L Standard Deduction for Certain Filers* which allows for the increase to the normal standard deduction for a net disaster loss.

### **Resulting California Casualty Nonconformity**

California does not conform to any of these recent federal changes. In order to claim a disaster loss, a California taxpayer must itemize deductions. The following rules apply to claiming a disaster loss on a California tax return:

- Personal disaster losses are only claimed as an itemized deduction;
- Each personal casualty and disaster loss is reduced by \$ 100;
- There is a 10% of federal AGI reduction for personal disaster and casualty losses;
- If the loss qualifies under IRC § 165(i), the taxpayer may elect to deduct the loss from the previous year's income;
- The NOL deduction is limited to 90% of AMTI; and
- A disaster loss is not subject to the NOL suspension rules for 2008 and 2009; and
- Disaster losses are allowed a 15 year carryover if designated by statute (R&TC §§17207 and 24347.5).

### **2009 California Disasters in Contrast to 2008 California Disasters**

There were ten California fires in 2009 which can be viewed at [www.FEMA.com](http://www.FEMA.com).

An important distinction between the 2009 fires, and the fires that began in November 2008, is that the 2009 California fires were governor-declared disasters **only** [AB 1568 (CH 09-299)]. This is in sharp contrast to the November 2008 fires that affected the counties of Los Angeles, Orange, Riverside and Santa Barbara which were presidentially-declared disasters, as well.

When both the president and the governor make a disaster declaration, special tax treatment is available on both the federal and state income tax return. When the disaster is a governor-declared disaster only, special federal tax treatment is **not** available. The losses are given normal federal casualty loss treatment.

Since the 2009 fire losses are not allowed federal disaster treatment, a California taxpayer will calculate the loss for federal purposes like any other casualty or theft loss occurring in 2009 on *Form 4684 Casualties and Thefts*, reducing the loss by \$ 500 and 10% of federal AGI. The net casualty loss transfers to *Schedule A Itemized Deductions*. The 2009 fire loss is **not** eligible as an increase to the standard deduction on new Federal *Schedule L Standard Deduction for Certain Filers*. It is treated as a regular federal casualty loss deduction.

Since the 2009 fires were not presidentially-declared disasters, the 2009 federal casualty loss may only be deducted on the 2009 Federal Form 1040, as an itemized deduction. For California purposes, a victim of the 2009 Southern California Wildfires may deduct the loss as an itemized deduction on either the 2009 return or the 2008 return, subject to the dates for making this election.

### **California Disaster Loss Treatment**

Once a disaster is governor-declared, subsequent state legislation is required in California to activate the disaster provision for California tax purposes.

California personal disaster losses are subsequently reduced by:

- \$ 100; and
- 10% of federal AGI.

Victims of the 2009 Southern California Wildfires are eligible to deduct the loss on either the tax return for the year of the disaster (2009), or to deduct it on the return for the year previous to the disaster (2008) as a result of AB 1568 (CH 09-299) which followed the governor's declaration. The election to deduct the loss on the previous year's tax return must be made by the later of:

- The due date (including extensions) of the return for the taxable year in which the disaster occurred (the 2009 return); or
- The due date (including extensions) of the return for the taxable year preceding the year in which the disaster occurred (2008 return).

To claim a 2009 California-only disaster loss on a 2008 California tax return, taxpayers should print "Southern California Wildfires 2009" in red at the top of the original or amended tax return for 2008 to alert the FTB to expedite the refund.

### **Property Tax Changes for Disaster Victims**

California disaster victims, who acquire a new property in the same county to replace damaged/destroyed property, are eligible for base-year value transfers for property tax purposes under R&TC § 69 for all property types. The requirements before recent law changes were:

- The damaged/destroyed property is located in a governor-declared disaster area;
- The damage to the appraisal unit (land and improvements) is more than 50% of its FMV before the disaster (see law change below);
- The replacement property is located in the same county;
- The replacement property is comparable to the damaged/destroyed property;
- The FMV of the replacement property does not exceed 120% of the FMV of the damaged/destroyed property before the disaster; and
- The replacement property is acquired (or built) within 5 years of the disaster.

When the replacement property exceeds the 120% of FMV rule, only the amount that exceeds the threshold is assessed for property tax purposes at FMV.

R&TC § 69.3 provides similar disaster base-year value transfer relief to principal residences only, when the replacement property is purchased in a **different** county from the county where the disaster occurred. This provision is also only available if the board of supervisors of that county makes this benefit available by ordinance. Currently, nine California counties allow the base-year value transfers for displaced homeowners from other counties. Additionally, the provisions of R&TC § 69.3 limit the amount of base-

year transfer to various percents of the FMV of the original property, depending upon the year the replacement property is purchased in relation to the year of the disaster.

**New Law:** Beginning January 1, 2010, the 50% damage test under R&TC §§69 and 69.3 is applied separately to land and improvements. This change will benefit taxpayers whose land comprises more than 50% of a property's total value. If either component suffers a loss in value of more than 50%, the property owner will now qualify for a base-year value transfer.

For purposes of comparing values of the original and replacement properties' values, within the 120% FMV limitation, land and improvements continue to be considered as one appraisal unit.

To request a base-year value transfer, file *Form BOE-65-P Claim for Intracounty Transfer of Base Year Value for Property Damaged or Destroyed in a Governor-Declared Disaster to Replacement Property* with the county assessor.

### **IRS Disaster Resources**

For additional information, practitioners should access the special "Disaster Relief Resource Center for Tax Professionals" at [www.irs.gov](http://www.irs.gov). The following federal publications can also assist with the preparation of a federal return, which includes a disaster loss:

Publication 547	Casualties, Disasters and Thefts
Publication 584	Casualty, Disaster, and Theft Loss Workbook
Publication 584B	Business Casualty, Disaster, and Theft Loss Workbook
Publication 1600	Disaster Losses-Help from the IRS

### **FTB Disaster Resources**

For additional information for California taxpayers, refer to *FTB Publication 1034 Disaster Loss: How to Claim a State Tax Deduction*.

### **New Tax Treatment for Certain Military Spouses**

The Military Spouses Residency Relief Act of 2009 (MSRRA) made changes to the treatment of certain military spouses for employment tax and income tax purposes:

- A spouse is not deemed to have lost a residence or domicile in any state solely by reason of being absent to be with a servicemember serving in compliance to military orders; and
- A spouse is not deemed to have acquired a residence or domicile in any other state solely by reason of being there to be with the servicemember serving in compliance with military orders.

## **Employment Tax**

Spouses of affected military servicemembers, whose wages are no longer subject to California income tax, as a result of MSRRA 2009, should complete the new *DE 4 Employee's Withholding Allowance Certificate* that was recently released by the EDD. The new form has a checkbox for electing the exemption from state taxes. California employers are required to continue withholding state income tax until the employee provides a new DE 4.

Once the signed DE 4 is in effect claiming the income tax exemption, employers continue to report the military spouse's total subject wages on *Form DE 6 Quarterly Wage and Withholding Report*. Employers report zero for both PIT wages and PIT withholding for the military spouse. The wages continue to be "subject wages", for SDI, UI and ETT.

## **Income Tax**

MSRRA 2009 applies if:

- The servicemember and the spouse have the same residence or domicile outside of California; and
- The spouse is in California solely to be with the servicemember who is serving in compliance with military orders.

**Note:** The MSRRA exemption from tax applies to the spouse, but does not apply to wages earned by the servicemember from a nonmilitary part-time or side job.

The FTB has revised *FTB Publication 1032 Tax Information for Military Personnel* as a result of MSRRA 2009. The publication includes these recent changes as well as how to apply the community property income rules to joint and separate tax returns of persons in the military. It is available online at [www.ftb.ca.gov](http://www.ftb.ca.gov).

## **Use Tax Return Update**

According to information recently received from the the Board of Equalization (BOE), the new use tax return account numbers that will be issued to non-retailing businesses with a 2009 use tax filing requirement (gross receipts of \$ 100,000 or more) will be mailed to the business in late February 2010. If a business is not assigned an account number, the only way to secure a number is to go to the local office of the BOE. They will not be assigned by phone or online.

The BOE has announced that they will be checking compliance for 2007 and 2008 as well. When appropriate, practitioners may want to suggest certain individuals or business consumers take advantage of the Voluntary Disclosure Program for In-State Consumers (VDP), which allows an individual and/or business to be subject to a three-year statute of limitations rather than the normal eight year statute for unreported use tax.

To qualify for VDP, the following requirements must be met:

- The consumer resides (or the business is located) in California, and has not previously registered;
- The consumer has not filed an Individual Use Tax Return (Form BOE-401-DS);
- The consumer has not reported use tax on the tax return filed with the FTB;
- The consumer is not engaged in a retailing business as defined in R&TC 6015;
- The BOE has not contacted the consumer for failure to report use tax;
- The purchases subject to use tax are not vehicles, vessels, or aircraft; and
- The consumer voluntarily comes forward (discloses).

To request an opinion as to whether or not the Board would be inclined to approve a voluntary disclosure request or to discuss eligibility for consideration, the consumer can contact:

Board of Equalization  
Voluntary Disclosure Program  
PO Box 942879 (MIC 44)  
Sacramento, CA 94279-0044  
916-324-2883  
916-322-0187 (fax)

Once a consumer is contacted by the BOE about a potential failure to report use tax, the consumer is no longer eligible for the VDP program.

To apply for VDP, the consumer completes *BOE-38-I Application for In-State Voluntary Disclosure* and *BOE-400-CSU California Use Tax Account Application*.

In cases where the returns were not filed due to reasonable causes or circumstances beyond the consumer's control, a relief of penalty request is available using *BOE-735 Request for Relief from Penalty*.

Information on the VDP program for In-State Consumers is available at:

<http://www.boe.ca.gov/sutax/isvdprog.htm>