

Tax News

April 2007

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No change to adjusted interest rate for July-December 2007

The new adjusted interest rate for the period July 1, 2007, to December 31, 2007, is eight percent, the same rate that is in effect for January 1 through June 30, 2007.

The interest rate (Revenue and Taxation Code Section 19521, formerly Section 19269) is compounded daily, and accrues for personal income tax, corporate income tax, and franchise tax. The rate for corporation tax overpayments for the period is five percent.

You can find [adjusted interest rates](#), both current and past, on our Website at www.ftb.ca.gov (search for "interest rates").

State grants tax relief to victims of the 2007 California freeze

FTB has announced special tax relief for California taxpayers affected by the recent California severe freeze.

Twelve counties are designated as federal disaster areas: Fresno, Imperial, Kern, Los Angeles, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Tulare, and Ventura counties.

The President declared the California freeze a major disaster on March 13, 2007. Special tax rules apply to disaster losses. Taxpayers can claim a disaster loss in the tax year the disaster occurred or in the tax year before the disaster occurred. The advantage of claiming the disaster loss in the prior year is that FTB can quickly issue a refund.

Taxpayers claiming the disaster loss should write "California Freeze 2007" in red ink at the top of the tax return to alert FTB to expedite the refund. If taxpayers are e-filing, they should follow the software instructions to enter the disaster information.

Taxpayers who need copies of lost or damaged state returns should complete Form FTB 3516, [Request for Copy of Tax Return](#). Disaster victims can receive free copies of their tax returns. Write "California Freeze 2007" in red at the top of the request.

To learn more about state disaster losses, refer to publication [FTB 1034](#), *Disaster Loss* at www.ftb.ca.gov. Refer to [IRS 547](#), Casualties, Disasters, and Thefts at www.irs.gov for federal information about disaster losses.

How to make e-filing even easier – pay balances due electronically

Paying electronically when filing electronically has benefits for your clients - those are described below. When your e-filing clients pay electronically, it also benefits you, and it

benefits us. Helping your clients get their taxes paid by April 17 will head off the balance due notices that inevitably follow if they forget to mail that paper check before April 17. You and they will avoid the time and exasperation associated with billing notices – not to mention the interest and penalties.

We also benefit when taxpayers pay electronically. Processing electronic payments is much more efficient than processing paper payments. Ultimately, electronic filing and payment enables us to get the job done faster, with fewer employees, and reduced storage space for paper documents. Most importantly, these efficiency gains mean we can spend fewer taxpayer dollars for the same results.

Here's how your clients can pay electronically:

Electronic funds withdrawal (EFW): Your clients who e-file, and owe money can use EFW instead of mailing a paper check. EFW can be authorized at the time they e-file, and scheduled for payment on April 17. The process is similar to paying for groceries or other goods with a debit card, but with the added convenience of determining the actual date when their funds can be accessed. Your clients simply choose the amount they want to pay, and the date they want the funds to be transferred from either their checking or savings account. They can even schedule EFW for their next year's estimated tax payments when they e-file.

Web Pay: Your clients can request a debit to their account online, at any time, to pay **any** FTB liability, including:

- A balance due on their current-year tax return.
- Extension payments (Form FTB 3519).
- Estimated tax payments (Form 540-ES).
- Prior-year amounts.
- Any bill.

Like direct debit, your clients choose the payment amount, and the date the funds should be transferred from their checking or savings accounts.

To use Web Pay, all your clients need are their Social Security Numbers, and an FTB [customer service number](#).

Credit card payments

Another payment option for your clients to pay their state personal income taxes is to "charge it" to their Discover/NOVUS, MasterCard, American Express, or Visa credit cards. Your clients who wish to pay by [credit card](#) should check our Website at www.ftb.ca.gov, or call the vendor (Official Payments Corporation, or OPC) at:

- (800) 272-9829 - English.
- (888) 357-8394 - Spanish.

OPC charges a 2.5 percent convenience fee, based on the amount charged.

New Service: Beginning April 9, 2007, FTB call center representatives can transfer PIT taxpayers directly to the credit card vendor. This new service is provided to callers if they decide during the course of their call that they want to pay by credit card. Taxpayers that do not have a need to contact FTB for any reason other than to pay by credit card, should visit our Website, or call OPC at the phone numbers listed above.

Individual, business e-file show strong gains in 2007

Individual and corporate taxpayers in California are using e-file in record numbers in 2007.

The biggest gain comes from business e-filers. As of March 15, there were 192,407 business returns filed. Business e-file, in just its second year, totals 8,084, a 271 percent increase from the same period in 2006. For 2007, FTB accepts Form 565 ([Partnership](#)), Form 568 ([Limited Liability Company](#)), and Form 100S ([S-corporation](#)) returns, along with current and prior year Form [100](#).

Another big increase in Individual e-filing

By March 29, 2007, with a little less than one month before the state tax-filing deadline, more than 76 percent of individual state income tax returns filed were received electronically. While the overall percentage is expected to drop by the April 17 deadline, FTB projects that its e-file figures will hit a record high this year.

As of March 15, 6.3 million state tax returns had been filed so far in 2007. Of that total, more than 4.8 million were received electronically. FTB's CalFile program, which offers free, direct, online filing, was up 18.7 percent over 2006.

Electronic refunds

Not only are taxpayers filing their returns electronically, more of them than ever are receiving their refunds electronically through Direct Deposit, and paying their tax liabilities online. Through March 14, more than 2.3 million refunds, amounting to \$1.9 billion have been issued via Direct Deposit, an increase of 11 percent over last year.

Save even more time - pay balances due electronically

Encourage your clients to pay electronically. There are numerous options, from electronic funds withdrawal, to paying by credit card. See related article "How to make e-filing even easier" in this issue.

W-2 and 1099 filing requirements

If you have clients that pay wages and compensation to employees, and independent contractors, make sure they file Forms W-2 and 1099.^{1, 2, 3} As part of our audit process, we

¹ California Unemployment Insurance Code Section 13050 and California Revenue & Taxation Code (CR&TC)

review Forms W-2 and 1099 to support business expense deductions. We may disallow business expense deductions for these types of payments, and may impose penalties of \$50 for each form that is not filed.^{1, 2, 4, 5} Proper filings must also support other business expense deductions like rent, profits, and income payments, among others.^{1, 2}

This audit strategy is part of our ongoing tax gap effort to ensure that business expense deductions are appropriately supported, and that employees and independent contractors report all income received during the year. As a tax professional, you can play a vital role in this effort by making sure your clients file the proper documents.

For more information, refer to our, FTB Informational Publication No. [4227a](#), Guide to Information Returns Filed With California. Find more information, and reporting requirements for Forms [1098](#), [1099](#), [5498](#), and [W2-G](#) on our Website at www.ftb.ca.gov (search for “information reporting”), and in FTB Publication 8305, Reporting Requirements for Forms 1098, 1099, 5409, and W-2G.

Registered domestic partner (RDP) news

We have posted an issue paper, “[Registered Domestic Partner AGI Limitation Discussion](#)” to the RDP Website. The paper explores the advantages and disadvantages of four alternative methods for calculating adjusted gross income (AGI) for limitation purposes:

- The law as enacted.
- Federal Pro Forma return.
- Stand-alone state AGI.
- Federal AGI as adjusted.

The paper’s objective is to evaluate each alternative in terms of its ability to provide both:

- Deductions and credits (ultimately California income tax) for RDPs that are as close as possible to the deductions and credits for spouses in the same circumstances.
- A method of AGI calculation that is least burdensome to RDPs.

Bookmark the [RDP Webpage](#), which you can find on our Website at www.ftb.ca.gov by searching for “RDP.” Check it regularly for updated FAQs, legislation related to SB 1827, and other important news and information.

Section 18631 (replaced Section 18637 and Section 18638).

² Internal Revenue Code (IRC) Section 6041 and Section 6041A.

³ CR&TC Section 18402.

⁴ CR&TC Section 19183 and IRC Section 6721 and Section 6722.

⁵ CR&TC Section 17299.8 and Section 24447.

Last chance to participate in FTB's online services survey

As part of FTB's effort to reduce taxpayer burden, we want to gauge tax professionals' interest in having online access to more of the account information we maintain for you or your clients. We are also interested in your opinion on FTB allowing commercial software companies to provide an "import" feature as part of their tax preparation product, which would take information FTB has on file for a specific taxpayer, and populate that taxpayer's return as you are preparing it.

We realize you are very busy during the filing season so we will continue to gather feedback until May 4, 2007. If you haven't completed the survey yet, go to www.ftb.ca.gov, and select "Online services survey" under "Tax Professionals." The survey takes just a few minutes to complete, and will help us determine what services to offer tax professionals in the future.

If you have any questions about the content of the survey, contact Alison Adams at (916) 845-3559, or Alison.Adams@ftb.ca.gov.

Filing facts

As we rapidly approach April 17, most of you are busy mailing or transmitting your clients' tax returns. By April 18, you'll probably breathe a sigh of relief that the filing season is winding down. As your filing season draws to a close, ours is just reaching its peak. It's still too early for comprehensive statistics about the 2007 filing season, but here are the facts on how the **2006** processing year shaped up (January 1, 2006, through December 31, 2006):

2006 Return processing statistics

Returns filed:

Corp. returns	1.2 million
Personal Income Tax (PIT) returns*	15.0 million
Electronic PIT returns	8.9 million (60 percent)
Paper PIT returns	6.0 million
Return preparation:	
Tax professional-prepared	68 percent
Self-prepared	32 percent
CalFile	111,529
ReadyReturn	10,582
5,001 e-filed	
5,581 paper-filed	
PIT refunds issued	9.7 million

PIT average refund	\$812
Total General Fund	\$60.2 billion

* All current year personal income tax returns (less fiduciary returns).

2006 Service statistics

Number of ftb.ca.gov Web visits	7.2 million
Number of CA Tax Service Center www.taxes.ca.gov Web visits	494,153
Number of forms downloaded	6.5 million
Number of e-installment agreements	13,879
Contact center phone calls	1.7 million
Phone calls answered by the automated response system	6.0 million
These calls are routed to specific programs for resolution:	
• 4.3 million resolved by Filing	
• 1.6 million resolved by Collections	
Number of field office contacts	124,745
Taxpayer Advocate cases	8,709
(Includes 2,334 emails addressed to Advocate and Executive Officer)	

First days in the life of a tax return

Once your clients' tax returns are in the mail, they join thousands of others that arrive at FTB by the truckload each day. Have you ever wondered exactly what happens to tax returns after they're dropped off at our door? In this brief tour of our processing system, follow the path taken by more than 15 million personal income tax returns, 1.2 million business entity returns, and millions of related documents and payments we receive each year. Keep in mind that e-filed returns get to skip the first two stops described below, and very efficiently enter the stream at the information validation stop.

First stop: Receiving

Each year, we process 30 million pieces of mail, most of it during filing season.

Receiving staff open envelopes, sort the contents, and prepare each return and payment for further processing.

- We employ a full-time, year-round workforce of 115 employees, which is augmented by 900 -1,300 seasonal workers during filing season.
- Two shifts per day operate from late February through mid-May.

- For approximately two weeks after April 15 (or April 17 this year), the two shifts per day operate for seven days a week.
- PIT receipts reached an all-time high in April 2006: nearly \$11.3 billion for the month, which is a 40 percent increase over April 2005.

Next stop: Information capture and banking

This is where all paper tax payments are cashiered, and where paper tax return information is keyed into our computer systems. In 2006, FTB received over 15 million tax returns, of which almost 9 million were electronically filed. Of the 6 million paper returns filed, 2.3 million were manually keyed, and 3.8 million were scannable returns processed through our high-speed scanners.

- During peak filing season (January through June), 250 temporary workers join 150 permanent, full-time workers.
- Two shifts operate per day during peak season.
- Each day in April, staff transcribes information from 120,000 tax returns, on average, and image-scans more than 100,000 documents.
- More than 9.6 million checks, totaling more than \$29.5 billion were cashiered in 2006 (these amounts include estimate payments, and bank and corporation payments).
- Over \$2.8 billion dollars were deposited on April 24, 2006 – the record for daily deposits.

One more stop: Information validation

The accuracy of return information is validated after it is keyed into our computer systems, or after we receive it electronically.

All personal income tax returns are “validated” (checked for mathematical errors or illogical entries). Electronically filed returns are validated at the time they are filed, and paper returns are validated after the information capture and banking area either manually keys the return data into our computer system, or processes the scannable returns through our high-speed scanners. If math, keying, or logic errors are present in tax returns, or payments made to FTB, they are referred to the information validation area.

Information validation staff members review the returns and payments, and correct any errors. If there is a change in the amount of tax owed, or refund due, the employee will issue a Return Information Notice ([RIN](#)) listing one or more codes that explain any changes made to the return. A RIN may be issued even when there is no change to the amount paid or owed (a “zero balance RIN”), so the taxpayer is notified that we changed certain information on the return.

Last stop: Data storage

At the end of this whirlwind processing journey, most tax returns are retired to our storage facility. The data storage area encompasses over 326,000 square feet of shelf space, and 190,000 square feet of floor space, for storing paper PIT and business entity returns. PIT

returns and documents are generally held for four years, and business entity returns for five years. If an audit is opened, this retention period can increase by several years.

We are currently storing more than 107 million documents, including partnership returns, Homeowner and Renter Assistance claims, payment documents, and the paper PIT returns, and business entity returns we have received. The good news is that a steadily increasing percentage of e-filed documents means a steadily decreasing need for such vast amounts of storage space - another great reason to e-file.

Inside FTB

Franchise Tax Board meeting, April 4, 2007

The next Franchise Tax Board meeting is scheduled for April 4, 2007, in the Gerald H. Goldberg Auditorium at 1:30 p.m. The [meeting agenda](#) is available on our Website.

Check our Website for updates on [meetings](#) scheduled for June, September, and November 2007.

Where to find last minute forms, filing information

With only a little more than two weeks before the final filing date (April **17** this year), you may find yourself needing some forms or filing information at the last minute. If that happens, check out the services offered on our Website at www.ftb.ca.gov. Here are shortcuts to some of our filing, e-filing, and payment Web pages:

- [e-file for tax preparers](#)
Lots of information for tax preparers on the e-file process, acknowledgement files, error resolution, and mandatory e-file, for the **individual** e-file program.
- [Tax forms updates](#)
Choose a form from the drop-down menu to see what changes have been made, and when they were made.
- [Payment options](#)
If your client needs some time to pay the tax owed, we offer an online [installment agreement request form](#). We will accept credit card payment also – read the details of the [credit card program](#) on our [Website](#).
- [Tax practitioner services](#)
Phone numbers and Package X are just a couple of useful items on this Web page.
- [California Tax Service Center](#)
This is a great one-stop shopping Website for information on taxes administered by FTB, the Employment Development Department, and the Board of Equalization (income, payroll, sales, use, property, and special taxes).

Thinking of incorporating in Nevada? Read this first

Are some of your clients thinking of incorporating in a state without income or franchise tax? Give them the facts and the FAQs on the tax consequences of incorporating in Nevada. See our [brochure](#) "Don't gamble with your taxes: Read the fine print about incorporating in Nevada."

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.

Fifth member of state income tax refund fraud scheme arrested

A Thousand Oaks woman was arrested February 22, 2007, on charges of grand theft and filing false state income tax returns for her role in a scheme involving a fraudulent refund ring. Katherine D. Garnica, 39, aka Katherine D. Amato, was arrested without incident by FTB special investigators. Garnica joins Kessler Wyatt, Jr., 66, of Los Angeles; Donna R. Goldring, 41, of Los Angeles; Frederick Johnson, aka Keg Johnson, 67, of Los Angeles; and Darnell Williams, 56, of Lake View Terrace; who were all arrested a week earlier.

According to FTB investigators, Wyatt is a self-employed job placement recruiter, and the alleged ringleader. Wyatt allegedly used his knowledge of payroll systems and recruiting skills to create a refund fraud scheme. During the period of 1999 – 2002, Wyatt prepared false wage and withholding statements, and filed them with the Employment Development Department (EDD). Wyatt then recruited four individuals, including Garnica, to file more than 50 fraudulent state income tax returns during these years, resulting in more than \$500,000 in fraudulent refunds being issued. FTB verifies withholding amounts claimed on tax returns with EDD records. Garnica and the others face charges of grand theft, filing false state tax returns, and negotiating false income tax refund checks. The scheme was discovered through an investigation conducted by FTB special investigators.

Garnica was booked into the Lost Hills Sheriff Station in Agoura Hills. The total amount of restitution will be determined at a later date.

Real estate controller pleads guilty to grand theft, tax charges

On March 1, 2007, an Alhambra woman pleaded guilty to felony charges for embezzling more than \$500,000 from her former employer.

Danna L. Rodriguez, 35, pleaded guilty on Wednesday to one count of grand theft, two counts of failing to file tax returns, and one count of filing a false state income tax return.

According to court documents, Rodriguez was employed as the controller of a South Pasadena real estate property management company. She abused her position of trust by printing and using duplicate company checks, which did not show up on the company's financial records, to embezzle more than \$535,000 during the years 2000 – 2004. The scheme was discovered when property owners had insufficient funds to cover expenditures paid out from their property management accounts. In addition to the theft, Rodriguez failed to claim the embezzled funds on her state income tax returns. All income is taxable, including income from illegal sources.

Rodriguez surrendered to authorities in February. She was remanded without bail, and faces a maximum of three years in state prison. Restitution to the victims is still to be determined. Rodriguez made a partial restitution payment of \$100,000 to the court. She owes the state more than \$75,000 in unpaid tax, penalties, interest, and investigation costs.

Tax preparer sentenced in global money laundering scheme

On March 23, an Orange County tax preparer was sentenced to 11 years in state prison for his role in an international money laundering operation that included \$28 million in unreported income. The sentencing culminates a multi-year investigation that included the California Attorney General's Bureau of Medi-Cal Fraud and Elder Abuse, the Inspector General of the US Department of Health and Human Services, and the FTB.

Yakoob Habib, 58, of Buena Park, pleaded guilty in February to laundering more than \$2.5 million from criminal activity. He also pleaded to charges of flight on bail, and tax evasion. Habib failed to report as income nearly \$10 million that flowed through his personal accounts, and another \$18 million that went through his corporation, K & K International. Habib was a certified tax preparer who operated K-Tax Services.

The source of the funds included money stolen from Medi-Cal through California Premier Medical Laboratories, located in Baldwin Park, and Professional Service Reference Laboratory, in North Hills.

The Attorney General's Office identified more than \$12 million that Habib illegally transferred.

Orange County Superior Court Judge James A. Stotler issued the sentence under a plea agreement between Habib and the Attorney General's Office.

In papers filed with the court, Habib said that he "received money with the goal of rendering it so that it would be difficult for law enforcement to determine the origin of this money, and its ultimate destination." Habib said he used a variety of aliases and businesses to handle the money, and moved funds through traditional banks as well as through hawala, an informal international money transfer system. Money in the hawala stream can be impossible for authorities to follow.

Habib was first arrested in June 2002, along with 11 other defendants in a laboratory fraud case. In 2003, Habib was sentenced to three years in state prison in absentia for violations of his plea agreement. He was later arrested in Canada, and indicted by the Orange County Grand Jury in June 2004. Habib's wife, Rashida Kalia, also was indicted by the Orange County Grand Jury for tax evasion. She remains a fugitive.

The buzz on big business

Audit 2015

Technological innovations, and changes in the way that people communicate and interact with their government have reshaped the expectations of our audit customers. These changes have created opportunities for partnering with taxpayers, the tax practitioner community, areas throughout the FTB enterprise, and other governmental agencies. As dramatic events continue to transform the landscape for California businesses, individuals, and government, the audit program is looking to the future.

Audit 2015, the audit program's strategic plan, is our blueprint for innovation and change. As our vision, it describes our future in 2015. As the future unfolds, our vision will continue to evolve and improve.

In the coming year, expect to hear more about [Audit 2015](#). We will be asking for feedback from the tax practitioner community, as well as other stakeholders. The audit program's mission has always been, and will continue to be, encouraging self-compliance. We will achieve our mission by:

- Administering a timely, responsible, and fair income tax audit program.
- Strengthening our commitment to become an innovative and dedicated organization.
- Continuously improving our administration of the income tax audit programs.
- Contributing to the overall mission of FTB.

We see ourselves as partners with our stakeholders, which includes tax professionals.

In the present, and in the immediate future, we will:

- Work cooperatively with, and seek input from all those affected by our actions.
- Apply the best technologies to enhance the Audit Program.
- Maximize the talents of a diverse, dynamic, and creative team.
- Continuously and actively strengthen our support of:
 - FTB's [Mission & Values](#).
 - [The Statement of Principles of Tax Administration](#).

- The [Taxpayers' Bill of Rights](#).
- Audit regulations (California Code of Regulations 19032).

For the next 10 years, we will continue to:

- Provide critical information, before and after filing a return, to allow taxpayers to self-comply.
- Focus our examination resources on those who fail to self-comply.
- Work with our stakeholders as needed, to resolve and address emerging issues.
- Transform into an organization that uses cutting-edge technologies, expanding our ability to conduct business in an electronic environment.
- Emphasize our one-touch audit policy by:
 - Redefining timeliness in an electronic age.
 - Using all available data to ensure compliance.
 - Protecting taxpayer information, and minimizing intrusiveness.
- Value our greatest assets – our people, and an organization that is fluid and responsive.
- Mobilize our resources to address noncompliance as it emerges, and increase taxpayer confidence in a self-compliance system.

Read more about [Audit 2015](#), and the [FTB Strategic Vision](#).