



# Tax News

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## A record-breaking filing season

FTB had a very successful filing season in 2006. Thank you for helping to make it possible.

### Filing and paying

- As of July 15, 2006, taxpayers filed 14 million personal income tax returns, up two percent from last year.
- E-filing was a popular option - nine percent ahead of last year, with 8.3 million returns e-filed.
  - Sixty-one percent of **all** PIT returns filed so far this year have been e-filed.
- FTB issued 9.1 million personal tax refunds amounting to \$7 billion.
  - The volume of refunds issued this year is 1.7 percent higher than last year.
  - The average refund issued this year is \$800 compared to \$750 for last year.
- Direct Deposit of refunds was another great success, up 12 percent over last year at 3.7 million.
  - In total, 40 percent of all personal income tax refunds were deposited directly into bank accounts.

Personal income tax revenue reached record highs this year, with \$11.7 billion received in April alone. The combination of personal income tax revenue, and bank and corporation tax revenue surpassed \$33 billion, also setting a record for January through June 19, 2006.

### “How may we help you?”

- During the filing season, our call center answered 848,000 calls, down 19 percent from last year.
  - On **April 17, 2006**, customer service agents answered 20,276 calls from 7:00 a.m. to midnight. Eight hundred calls came in after 8:00 p.m.
- The total volume of calls reaching our automated Interactive Voice Response system reached 3 million this year.
- Our tax practitioner hotline answered 107,000 calls, down 11 percent from last year.

Call volume decreases indicate that more taxpayers and practitioners are visiting our Website for tax help.

**Welcome to our Website**

- 5.5 million visitors have stopped by our Website so far this year.
- Top visited Web pages are:
  - Forms and Publications.
  - Get Your Customer Service Number.
  - 2005 Forms, and Refund Status.
- Five million tax forms and schedules were downloaded.
- We implemented e-filing for simple corporation returns in January 2006.
  - As of July 15, 5,242 business e-file returns were received.

**FTB's criminal investigation program taking a bite out of the tax gap**

The monthly *Tax News* feature *Criminal Corner* chronicles our ongoing efforts to uncover and halt income tax crimes. We believe publicizing some of our cases can highlight the practitioner's role in compliance, and help deter noncompliance. Our Investigations Bureau leads our criminal investigation program with strong support from our Public Affairs program, which publicizes the results of our investigations.

The mission of FTB's criminal investigation program is to:

- Identify, investigate, and effect prosecution of tax evasion, fraud, and employee misconduct.
- Encourage compliance with the California income tax laws.
- Maintain the public's trust through publicity.

Our Investigations Bureau is staffed with 42 Special Agents. They maintain case inventories consisting of failure to file, and false income tax return cases; refund fraud cases, and joint task force operation cases. Joint task force operation cases can involve local, state, and/or federal agencies. Crimes typically investigated and prosecuted with income tax violations include elder abuse, identity theft, embezzlement, grand theft, money laundering, workers' compensation insurance, employment taxes and labor crimes, medical fraud, and "capping." Capping is soliciting business for another, and becomes a crime when the business objectives are fraud and deception (recruiting patients for unnecessary medical procedures, for example).

Our Special Agents are peace officers, and perform most of the duties associated with the peace officer role. They write and serve search warrants, gather and analyze evidence, interview witnesses, interrogate suspects, make recommendations to prosecute, serve arrest warrants, assist prosecutors through all stages of the prosecution, track and apprehend fugitives, and monitor terms of probation.

**You can help**

Here's how you can help us fulfill the mission of the criminal investigation program. Communicate our message to those you meet with throughout the day. Reassure the honest taxpayer that we support their commitment to pay their fair share, and only their fair share of the tax burden. At the same time, let those who are tempted to cheat know that we are out there enforcing the criminal income tax provisions of the Revenue and Taxation Code. We will use all available resources to identify and pursue those who cheat. You can also support our program by letting us know when you become aware of those who do not comply with the tax laws. Your efforts will help reduce the tax gap, and the tax burden on honest, compliant taxpayers. Please contact us by phone at (916) 845-4037, or by fax at (916) 845-0185.

## State tax information accessible to more taxpayers

### Chinese, Korean, Spanish, and Vietnamese electronic publications now available

For the first time, several income tax publications have been translated into Chinese, Korean, and Vietnamese. In the past, FTB has offered various tax publications in Spanish.

This milestone reflects California's status as one of the nation's most diverse states. More importantly, it demonstrates our commitment to making services available to more of the state's taxpayers. We encourage speakers of these languages to visit our Website [www.ftb.ca.gov](http://www.ftb.ca.gov), and download the forms as needed.

The newly available, translated electronic forms are:

- *California Taxpayers' Bill of Rights* (FTB 4058C).
- *Franchise Tax Board Privacy Notice* (FTB 1131).
- *Request for Innocent Spouse Relief Form and Brochure* (FTB 705).
- *Homeowner and Renter Assistance Booklet* (FTB 9000/9000R).  
Note: This form will be available in Vietnamese for the **2007** HRA season.

The Homeowner and Renter Assistance Program provides a once-a-year payment from the state, based on the property taxes paid by qualified homeowners and renters. For the 2006 claim year, eligible homeowners can receive a payment of up to \$472.60, while eligible renters can receive up to \$347.50.

FTB offers tax help from several sources:

- Our Website is the best source of assistance. Available 24/7, 365 days a year, the site includes FAQs, tax forms, and a "Contact Us" page.
- Our customer service representatives are available year-round Monday through Friday, from 7:00 a.m. to 6:00 p.m. at (800) 852-5711.
- There are also six field offices ([www.ftb.ca.gov/aboutFTB/tscadd.html](http://www.ftb.ca.gov/aboutFTB/tscadd.html)) open from 8:00 a.m. until 5:00 p.m. in Los Angeles, Oakland, Sacramento, San Diego, San Francisco, and Santa Ana.

The following publications are currently in the translation process, and will be available in the near future. We will alert you as soon as they are available.

- *Exempt Organizations* (Publication 927).
- *Frequently Asked Questions About Your Tax Audit* (Publication 1015B).
- *Frequently Asked Questions: Residency Tax Audit* (Publication 1015R).

- *California Glossary of Tax Terms: English/Chinese, English/Korean, and English/Vietnamese* (Publication 1209).  
Note: Publication 1209 is currently available in *English/Spanish*.

## The tax gap's biggest contributor – underreported income

FTB's audit program has its eye on underreporting, as the largest segment of the tax gap. Underreporting includes unreported cash transactions, and several other types of transactions that business owners may not think of as income.

If asked what should be included in business income, most people would list cash, checks, or credit card payments that are received for goods sold, or services provided. While that answer would be correct, it would be incomplete. It overlooks other forms of income that are received in connection with business operations (except those specifically excluded by law). Although many people may not realize it, business income also includes the benefits received in these transactions:

- Bartering
- Canceled debt
- Promissory notes
- Kickbacks
- Redirecting income

**Bartering** is a common business practice where property or services are exchanged for other property or services. Bartering is gaining popularity on various Internet Websites. In a bartering agreement, the fair market value of the property or services received should be included in business income.

**Example:** Jane is a veterinarian. Jane consults with Joyce, a florist, about flowers for her wedding. Joyce suggests to Jane that they should exchange \$3,000 worth of flowers for \$3,000 worth of veterinary services. Both Jane and Joyce should report \$3,000 in their gross receipts for the exchange of business services regardless of the personal nature of the barter exchange.

**Canceled debt** is income if your debts are paid by another person, or canceled by a creditor. The amount paid or canceled should be reported as income.

**Example:** Joe, a doctor, is being sued by a patient. Joe hires Valerie, an attorney, to represent him. Several months later Joe owes Valerie \$10,000 for her services. Joe cannot afford to pay Valerie. Since Joe is a long-time client of Valerie, she decides to relieve \$8,000 of his debt. Joe must report \$8,000 of income for the canceled debt.

**Promissory notes** received in exchange for property or services should be included in income.

**Example:** Gerri is a CPA. She buys furniture for her office from Dan's Furniture Store. Dan's Furniture Store provides a 90-day, same-as-cash program. Dan's Furniture Store obtains a promissory note from Gerri stating she will pay the balance of \$5,000 within 90 days. Dan's Furniture Store must report the \$5,000 promissory note in its gross receipts.

**Kickbacks** are payments or other types of compensation that are made to influence and gain profit from an individual or company. In spite of its unsavory or unethical character, kickback payments or compensation should be reported as income. All income is taxable, including income derived from illegal activities.

**Example:** Dan's Furniture Store owns a delivery truck, which was involved in an accident. Dan's Furniture Store takes the truck to Tim's Repair Shop. Tim's Repair Shop agrees to bill the insurance company for more than the actual cost, and agrees to split the difference. Tim's Repair Shop kicks back one-half of the excess proceeds to Dan's Furniture Store. Although the income was received through illegal activity, the kickback is taxable. Dan's Furniture Store, as well as Tim's repair shop, should report this income as gross receipts.

**Redirecting income** is another form of underreporting. Directing a customer to pay a third party does not exclude the amount from the seller's income.

**Example:** Jim and Mary have a rental business. They have a recurring customer whose rental agreement stipulates that the payments are to be made directly to Jim and Mary's son. Jim and Mary must include this amount as gross receipts. Moreover, accumulating cash, paying expenses out of cash, or other receipts that are not deposited, should also be included in gross receipts. For instance, Jim and Mary like to accumulate rental income that is paid to them in cash, for emergency repairs. Although this income is kept in their safe and not deposited, it must still be included in gross receipts.

Business owners must maintain accurate books and records to insure the proper amount of income is reported. Accurate information will help the business owner to monitor the business's progress, prepare financial statements, track deductible expenses, prepare tax returns, and substantiate items reported on the tax returns.

Although there is no specific method of maintaining books and records, your clients should ensure that their record-keeping systems accurately reflect business income. They need to keep documents that identify and support the amount and source of gross receipts. For example, cash register tapes, bank deposit slips, receipt books, invoices, credit card charge slips, 1099 forms, and other similar documentation will meet this need.

Underreported income is the largest portion of the tax gap. Although cash transactions are largely responsible for underreporting, we have seen that there are other ways income is underreported. We will continue to scrutinize underreporting in all its forms, and take actions to reduce it through taxpayer education, encouraging self-compliance, and conducting audits.

**Should you amend for a prior year carryover revision?****Is my client required to file an amended return for a prior year if the only change is revision of a carryover amount?**

The answer to this question depends on whether:

- Your client is an individual or business entity.
- The change in carryover amount is the result of your client's discovery or a federal audit.
- Your client is currently under audit by the Franchise Tax Board.

***If your client is not under FTB audit*****Individuals**

Your client is not required to file an amended return reporting a change in a carryover item if it does not change their tax liability in the tax year. We recommend your client include a schedule with the first return where the tax liability is affected by prior year changes of a carryover amount. The schedule allows your client to inform FTB of prior year changes to carryover amounts where there was no change in tax liability.

Your client is not required to file an amended return after a federal audit unless the audit results in an increase in their tax liability [Revenue & Tax Code Section 18622(a)].

**Business entities**

As is true for individuals, business entities are generally not required to file an amended return to report a change in a carryover item if it does not change their tax liability in the tax year. We recommend your client include a schedule with the first return where the tax liability is affected by prior year changes of a carryover amount. The schedule allows your client to inform FTB of prior year changes to carryover amounts where there was no change in tax liability.

All business entities must file an amended return any time a federal audit changes gross income, deductions, penalties, credits, or tax [Revenue & Tax Code Section 18622(a)].

***If your client is under FTB audit***

If your client is under audit, discuss the carryover adjustments with the FTB auditor to determine whether you should file an amended return with the auditor. In most cases, any carryover adjustments can be included as part of the audit. If the audit determines that a reduction to a carryover amount is necessary, we will incorporate it into any adjustments, or issue a Notice of Proposed Assessment Carryover Amount. This notifies your client of a change in a reported carryover amount where no additional tax is due. The notice gives your client protest and appeal rights at the conclusion of an audit.

Always notify the auditor if your client is, or was, under federal audit, and the issues would affect their California return. If the IRS completes its audit before we complete our audit, send the FTB auditor a copy of the Revenue Agent's Report. If the IRS does **not** complete its audit first, follow the guidance provided under "Client not under FTB audit" above.

**Important to know:** The statute of limitations for a deficiency assessment does not begin until the carryover amount is used.

**Example:** A loss generated in 1999 was not discovered until 2005. Your client reported the 1999 loss carryover on the 2004 amended return, since this was the first return reflecting a change in the tax liability. Your client must be able to support both the 1999 loss, and the carryover amount reported on the 2004 amended return. Remember, the statute of limitations for the amount reported in 2004 is the normal 2004 statute, not the 1999 statute.

**FTB ID number protects against identity theft**

On January 1, 2006, FTB began using a new identification number on many of the notices and bills we sent to taxpayers. Senate Bill 25 (Chapter 907, Statutes of 2003) mandates protection of taxpayers' Social Security Numbers from unauthorized use. This law makes it illegal for us to print Social Security Numbers on materials we mail to taxpayers. This law does not prohibit us from using Social Security Numbers internally, or from printing Social Security Numbers on documents mailed to authorized third parties, e.g., garnishments and levies. Taxpayers are not prohibited from using Social Security Numbers on their tax returns.

We are very serious about protecting the privacy of taxpayer information. All taxpayer information is confidential, by law, and is further protected by our strict policies and procedures covering privacy and disclosure. We share taxpayer information with federal or state agencies only for purposes specifically covered in the law. Our employees participate in annual training on ensuring the confidentiality of taxpayer information, and regularly receive updated procedures on privacy and confidentiality protection. Employees who violate any of these policies or procedures are subject to disciplinary action. Violations of taxpayer information privacy and confidentiality protections are also punishable by law.

You have probably noticed the new FTB ID number on some of your clients' documents. Recording the new number in your client records will help you avoid any identification number mix-ups. And, supporting our use of the FTB ID number will help us protect your clients from identity theft.

## **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.

Tax fraud is not a victimless crime. You can report suspected tax fraud by calling FTB at (800) 540-3453.

Some of the cases prosecuted in the last couple of months are described below.

### **Million dollar real estate fraud gives Beverly Hills man a new address**

On June 12, 2006, a Los Angeles man was sentenced to nine years in state prison on six felony counts of grand theft, and one felony count of state income tax evasion.

Ruben G. Mendoza, 51, and his wife, Tania Mendoza, 33, were the owners of Pacific Associates and Investors, BDH and Associates, and Equity Investment Group. According to court documents, the Mendozas were involved in a scheme involving illegal real estate activities. Mendoza defrauded his investors, and illegally encumbered investors' properties resulting in foreclosures of property. Related charges on Tania are still pending

Mendoza also failed to file corporate or personal income tax returns on the more than \$3.8 million in gross receipts the corporations earned, or the more than \$3.2 million he earned personally. In addition to the nine-year prison sentence, Mendoza was ordered to pay restitution of \$7.5 million to his victims, and \$1.4 million to FTB.

This was a joint case with the Los Angeles County District Attorney's Office and the FTB.

### **LA dentist extracts millions of dollars in NY fraud scheme**

A Los Angeles dentist awaits extradition following her June 30, 2006, arrest by the New York Port Authority Police, on nine felony charges involving state income tax evasion, and fraud.

Hengameh Paulina Khalilzadeh, D.D.S., 39, owner of Hengameh Khalilzadeh D.D.S., INC., also known as Bright Now Dental, is charged with allegedly failing to file personal income tax returns, and the corporation's tax returns for 2002-2004. In addition to the tax charges, Dr. Khalilzadeh is charged with violations of the Penal Code, Welfare and Institutions Code, and California Code of Regulations. According to investigators, she is allegedly involved in filing fraudulent Denti-Cal claims for 2002. Dr. Khalilzadeh allegedly failed to report corporate gross receipts in excess of \$3.9 million, and personal income in excess of \$1.9 million for the years 2002-2004.

Each felony tax count carries a maximum term of three years in state prison. The tax liability on the corporate and personal income is in excess of \$186,000.

The status of the extradition from New York is pending. This is an investigation involving the Los Angeles County District Attorney's new Fraud Interdiction Program, which targets health care fraud.

### **Large-scale auto fraud parks LA man in prison**

A Los Angeles man was sentenced on July 7, 2006, to three years in state prison on felony counts of filing false state income tax returns, conspiracy, and insurance fraud.

Ahmed Sharif Khan, 41, of Los Angeles, was among 18 people charged in a case that covered a multimillion-dollar accident fraud scheme stretching from 1993-2000. The scheme involved staging traffic accidents primarily in the San Fernando Valley to defraud auto and medical insurance companies. The ring netted approximately \$2.5 million by submitting phony medical bills and reports to several insurance companies. The case centered on the law offices of Curtis Mitchell Shaw of Beverly Hills and Keith Darran Washington of Reseda. Shaw and Darran, Khan's brother, Munir Sharif, and the others have previously been sentenced.

Khan also filed a false state income tax return, failing to report the income received from these illegal activities during the years in question. All income is taxable, including income derived from illegal activities.

This was a joint investigation between the California Department of Insurance, the Los Angeles Urban Auto Fraud Task Force, California Highway Patrol, Los Angeles County District Attorney's Office, and the FTB.

### **Irvine businessman jailed for grand theft and tax evasion**

On July 7, 2006, an Irvine businessman was immediately taken into custody on felony charges of grand theft and state income tax evasion after failing to meet the conditions of his plea agreement.

Dianoush D. Emami, 46, pleaded guilty in January to six counts of grand theft and two counts of filing a false state income tax return. He also promised to pay full restitution to his victims, including FTB, in exchange for a sentence of not more than nine months in jail, plus probation.

Emami is the sole owner of two investment companies: Paradigm Capitol, LLC, and Sea Country International, LLC. According to court documents, Emami presented investors with the opportunity to buy second trust deeds. Instead, Emami actually operated a ponzi scheme (a type of illegal pyramid scheme named for its creator, Charles Ponzi), and stole more than \$12.5 million from investors. He used the investment made by one individual to pay other investors to give the impression they received a return on their investments. In addition, he did not report the embezzled income on his 1999 and 2000 tax returns.

Emami faces up to nine years and eight months in state prison. He owes FTB nearly \$200,000 in unpaid state income tax, penalties, interest, and the cost of the investigation.

**Casino controller gambles on embezzlement scheme, and loses**

A Murrieta man received a four-year state prison term on July 12, 2006, following his guilty plea earlier this year on 26 felony counts of grand theft and tax evasion.

Paul Theodore Del Vacchio, 40, former controller for the Pechanga Resort and Casino in Temecula, pleaded guilty in February of embezzling more than \$425,000, and transferring it into his bank account in 2003 and 2004. Among the felony counts were two state tax charges for filing fraudulent returns for tax years 2003 and 2004.

Del Vacchio was ordered to pay restitution of \$72,318 to FTB, including \$1,550 for the cost of the investigation.

This case was a joint investigation between the Riverside County District Attorney's Office and the FTB.