Tax News
for tax professionals

Tax News

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Contents

Tax clearance: how to deal with the 15-day rule and avoid an additional $800 in minimum tax.

Differences exist in the statutory language and administration of the Corporations Code by the Secretary of State (SOS), and the Revenue and Taxation Code by the Franchise Tax Board (FTB) concerning when a document is considered to be "filed." The SOS date-stamps and processes documents as of the date **received** without regard to postmark. FTB accepts documents as timely if the postmark is no later than the due date of a return or payment (or the next business day if the due date falls on a weekend or holiday).

The following guidelines reconcile these differences and provide business entities treatment consistent with other FTB filing and payment policies.

Guidelines for tax clearance when the 15th day of the taxable year falls on a weekend or holiday.

To avoid entering another tax period and owing the minimum franchise or annual tax, a corporation that is dissolving or surrendering, or an LLC or LLP that is canceling or withdrawing must conduct no activity during the new tax year, and that year must be 15 days or less (R&TC Sections 17946, 17948.2, and 23114).

If the dissolving or canceling entity's 15th day of the next taxable year falls on a weekend or holiday, FTB may accept a postmark date of the next business day for a request for tax clearance as deemed filing on or before the 15th day if the entity can provide proof of postmark by:

- Sending dissolution, surrender, or cancellation forms (including 3555 or 3555L) by registered or overnight shipping directly to the SOS using a method that documents the date of mailing as well as the date of delivery.

- Providing evidence that documents were shipped to the SOS before the 15th of the month and that the 3555 was "received" by the SOS within one business day of the documented delivery of that package.

FTB will then accept it as a timely request for tax clearance. Postage marks without supporting delivery confirmation (such as regular ground mail) are not acceptable.

Guidelines for tax clearance when the business is forced to close as a result of a Presidentially declared disaster.

The R&TC provides special treatment for taxpayers impacted by a Presidentially declared disaster. Business entities forced to dissolve as a result of a declared disaster often incur an additional year minimum franchise or annual tax due to the 15-day rule since nothing specific is provided in the R&TC for these circumstances.

For purposes of a tax clearance request, FTB will process the request as being received the last day of the entity's final taxable year, if all of the following conditions are met:

- The dissolving or canceling entity's business was located within a qualified disaster area as provided under R&TC Sections 17207 and 24347.5.
- The entity was not doing business after the last day of the final tax year.
- The entity filed all required returns and payments within the extension period provided for disaster treatment under the R&TC.
- Any necessary dissolution or cancellation paperwork is filed with the SOS including FTB Form 3555 or 3555L within the extension period provided for disaster treatment under the R&TC.

For general information about obtaining Tax Clearance, visit our Website at www.ftb.ca.gov and search for **tax clearance FAQs**. You may also contact the tax clearance unit directly at (916) 845-4124.

When is the “due date” not the deadline?

Two out of every seven years, April 15 falls on a Saturday or Sunday. For simplicity, we often refer to the next business day as the "due date" of the return or payment. But that is not technically correct. The actual due date of returns and payments is set by statute, and it remains the 15th of the month. Legally, where the actual due date falls on a weekend or holiday, returns may be filed and payments may be made on the next business day without penalty. However, interest computations, statutes of limitation, and extension periods all begin on the actual due date, April 15 for individual, calendar year taxpayers, even if it falls on a weekend or holiday.

These same rules apply in other areas where deadlines fall on weekends or holidays. The statute of limitations for proposing assessments and filing refund claims is normally four years from the date the return is filed or one year from the date of payment. Tax returns and payments for the current tax year that are filed before the original due date are treated as if they are filed on the original due date. So for a personal income tax or LLC 2005 return filed early, the original due date is still Saturday, April 15, 2006, and the four-year statute of limitations will expire Thursday, April 15, 2010. But if a taxpayer takes advantage of the weekend grace period, and actually files the return on Monday, April 17, 2006, then the four-year period ends Saturday, April 17, 2010, four years from the date the return was actually filed. Since April 17, 2010, falls on a Saturday, in this particular situation a claim or assessment notice will be timely if mailed on Monday April 19, 2010.

Where the deadline is not based on a specific date, but on a period of time like "six months" or "one year" then even more interesting problems arise. What happens if the six-month period begins on August 31? There is no February 31. The answer is that on the last day of February, six months have elapsed, so the payment or filing is due on February 28 (February 29 if it is a leap year). In the opposite situation, where the six-month period starts on February 28, the last day of the month, the notice is not late until September 1. It can be filed on August 30 or 31 and still be within six months of February 28. Unless, of course, that due date is a weekend or holiday, then it would be timely if mailed on the next business day as described above.

References: 18 Cal. Code Regs. Section 18566 (return due dates); Calif. Civil Code Section 11 (general rule that action performed on the next business day after a weekend or holiday is timely); Cal. Code of Civil Proc. Section 12 (Computation of time for performing acts required by law.) See also federal Internal Revenue Code Section 7503, PLR 6002104690A, 02/10/1960 (six months issue).

Check casher businesses must file information returns

New information reporting requirements for check casher businesses operating in California went into effect on January 1, 2006. Assembly Bill 139, enacted on July 19, 2005, amended Civil Code Section 1789.30 and added Revenue and Taxation Code Section 18631.7 to the law. If you have clients who are check cashers, we have established a new Webpage to assist them in meeting these requirements. The Webpage offers guidance on how to comply with the new law and instructions on how to get assistance. Click **on http://www.ftb.ca.gov/businesses/ck_cash.html** or visit our homepage at **www.ftb.ca.gov** and search for **check casher.**

Who must file as a check casher?

"Check casher" means a person or entity that for compensation engages, in whole or in part, in the business of cashing checks, warrants, drafts, money orders, or other commercial paper serving the same purpose (Civil Code Section 1789.31).

Exceptions

This law does not apply to state and federally chartered banks, savings associations, credit unions, and industrial loan companies.

"Check casher" also does not include a retail seller engaged primarily in the business of selling consumer goods, including consumables, to retail buyers who cashes checks or issues money orders for a minimum flat fee not exceeding two dollars ($2) as a service to its customers that is incidental to its main purpose or business (Civil Code Section 1789.31(a)).

What to report

Check cashers who cash checks in the course of their trade or business are required to file an information return with the Franchise Tax Board for either:

- Checks totaling more than 10 thousand dollars ($10,000) in one transaction.
- Checks totaling more than 10 thousand dollars ($10,000) in two or more transactions for the same person within the calendar year.

Check cashers must provide the following information about affected transactions:

- The name, address, taxpayer identification number, and any other identifying information of the person presenting the check that the Franchise Tax Board deems necessary.
- The amounts and dates of each transaction.

For reporting purposes, examples of acceptable identifying information include the person's taxpayer identification number or social security number. If your clients are unable to provide either of these identifying numbers, they should provide the form of identification and identifying number used to cash the checks, or any other identifying information used to cash the checks. If no identification was used to cash the check, check cashers must provide a short explanation with their returns explaining why they are unable to provide identification information.

Missing information
Check cashers who are unable to provide information about a reportable transaction occurring during the first half of the first reporting year (January 1 through June 30 2006), should send us a letter or email explaining the reason for the inability to comply. Send your letter with your return during the filing period, January 1 2007 - April 2, 2007. Send it to:

Check Casher Information Reporting MS A-181
Franchise Tax Board
PO Box 1468
Sacramento CA 95812-1468

Email address:
IRPhelp@ftb.ca.gov

Checks
For information reporting purposes, “checks” includes warrants, drafts, money orders, and other commercial paper serving the same purpose (Revenue and Taxation Code Section 18631.7).

When to file
Annual filing is on a calendar year basis. The law requires check cashers to provide the information to the Franchise Tax Board no later than 90 days after the end of the calendar year.

The filing period for reporting on transactions occurring in calendar year 2006 is January 1, 2007, through April 2, 2007.

How to file
Your clients can file on paper or put their information on CD-ROM. Forms for paper filing, and record layouts and media specifications for submitting returns on CD-ROM will soon be available on the Check Casher Webpage. For answers to questions, you or your clients can also call our Information Reporting Helpdesk at (916) 845-6304 and we will send filing resources to you. When you mail your clients’ returns:

- Clearly identify all CD-ROMS. Do not, however, place large gummed labels on the CD-ROMS – they block our ability to read the data.
- Include the submission date, your clients’ business names, and the sequence of each volume submitted e.g., 1 of 2, 2 of 2, etc. If only one volume is submitted, label it 1 of 1.
- Be sure to download a Check Casher Program Transmittal Form from our Website and include it with your file. Do not mail it separately.

Businesses with multiple locations
Individuals, partnerships, or corporations that operate more than one check casher location should aggregate the data from all locations and submit a single information return through their headquarters.

Penalties for noncompliance
Check cashers that fail to file correct information returns by the due date and cannot show reasonable cause, may be subject to a penalty. The penalty applies for failure to file timely, failure to include all information required on a return, or including incorrect information on a return. The penalty also applies if your client does not file machine-readable paper forms.

The amount of the penalty is based on when the correct information return is filed. The penalty is:

- $15 per information return if correctly filed within 30 days of the due date of the return; maximum penalty $75,000 per year ($25,000 for small businesses).
- $30 per information return if correctly filed more than 30 days after the due date but by August 1, maximum penalty $150,000 per year ($50,000 for small businesses).
- $50 per information return if filed after August 1 or if the required information returns are not filed, maximum penalty $250,000 per year ($100,000 for small businesses).

Small businesses - lower maximum penalties.
For information reporting purposes, you are a small business if your average annual gross receipts for the three most recent tax years (or for the period you were in existence, if shorter) ending before the calendar year in which the information returns were due are $5 million or less.

Where to get help
Call our Information Reporting Helpdesk at (916) 845-6304. We are available from 7:00 a.m. until 4:00 p.m., Monday through Friday except for official State holidays.

Write to us at:
Check Casher Information Reporting MS A-181
Franchise Tax Board
PO Box 1468
Sacramento CA 95812-1468

Email address:
IRPhelp@ftb.ca.gov.

Recommended practices for protecting the confidentiality of social security numbers
We recognize that information reporting places new burdens on check cashers, which includes collecting and protecting customers' social security numbers. The California Department of Consumer Affairs' Office of Privacy Protection has guidelines for protecting the confidentiality of social security numbers. Their recommendations are available on their Website at **www.privacy.ca.gov.**

FTB guidance on tax deposits, interest netting, and informal claims

Background

Tax Deposits: FTB Notice 2005-6 explained that California has now conformed to the federal "tax deposit" procedures for payments made after a return has been filed but before a final tax liability is assessed, and that FTB would follow federal procedures as outlined in Rev. Proc. 2005-18. Under the new rules, amounts remitted or credited when there is no final liability for the tax year are "deposits" that become "payments" when they are applied to a final liability or the taxpayer requests in writing that they be applied or refunded.

Informal Claims: FTB Notice 2003-5 explained the procedure for informal claims as added by Revenue and Taxation Code Section (RTC §) 19322.1. Where a taxpayer has made a tax payment (not a deposit) and filed a refund claim, the claim remains as an informal claim until it is perfected by full payment of all amounts due for the year. There is no corresponding federal statute to §19322.1.

Interest Netting: AB 911 (Stats. 2005, Ch. 398) amended RTC §19777.5 to allow interest netting to apply in computing the post-amnesty penalty. Interest netting allows an overpayment amount that would have received interest if it had been refunded, to instead be applied to an unpaid deficiency or due and payable amount. Underpayment interest is reduced for the period of time that overpayment interest would have been paid.

FTB staff is developing forms and procedures to implement the tax deposit process, and to clarify how these various provisions interrelate.

1. How do I make a tax deposit?
2. Can I make a tax deposit for more than one tax year?
3. Can I make more than one tax deposit per tax year?
4. How do I request a return (refund) of a tax deposit?
5. If I request a refund of my tax deposit, will California offset it against any other balances due?
6. How is the post-amnesty penalty computed?
7. I made a "protective claim" tax deposit for my corporation before the end of the amnesty period (3/31/05). I paid the full amount of the proposed deficiency, including proposed interest on that deficiency amount. Can I now request a return of the portion of my tax deposit equal to the interest amount and still avoid the post-amnesty penalty?
8. Does my tax deposit automatically convert my protest to a refund claim or my deficiency appeal to a claim appeal?

e-file News

e-payments
The April 17, 2006, deadline to timely pay has come and gone. If you have clients who still have not paid, encourage them to try one of our online payment options.

Your clients can use WebPay, for example, and arrange with us to debit their checking or savings account to pay any FTB bill, including current and past tax liabilities, current-year return payments, estimated tax payments, and extension payments. WebPay is available free of charge on our Website at **www.ftb.ca.gov.** Click on **payment options** or search for **WebPay**. Your client will need a CSN to use this service.

Your clients can also make credit card payments by using their Discover/NOVUS, MasterCard, Visa, or American Express Card. This service is available through **www.officialpayments.com**. (**Please note**: Official Payments Corporation charges a fee for this service.)

If you have clients with financial hardship who cannot pay their taxes in full, they can apply online to make monthly installment payments, if they meet the following criteria:

- Owe a balance of $25,000 or less.
- Agree to pay their account in five years or less.
- Have filed all required personal income tax returns.
- Agree to pay by electronic funds transfer.

For more information on credit card or installment payments, click on **payment options** or visit our Website (**www.ftb.ca.gov**) and search for **payment options**.

e-file extension
You can still e-file your clients' California individual tax returns during the automatic six-month extension period following the April 17 deadline. We accept both refund and balance due returns through October 16, 2006.

Your clients must have paid any taxes owed on or before April 17, 2006, to avoid penalties and interest. If they have not paid, they can reduce penalties and interest by making an electronic payment now. For more information, please refer to the e-payment information above.

If you are not yet an approved Electronic Return Originator (ERO) and want to e-file your clients' tax returns, you must first enroll with the Internal Revenue Service. Once you have your Electronic Filer Information Number (EFIN), complete and submit *California e-file Program Enrollment Form* (FTB <u>8633</u>) online. For more information, go to our Website at **www.ftb.ca.gov** and search for **join e-file** or click on FTB <u>8633</u>.

IRS e-Services
The IRS has scheduled a series of free phone forums qualifying for Continuous Education (CE) credit explaining how to use their e-Services. For more information and

to register, please check their California event schedule at the following link:
http://www.irs.gov/businesses/small/article/0,,id=127814,00.html

FTB follows federal extension periods, postpones deadlines for victims hardest hit by Hurricane Katrina

FTB is giving taxpayers in the hardest hit areas of Louisiana and Mississippi until August 28, 2006, to file returns and make tax payments that had a due date or extended due date on or after August 29, 2005, through August 28, 2006. This action conforms the state to the same postponement periods announced by the IRS.

An automatic postponement applies to taxpayers in the following Louisiana parishes: Cameron, Jefferson, Orleans, Plaquemines, St. Bernard, St. Charles, and St. Tammany. The postponement also applies automatically to taxpayers in the following Mississippi counties: Hancock, Harrison, and Jackson.

Taxpayers outside the above areas that suffered severe hurricane damage are also entitled to the extra time. They should identify themselves by writing “Hurricane Katrina” in red ink at the top of the tax return. If taxpayers are e-filing, they should follow the software instructions to enter the disaster information.

Taxpayers needing copies of state returns to replace returns that were lost or damaged should complete Form FTB 3516, *Request for Copy of Tax Return*. Print “Hurricane Katrina” in red at the top of the request. Disaster victims receive free copies of tax returns.

To learn more about state disaster losses, refer to publication FTB 1034, *Disaster Loss* at **www.ftb.ca.gov** or the IRS 547, *Casualties, Disasters, and Thefts at* **www.irs.gov.**

Will Bush Appointed Undersecretary of State and Consumer Services Agency

On April 3, 2006, Governor Schwarzenegger announced the appointment of Franchise Tax Board Assistant Executive Officer Will Bush to the position of Undersecretary of the State and Consumer Services Agency. Bush held the position of Interim Executive Officer of the Franchise Tax Board since 2005.

Bush joined FTB in 1975 as a tax auditor. Some of the positions he held during his 30-year career at FTB include Assistant Executive Officer and Chief Deputy from 2003 to 2005, Assistant Executive Officer for operations and enterprise technology from 2000 to 2003 and Assistant Executive Officer for operations from 1988 to 2000. Bush was instrumental in introducing many changes and innovations during his tenure at FTB, including Web-based customer services like electronic filing, major upgrades to departmental information systems, and automating procedures in return processing, accounts receivable, and cashiering.

Adjusted interest rate will change in July

The new adjusted interest rate for the period from July 1, 2006, to December 31, 2006, is seven percent. The interest rate (Section 19521, formerly 19269, of the Revenue and Taxation Code) is compounded daily and accrues for personal income, corporate income, and franchise taxes. The rate for corporation tax overpayments for the period is four percent.

The adjusted interest rate is currently set at six percent for the period January 1, 2006, through June 30, 2006. You can find current and past adjusted interest rates on our Website at **www.ftb.ca.gov** (search for **interest rates**).

Correction: Tax News online article

Please note that we have corrected a typographical error in the online article **LLC Fee Constitutionality Comes Into Question** (http://www.ftb.ca.gov/professionals/taxnews/Index.html). In the article's second paragraph, first line, we incorrectly cited R&TC §19742. The correct R&TC Section is §17941. The paragraph should read as follows:

> Please note the Northwest decision does not address the $800 annual tax levied under R&TC §17941. Protective claims based on the Northwest decision should only be filed for payment of the annual fee under R&TC §17942.

Criminal Corner

We are committed to closing California's $6.5 billion tax gap, defined as the difference between tax that is owed and tax that is paid. Our special agents work cooperatively with law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees. You can report suspected tax fraud by calling the FTB at (800) 540-3453. Some of the cases prosecuted in the last couple of months are described below.

Former fugitive pleads guilty in state tax fraud case
A Santa Clara woman who, along with her husband, fled the country to avoid prosecution pleaded guilty to felony counts of state tax fraud and grand theft.

On February 28, Patricia Stenshoel, 74, pleaded guilty to three counts of filing fraudulent state income tax returns, two counts of failing to file state sales tax returns, and one count of grand theft for stealing a customer's sales tax payment. She also owes the state more than $1.4 million in restitution, representing the unpaid sales and income tax, penalties, interest, and the cost of the investigation.

Larry M. Stenshoel, Patricia's husband, pleaded guilty to the same charges in January.

The Stenshoels fled the country in 2001 to avoid prosecution, and were arrested in Texas in January 2003, when they tried to re-enter the country. Texas authorities inexplicably released Patricia Stenshoel, but kept Larry Stenshoel in custody. After fighting his extradition, Patricia Stenshoel was brought back to California in June 2005.

Stenshoel owned and operated a local waterproofing company and set up fraudulent trusts for the business and his personal matters for the purpose of evading state income taxes. The Stenshoels filed false state tax returns for 1994-1996 and failed to pay the 1995-1996 state sales tax for the business.

This was a joint investigation between the State Board of Equalization, the Santa Clara County District Attorney's Office, and the FTB.

Electrician family charged in tax evasion
A San Clemente family was arrested on 38 felony charges involving state income tax evasion, and filing false state income tax returns.

FTB special agents arrested Oscar David McDaniel, Jr., 68, his wife Marianne, 64, and son Bryan McDaniel, 35, without incident at their homes on March 10, 2006. The family operates McDaniel Electric Corporation out of their home. Secretary of State records show Oscar is the President, Bryan is the Vice-President, and Marianne is the corporation's CFO/Treasurer. According to investigators, Oscar faces felony charges of allegedly failing to file his 1999-2004 income tax returns on the more than $230,000 in unreported income he earned. Marianne faces five felony charges of filing false state income tax returns and one felony charge of failing to file a return on the more than $545,000 in income she earned during this same period. Bryan faces six felony charges of failing to file tax returns on the more than $404,000 in unreported income he earned. Oscar faces additional felony charges for allegedly filing fraudulent corporate income tax returns. Each felony tax count carries a maximum term of three years in state prison.

McDaniel Electric specializes in performing electrical work for school districts including the Rancho Santiago College District, Saddleback Valley School District, and the Anaheim High School District.

The McDaniel family owes the state more than $55,000 in unpaid tax. McDaniel Electric owes the state more than $74,000 in unpaid tax.

Millions in unreported income leads to tax charges
Two San Diego County couples, each having unreported income of more than $1 million, were arrested April 13 on felony charges of state income evasion.

The two cases are unrelated. According to investigators, the couples allegedly either failed to file their state income tax returns or filed false returns. Each felony count of tax evasion carries a maximum state prison term of three years.

According to state records, Steve Gardality, 51, owns and operates Twin Oaks Estates, Inc., a corporation created for the development and sale of 26 lots located in San Marcos. Steve and Mandana, 48, allegedly received payments from the business and failed to file tax returns on more than $3 million in personal income for 1999-2004.They also earned more than $2.5 million in business income for tax years 2000 to 2004.The Gardalitys owe California over $300,000 in personal income tax and corporate tax. Both are charged with 12 felony counts of tax evasion, and Steve is charged with five felony counts of filing false tax returns.

Alex Silva, 48 and Juana Silva, 46, own and operate A&C Framing Services, and A&C Embossing Wheels in Chula Vista, which manufactures products in Mexico to be sold in the United States. Allegedly, the Silvas made checks payable to cash to finance the Mexico operation. The Silvas failed to report over $1 million in cash income on their tax returns for 1999-2001. They owe $88,000 in tax, and are charged with six felony counts of filing false tax returns.