Transcript for FTB Webinar – FTB 5805 – PIT Estimated Tax Penalty

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[Good morning and welcome to today’s webinar. My name is Connie] Hughes and I will be your presenter today.

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Before we get started, I would like to go over a few webinar tips for today’s presentation and mention our upcoming webinar.

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This slide shows an image of the control panel that is similar to the one on your screen. On it are the various parts of the control panel and their functions. Please use it as a reference on how to use the control panel during the presentation.

Notice that your control panel has a dial-up number and an access code on it. If at any time during the presentation, you lose our signal, or you cannot hear an audio, please call the number listed on your screen to hear the webinar over the phone.

At the bottom of the control panel, you can type a place in questions. Please feel free to type in your questions at any time during the webinar. I’ll do my best to answer those questions at the end of the presentation or respond back to you after the webinar.

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Check our September Tax News for a registration link for our upcoming webinar. On September 23rd, we will cover Filing a FTB Form 540NR from 10 a.m. to 11 a.m.

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For tax professionals attending today, due to the limited FTB resources, this webinar does not qualify for Continuous Educational Credit.

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Let’s get started!

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Today's objectives include:

- When to make estimated tax payments
- Required payment amounts
- How to calculate quarterly payment amounts
- How to calculate underpay of estimated tax payment penalty
- Self-help tools available, *and*
- Bits and pieces

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For California, individuals are **not** required to make estimated tax payments, if:

- The current or the prior year tax liability, not including lump-sum distribution, minus credits and withholding, is less than $500, or less than $250 if married filing separate, *or*
- The prior year was a full 12 months and the tax liability, even if the return was not required, was $0

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In order to avoid an estimated tax penalty, individuals must pay at least 90% of current year tax liability or 100% of prior year tax liability including AMT.

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Let's look at an example Mr. and Mrs. Smith's joint tax liability for 2013 was $2,859. For tax years 2012, their tax liability was $2,919. 90% of the current year, tax liability is $2,573. Mr. and Mrs. Smith must pay at least $2,573 in four quarterly installments which is less than 100% of prior year.

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Individuals with an AGI of more than $150,000, or more than $75,000 if married filing separate, must pay at least 90% of current year, or 110% of prior year's tax.

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Let's take a look at an example of the 90, 110% calculation. Let's assume Mr. and Mrs. Jones' AGI was $155,000 for 2013. Their tax liability including AMT was:

a) $8,813 for 2013, and
b) $2,919 for 2012

1. 90% of current year tax liability is $7,932 or
2. 110% of prior year tax liability is $3,211

Mr. and Mrs. Jones must pay $3,211 in four quarterly installments to avoid a penalty.

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Beginning with tax years 2009, individuals with an AGI of $1 million or higher, or $500,000 or more, if married filing separate, are *not* eligible to use the prior year exception to calculate their estimated tax base. They must use 90% of current, even if the prior year is less.

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Let's look at an example of the 90% current year rule for higher income taxpayers:

Mr. and Mrs. Grant's 2013 joint AGI was $1,250,000. Their tax liability including AMT and mental health tax was:

a) $127,518 for 2013 or
b) $80,715 for 2012

1. 90% of current year is $114,766 or
2. 110% of prior year tax is $88,787

Because the AGI exceeds $1 million, they would have to pay at least 90% of current year tax liability, even though prior year is less.

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Now, let's look at how to calculate quarterly payment amounts.

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Using the worksheet in the 540-ES instructions to calculate the tax base, the prior year AGI can be used if the current year estimate AGI is undeterminable. Tax preparers using software to calculate the tax base should manually verify the calculation is correct before determining the tax payment. Let's walk through an example of the calculation.

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Mr. and Mrs. Williams' estimated California AGI is $1,750,000.

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Subtracting their standard or itemized deductions.

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Their taxable income is: $1,742,188.

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Their tax, based on the taxable income, equals $188,057.

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If adding AMT and mental health, their estimated tax liability comes up to: $195,479.

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Let's get to the tax base, multiply the estimated tax liability, by 90%. Remember individuals with an AGI exceeding $1 million, or $500,000, married filing separate, and are ineligible to use the prior year exception. In this case, the tax base equals $175,931.

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There are two methods individuals can use to calculate the estimated tax payment amounts: the income method or the annualization method.

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The income method is the default method. Individuals may use the income method if their income is earned or received evenly throughout the year. Payments are calculated by multiplying the tax base by the California quarterly percentages, which are 30, 40, 0, 30%, respectively. The Federal percentages are still 25% per quarter.

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Using the prior tax base of $175,931 calculated in the Mr. and Mrs. Williams' example, let's determine their quarterly payment amounts under the income method. They would multiply the tax base by 30% for the first and fourth quarter, 40% for the third quarter. And no payment are generally is due in the third quarter. Their quarterly payments would be $52,779, $70,372, $0, and $52,779, respectively.

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The annualization method may be elected if the individual's income is earned or received unevenly throughout the year. The election is made by checking the box for Question 2 on the 5805, Part 1.

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The 5805, Part 3, is completed by determining the quarterly payment amounts under the annualization method.

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The results from line 23 of the 5805 are the payment amounts due per quarter. The sum of the payments should equal the tax base. If it doesn't, check the calculation even if software was used.

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Mark "*yes*" for Part 1, Question 3, if the withholding credit was not withheld evenly throughout the year. Individuals answering "*yes*" to the question will need to maintain substantiation for the allocation and provide it upon request.

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Let’s look at how to apply withholding. Jocelyn is a sales representative and receives commissions based on her monthly sales.

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She would allocate the withholding in the quarter the income is reported by completing Question 3 as shown on your screen.

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Now that we have calculated the tax base and the required payment amounts, let’s discuss payment dates. Payments are due on April 15th, June 15th, September 15th, and January 15th. If the due date falls on a weekend or a holiday, the payment is due the next business day. Keep in mind, penalties may apply, if a partial payment is made for any quarter, until the complete payment is made.

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Using the required payments calculated under the “income method” example earlier; let’s look at the “partial payment” example. The taxpayer is required to make the following quarterly payments:

a) 1^{st} quarter is $52,779
b) 2^{nd} quarter is $70,372
c) 3^{rd} quarter is $0 and the
d) 4^{th} quarter is $52,779

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For this example, the taxpayers make the following timely payments of:

a) April 15^{th} of $50,000
b) June 15^{th} of $70,372
c) September 15^{th} of $0 and
d) January 15^{th} of $55,558

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As you can see, the taxpayer underpaid the first quarter and overpaid the fourth quarter.

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Now that you have established the tax base, the required payment amount, and the underpayment amount, we can calculate the penalty.

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Individuals can calculate their penalty by using:

a) Worksheet 2 in the 5805 instructions
b) The short method on the 5805, Part 2, if qualified, *or*
c) Letting us calculate it for you.

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1. The penalty is figured by multiplying the underpayment amount by the ratio of (the number of days the payment is late divided by 365 days) then by the appropriate rate. The rate is established at various times throughout the year. Individuals can use Worksheet II in the 5805 instructions for the year the penalty applies.

2. The short method to calculate the penalty amount may be available for some individuals. To qualify for the shorter method, individuals must be a calendar year taxpayer, and meet one of the following situations:

   a) No estimated tax payments were made
   b) The only payments were CA withholding, or the
   c) Estimated tax payments were paid on the required due dates

3. If we calculate the penalty for you, and issue a bill, you will have 15 days to pay it in full before additional interest is assessed.

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Let's look at how we calculate the penalty for you:

Using the due dates for 2013, which were April 15th, June 15th, September 15th, and January 15th, 2014.

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We add the required installment amount determined in the previous example for each quarter.

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We would apply any withholding based on the amount from Question 3 on the 5805 or apply the withholding based on the quarterly percentages of 30, 40, 0, and 30%.

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The timely payment for each quarter was $50,000, $70,372, $0, $55,558, which $52,779 is applied in the 4th quarter. The overpayment of the 4th will be used to pay the underpayment in the 1st quarter.

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Add any overpayments from the previous quarter

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We total the timely payment and the withholding credit, then

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Subtract the total from the required payment amounts to get the underpayment amount.

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As you can see on the screen, the first quarter was underpaid by $2,779. What you don't see is the residual from the 3rd from the 4th quarter payment, which will be applied later.

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The payment or the penalty amount is$62.82.

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We arrived at the penalty by applying the equation discussed earlier:

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The partial payment was received on April 15th and completely paid on January 15th, 2014, which is 275 days.

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To calculate the penalty amount, we take 275 days divided by 365 days.

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For a ratio of .7534

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Now multiply the ratio by the underpayment amount.

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Which equals $2,094.

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Finally, multiplying the result of $2,094 by the appropriate rate of 3% for 2013.

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The result, $62.82, is the penalty amount.

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The equation that we used to calculate the penalty amount is the same one shown on Part II of Worksheet II in the 5805 instructions.

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Let's talk about self-help tools available to assist you and your clients.

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My FTB Account is available to view:

- Account summary and tax year detail
- Up to 25 estimated tax payments, estimated transfers and extension payments
- Up to 60 of the most recent payments applied to the balances due, which include all forms of payment such as webpay, credit cards, or check
- California wages and withholding information
- Up to 3 years of FTB-issued 1099-Gs and 1099-INTs
- General information such as mailing address and telephone numbers

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For frequently asked questions regarding estimated tax payments, view our website and search for "FAQ estimate."

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Now let's go over some bits and pieces of advice regarding estimated tax payments.

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One of the most common requests we get on the Tax Practitioner Hotline is to move the current year estimated tax payment or credit over to pay a prior year balance.

How many of you know that you are making a binding election when you elect on the FTB form or in writing, to have the overpayment applied to the following year.

The election to apply this year's overpayment to the next year's estimate generally cannot be revised. Once the election has been made, the overpayment cannot be brought back or used against a deficiency occurring in a prior year.

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Let’s go over a common example:

When Ryder filed his 2013 return, he had a $2,000 refund which he elected to have applied against his 2014 estimated tax.

Later in the year, he discovered that he had forgotten to include some interest income that increased his tax liability by $500.

Since the election is irrevocable, Ryder must pay the $500 plus interest and any applicable penalty.

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When your client makes an estimated tax payment for the current year, we are prohibited, by law, from moving the payment to cover a prior year deficiency.

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Another common request is to waive estimated tax payment penalty. If an individual does not meet one of the exceptions discussed earlier, generally, the penalty cannot be abated. However, two situations allow us to waive the penalty:

a) Underpayment of estimated tax payments due to casualty, disaster, or unforeseen circumstances, *or*
b) An individual is at least 62 years old and newly retired or disabled and the underpayment is due to reasonable cause and not willful neglect.

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A law change is also a common concern when determining estimated payments. I can’t tell you how many times I am asked to waive the entire penalty amount because a law change, but the individual did not make any required payments or paid late. The individual still subject to the penalty regardless of the change in the law. However, it is unfair to an individual if the penalty is increased by the law change that is chaptered and operative in the same year.

Therefore, we will waive the difference between the penalty amount after the law change, and the amount before the change; not the entire penalty. This is the reason why we asked to submit two 5805s: one to calculate the penalty using new laws and one to calculate the penalty prior to the law change. The difference in the penalty amount will be waived.

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Let’s assume a bill was chaptered on September 29, 2011 for tax years on, or after, January 1, 2013. The bill repealed the use of all prior year exceptions when calculating the estimated tax payments. As a result of our hypothetical law change, all the individuals would have to use 90% of current year even if prior year was less.

R&TC §19136(g) (1) would not apply because the law was chaptered in 2011 but operative in 2013. Therefore, the law change was not operative and chaptered in the same year.

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Some of you can remember, CA voters approved Prop 30, which increased the tax rate for the higher income individuals. The new rates applied for tax years on, or after, January 2012.

Prop 30 was retroactive, so it was operative for the entire year, but enacted in November. R&TC §19136(g) (1) would apply because the change was operative and enacted in the same year.

For more information, you can view our webinar, *How to Request Waiver for the Underpayment of Estimated Tax Penalty due to Prop 30*, which is available on our website.

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Now it is time for questions. Please note, that we will answer only general questions. For account specific questions, please call us at 916.845.7057. Again, that number is 916.845.7057.

You can submit your questions through "Ask Question" window on our Go to Meeting Dashboard. Depending on the volume of questions received, we may present a series of standard questions and answers.

If we cannot answer all your questions within the allotted time period, we will email you with the answer.

Questions and Answers

Question 1: How do I get a copy of this presentation?

You can request a copy of this power point presentation and script by using the question box on our dashboard. You may also visit our website within a week to view a copy of this presentation and script online.

Do I have to complete a 5805 if I want to use the annualization method?

Yes. The form is used to make the election and allocate the income in the quarter the income is earned or received. Without a completed 5805, the election is not made and the income allocation per quarter is not substantiated.

Can I elect to use the annualization method if I have already filed my return?

Yes, the election does not have to be on the original return. It can be made anytime to lower the penalty amount.

Why do I have a penalty when my tax liability was increased by a law change?

R&TC §19136(g) (1), generally, allows us to waive only the portion of the penalty attributable to a law change but the law must be chaptered and operative in the same year. In other words, if the individual would have had a penalty before the law change, the penalty would still be valid.

Why is there a penalty when the tax base amount was paid by January 15th?

The penalty applies when the quarterly payment amounts were not paid timely, even though, the entire amount was paid by the fourth quarter.

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That is all the time we have for questions today. If you would like to view this or prior…prior webinars, please go to our website and ***click*** on “News & Events.” Webinars are the third item listed on the left navigation bar.

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Just as a reminder, we will be hosting a webinar on Tuesday, September 23, Filing an FTB Form 540NR. Check our September Tax News for the registration link.

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This concludes our presentation today. We hope you found this webinar interesting and helpful. On behalf of the California Franchise Tax Board, thank you for attending today’s webinar.