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### Filing compliance agreements will aid certain out-of-state nonfilers

Out-of-state businesses and trusts with California tax liabilities may be eligible for penalty relief if they can show reasonable cause for their failure to file. This will give some out-of-state entities the opportunity to come forward voluntarily if they have unmet filing requirements and owe California State tax.

The category of taxpayers eligible for a penalty-relieving filing compliance agreement is generally limited to certain corporations, limited liability companies, and trusts.

The program allows FTB to review a taxpayer's particular facts and make a finding of reasonable cause **before** the return is filed. Taxpayers who qualify must file and make full payment to FTB for every year they failed to file a California return. FTB will waive various penalties associated with the return filings identified in the agreement. Penalties most commonly waived are the failure to file, and the failure to pay tax penalties.

Filing compliance agreements are also available to certain taxpayers who do not satisfy the statutory requirements of the existing Voluntary Disclosure Program. That program allows qualified companies, shareholders, and beneficiaries to avoid return-filing penalties by voluntarily disclosing and paying tax liabilities from the past six years.

For more information, go to our website at [ftb.ca.gov](http://ftb.ca.gov). If FTB accepts the taxpayer's request for a filing compliance agreement, the taxpayer must generally file the required tax returns, and make full payment within 30 days.

The authority for FTB's filing compliance agreement is found in California Revenue and Taxation Codes (CRTC) Sections 19131 and 19132. The Voluntary Disclosure Program is defined in CRTC Sections 19191-94.

We also offer assistance to others taxpayers, including individuals who fail to file their California income tax returns. Taxpayers can request more time to respond to notices, retrieve information that can assist them in filing a tax return, request tax forms, and find out how to set up an installment agreement by contacting us online at [ftb.ca.gov](http://ftb.ca.gov), or calling **800.852.5711**.

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### California counties' median income for 2006

FTB has released *Personal Income Tax Statistics for 2006*, showing that the statewide median income for all personal income tax returns rose to \$35,390, an increase of 3.7 percent over 2005. The median income listed on joint returns rose to \$66,810, an increase of 5.1 percent over 2005.

Four Bay Area counties again top California's 2006 median income report: Contra Costa, Marin, San Mateo, and Santa Clara. These counties have consistently reported the highest median incomes.

“Median income” is the point where one-half of the tax returns are above and one-half are below the midpoint of the range of values. Median income represents the income reported by a typical California individual or couple.

California taxpayers filed 15.1 million 2006 state income tax returns reporting \$1.2 trillion in adjusted gross income, a 9.4 percent increase over 2005 figures. Adjusted gross income is a figure taken from tax returns that reports total income after specific tax deductions are subtracted.

Marin County still has the highest median income for joint returns, reporting \$116,626, an increase of 8.1 percent over 2005. Santa Clara County ranked second this year with \$95,457, San Mateo County ranked third with \$95,394, Contra Costa County ranked fourth with \$87,478; El Dorado County ranked fifth with \$78,489.

Los Angeles County taxpayers filed 25.5 percent of all 2006 income tax returns in California. They reported median incomes of \$30,822 for all returns and \$57,725 for joint returns, ranking 39 and 31, respectively.

The largest percentage gain in median income for all counties was 8.5 percent, reported in Mono County. For joint filed returns, the largest increase was in San Francisco County with an 8.8 percent increase.

See the 2006 median income by county [chart](#) for information on specific counties. Please go to [ftb.ca.gov](http://ftb.ca.gov) and search for **press releases** to view [1999-2005 data](#) personal income statistics income by county.

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## CSI at FTB?

### Computer forensic lab helps solve tax crimes

Each month in “Criminal Corner,” we report the latest news on tax criminals brought to justice. Our Investigations Bureau special agents work closely with California counties’ District Attorneys and court systems to uncover fraud and illegal behavior – but you probably did not know that our investigations program also has a state of the art computer forensic lab, which fills a very important niche in “crime scene investigation.”

The Computer Forensic Lab’s goals are to facilitate gathering facts and evidence to determine the truth, and maintain FTB’s credibility in the court and in the eyes of the public. Highly trained special agents, or forensic examiners, execute search warrants, seize computers and computer systems, acquire forensically sound images, and conduct forensic analysis of those images to retrieve vital financial information in support of the investigation.

### What it takes to become a forensic examiner

Forensic examiners are sworn peace officers, each with more than 500 hours of computer forensic training. All agents assigned to the forensic unit hold these certifications:

- **Seized Computer Evidence Recovery Specialist**, certified by the Federal Law Enforcement Training Center, a Federal Certification.
- **Certified Forensic Computer Examiner**, certified by the International Association of Computer Investigative Specialists.
- **Certified Encase Computer Examiner**, certified by Guidance Software, makers of the industry-leading forensic software Encase.
- They also are certified to retrieve data from cellular telephones and PDAs (Personal Digital Assistant).

### **Why forensic examinations are so important**

The business world has gone digital and made the move to computers versus paper documentation of business transactions. Forensic examiners find that more often than not, people are keeping less paper, and using electronic storage instead.

Computers hold valuable information that even the suspect may be unaware of, including file time stamps, computer ownership information, document ownership, and Internet usage history. Our agents are able to recover deleted files and entire hard drives because data is never really deleted.

Most financial information is also maintained on computers and can provide valuable incriminating evidence recovered from the hard drive. Internet communication can also be retrieved, like online banking off-site file storage, for example.

Forensic examiners must always stay at least one step ahead of computer-savvy scofflaws. Computer evidence can be easily destroyed by booby traps set up by the suspect, or by improperly handling computer equipment. Computer forensic agents undergo an extraordinary amount of training on how to successfully retrieve data.

### **How it all works**

All criminal tax investigations begin with special agents gathering intelligence through informants or undercover field operations. They determine the size of the operation, and estimate the number of computers in use, the type of systems, size of the network, etc. Based on this information, search warrants are executed, and the forensics lab gathers all electronic evidence. Forensic examiners analyze the evidence and prepare a computer forensics report, which is given to the case agent. Because we only get one chance to gather the evidence, our field agents always assume there is more computer evidence to gather than what is observed. Forensic agents don't have the time or ability to "run to the store" and pick up additional storage devices; they must travel with everything they think they will need. On one particular search warrant, which consisted of 7 locations and 30 computers, the forensics team set up a field lab at 6:00 a.m. and did not complete their work until 2:00 a.m. the following day.

A search warrant recently executed by special agents netted 14 computers, and resulted in approximately one terabyte of information. To understand its scale, data in a terabyte is equivalent to more than 300 feature length movies, 50,000 trees made into paper and printed, and enough words that it would take every adult in America speaking at the same time five minutes to say them all.

Clearly, this is a lot of evidence to sort through. To accomplish this, agents run keyword searches and extract the various files that contain those keywords to see if the file is relevant to the investigation. They also extract emails, both active and deleted, and extract financial data files including Quicken, Excel, Money, Peachtree, TurboTax, etc. They identify multiple sets of accounting/tax books that require the agent to reconcile which file is the most reliable source for income reconstruction.

### Closing the tax gap

Forensics lab results speak for themselves. Since the lab's inception, forensics special agents have assisted on every case worked by the FTB Investigations Bureau. Of cases referred for prosecution, 99 percent have resulted in either convictions or plea bargains.

One of FTB's forensic agents at work in the lab



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### California Indians and California tax

California is home to more than 265,000 American Indians and Alaska natives, according to a 2006 update to Census 2000.<sup>1</sup> Although the largest numbers are concentrated in the population centers of Los Angeles, Orange, Riverside, and San Diego Counties, each of California's 58 counties has a population of American Indians. Most belong to one of the dozens of California Indian tribes and communities.

Many people are under the impression that California Indians do not pay income tax. In some cases, this is true – however, in many circumstances California Indians do pay income tax. What are the determining factors? The answers to many questions about income earned by California Indians, and its taxability, are offered below.

#### 1. What is Indian country?

##### Indian country is:

- All land within an Indian reservation under jurisdiction of the U.S. Government, including rights-of-way running through the reservation.

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<sup>1</sup> The 2006 American Community Survey reported 265,963 American Indian and Alaskan Natives in California.

- All dependent Indian communities within the borders of the United States under the jurisdiction of the U.S. Government.
- All Indian allotments, the Indian titles to which have not been extinguished, including rights-of-way running through the allotments.

**2. If my client lives in California Indian country, is he or she considered a California resident?**

**Yes.** Even if they live in Indian country, they are considered California residents.

**3. I have clients who are Native American. Are their earnings exempt from California income tax?**

Generally, California taxes the entire income of residents of the state, and the California source income of nonresidents. If your clients meet **all** of the following requirements, their income is exempt from California income tax:

- They must be members of a federally recognized Indian tribe.
  - For a list of all federally recognized tribes, go to the IRS website at [www.irs.gov](http://www.irs.gov). Search for federally recognized tribes. A list is available in Internal Revenue Service Bulletin Number 2002-42, Rev. Proc. 2002-64 (page 718).  
You can find a listing of federally recognized California Indian tribes on the National Conference of State Legislatures website at [ncsl.org](http://ncsl.org) (search for **federally recognized**).
- They must live in their tribe's Indian country, which includes reservations, dependent Indian communities, and Indian trust allotments.
- The income they earn must be sourced in the same Indian country in which they live, and where they are tribal members.

**4. What if my clients meet all of the requirements to be exempt from California taxation, and also earn income from sources outside of Indian country?**

Their tribally sourced income is exempt from California taxation if they meet all the requirements. However, California taxes income that is earned outside of Indian country. This includes income your clients earn from tribes of which they are not members, or income they earn outside California. This also includes income from other sources in Indian country.

**5. What if all my clients' income is from Indian country sources, but they live outside Indian country?**

If your clients live outside of Indian country and within California, California taxes all income including income from Indian country sources.

**6. What if my clients are California residents, whose only income is from sources outside Indian country or from sources outside California?**

For California purposes, their entire income is taxable. California taxes the entire income of residents.

**7. One of my clients is on active duty status with the U.S. military. His station is in California, but his military orders require him to live outside Indian Country. Does California tax his military pay if he is a member of a California tribe?**

**No.** California treats members of California tribes on active duty status as if they live within Indian country. California considers his military income to come from tribal sources, and does not tax it.

**8. What if my clients live outside of California, but receive casino income from California Indian country sources?**

If your clients are nonresident Native Americans, California does not tax their share of income from tribal casino operations. California may tax other income, such as wages received from California sources while a nonresident. For more information about California residency, get FTB Publication 1031, *Guidelines for Determining Resident Status*.

**9. Do my clients have to file California income tax returns if they live in California Indian country and all of their income is from the Indian country source where they live as tribal members?**

**No.** California does not require them to file an income tax return. However, we recommend they file the return to show the amount of exempt income as an adjustment on Form 540, Schedule CA. Also, if their income sources withhold tax from that income, they must file a California resident income tax return to obtain a refund of the withholding amount.

**10. What documents should my clients attach to their California income tax returns?**

Attach copies of Form 1099, *Miscellaneous Income*, and Form W-2, *Wage and Tax Statement* that show the details of their tribal income and non-tribal income.

**11. Should they attach a declaration regarding their tribal membership, income sources, and places of residence?**

**No.** Do not attach additional documents to their returns. If they claim some or all of their income is exempt from California tax, show the adjustments on the Form 540, Schedule CA, *California Adjustments*, other income line. Also, if they use a PO Box, please list their physical addresses in the blank spaces we provide on the Form 540 Schedule CA, "Other Income" line.

**12. Should my California Indian clients keep certain documents for state income tax purposes?**

**Yes.** They should keep documents that establish their tribal source of the income, and documents that establish their place of physical residence. They will need the information if we examine the income exclusion for earned income from Indian country sources. If we contact them and request this information, they must respond in a timely manner even if they believe their income is exempt and/or they did not file a California income tax return.

**13. What documents should my clients keep to support their income exclusions for income earned in their tribes' Indian country?**

Your clients should retain these documents:

- Form 1099-Misc and Form W-2 if they did not attach them to their California returns.
- Their federal tax return if they did not attach them to their California returns.
- The declarations page from their homeowner or renter insurance policies showing their Indian country addresses.
- The declarations page from their automobile insurance policies showing their Indian country addresses.
- Department of Motor Vehicles documents showing their Indian country addresses (California driver's license and any vehicle registrations).
- Utility statements showing their Indian country addresses, or a letter from a utility company that shows:
  - The customer and mailing address.
  - The service address.
  - The timeframe the utility provided service at that address.
- Any other documents they believe verify or establish their residence such as school records.

**14. If I have clients who are living with their parents, another relative, or a friend in their tribes' Indian country, what other documents might they need for an examination?**

Your clients should gather the following documents at the time they file a California return:

- A declaration by their parents, relative, or friend that shows each of the following:
  - The physical address of their living accommodations.
  - The time period when they lived there.
- Utility statements, or a letter from a utility company that shows:
  - Their parent's, relative's, or friend's customer mailing address.
  - The service address.
  - The timeframe the utility provided service at that address.
- Any other documents your clients believe verify or establish their residence, particularly if the document lists their names. See the list in the answer to the preceding question.

**15. Can my client's tribe verify he or she lives in Indian country?**

We do not require proof from your client's tribe. If you get the documents from your client's tribe, it is not enough for the tribe to merely report your client's primary address or address of record. Your client must provide documents that support where he or she claims to live, and the time period he or she lived at the location.

**16. I have clients that own or rent more than one home. If they possess a home in Indian country, is possession sufficient to make their income exempt from tax?**

**No.** They must show that their Indian country residence is the residence in which they lived during the period in question. In addition to the documents they need for their primary

homes, they should save documents that pertain to their second homes. For example, they should keep their lease agreements that list their tenants, or utility bills in their tenants' names.

**17. What is per capita distribution?**

Indian tribes that conduct gaming activities on a California reservation may use gaming profits for the general welfare of the tribe and its members. The law allows tribes to distribute gaming income to each member (per capita) of the tribe after tribal obligations are met or accounted for. Whether or not the per capita payments are taxable by California depends on where the tribal member lives.

Keep in mind that per capita income is subject to federal tax regardless of where tribal members reside.

**18. I have California Indian clients that are married, and live in the wife's tribe's Indian country. Is the husband's per capita distribution from his tribe exempt from tax?**

**No.** The wife's income is exempt from tax, but the husband must live in his own tribe's Indian country for his income to be exempt from California taxation.

<b>If the tribal member resides</b>	<b>The Per Capita income</b>
<ul style="list-style-type: none"> <li>On his own tribe's reservation in California and derives income from that tribe</li> </ul>	Is <b>not</b> taxable by California
<ul style="list-style-type: none"> <li>Off the reservation in California, even if living on his spouse's tribe's reservation in California</li> </ul>	Is taxable by California
<ul style="list-style-type: none"> <li>In another state, and is not a California resident</li> </ul>	Is <b>not</b> taxable by California

**19. My client is a California Indian who lives in Indian Country with his non-Indian wife. Is her income exempt from taxation?**

**No.** The **entire** income of a **non-Indian** spouse is subject to taxation, regardless of whether the non-Indian spouse lives on tribal lands.

**20. Where can my clients and I get more information, and find tax forms and publications?**

**Information:**

Website: [ftb.ca.gov](http://ftb.ca.gov)

Telephone: **800.852.5711**

Assistance for persons with disabilities: We comply with the Americans with Disabilities Act. Persons with hearing or speech impairments, please call TTY/TDD **800.822.6268**.

**Tax forms and publications:**

Website: [ftb.ca.gov](http://ftb.ca.gov)

Telephone: **800.338.0505**

Mail: TAX FORMS REQUEST UNIT  
FRANCHISE TAX BOARD  
PO BOX 307  
RANCHO CORDOVA CA 95741-0307

If you would like to have this information in brochure form to distribute to your clients, you can download *Frequently Asked Questions About the Taxation of Native Americans (FTB 674)* from our [website](http://ftb.ca.gov) at [ftb.ca.gov](http://ftb.ca.gov) (search for "Native Americans"). For information on California Indians and military duty, get FTB Publication 1032, *Tax Information for Military Personnel*.

The IRS website provides detailed and in-depth information on the federal taxation of Native American income. For general information on Indian tribal governments, you may want to begin with the *FAQs for Indian Tribal Governments Regarding Miscellaneous Issues*. More specific tax information is discussed in their *FAQs for Indian Tribal Governments Regarding Taxable and Nontaxable Distributions*.

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### **Want to learn more about HOH or RAR?**

We can help - workshops are coming soon!

FTB will provide a limited number of Head of Household (HOH) and Revenue Agent Report (RAR) workshops starting in July 2008. The workshops give tax practitioners an in-depth review and updated information about the HOH and RAR audit programs.

### **Some of the things we will cover at the HOH workshop:**

- An overview of the HOH program.
- Answering the question "Who qualifies for the HOH filing status?"
- Pertinent HOH law information.
- Common denial reasons.

For more information, see FTB 1585, *Head of Household Workshop Supplement*, and our workshop *PowerPoint presentation*.

### **Some of the things we will cover at the RAR workshop:**

- An overview of the RAR program.
- Taxpayer responsibilities for notifying California after a federal examination.
- Statute of limitations and penalties related to the audit.

Each workshop is two hours long, and they can be held separately or jointly.

We will be mailing invitation letters in June to chapters of the California Society of Enrolled Agents, California Society of Certified Public Accountants, California Society of Tax Professionals, and other tax professional organizations. The letter will include forms for requesting either workshop, as well as contact information.

If you have questions about scheduling an HOH or RAR workshop, please contact:

- Bonnie Hoyle for the HOH workshop at **916.845.3959**.
  - Estela Evangelista for the RAR workshop at **916.845.7359**.
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## Inside FTB

### Billing notices and balance due returns

Some taxpayers who filed balance due, individual income tax returns have received a *Return Information Notice* or *Statement of Tax Due*. These notices indicate that we have not yet received payment of their balance due, even though many of these taxpayers paid separately by paper check on or before April 15.

This usually happens when one or more of these circumstances exist:

- Taxpayers mail their paper checks separately from their returns (both paper and e-filed returns).
- Checks are not mailed to the correct PO box.
- Payment vouchers or other identifying information do not accompany the checks.
- Paper copies of e-filed returns are submitted with the checks.

This problem does not occur when payments are made electronically.

FTB is initiating a pilot program for 2008 PIT returns received during the 2009 filing season, to explore ways to resolve this issue.

### RDPs may receive underpayment of estimated tax penalty in error

Registered Domestic Partners (RDPs) who have underpaid their 2007 tax liability may be issued a notice for underpayment of estimated tax in error.

Senate Bill 105, Stats. 2007, Ch 426, added a provision to the Revenue and Taxation Code that prohibits RDPs from being assessed a penalty for underpayment of estimated tax to the extent that the penalty was assessed because of this act or Senate Bill 1827, Stats. 2006, Ch 802.

RDPs who underpaid their tax liability regardless of their filing status as RDPs, may be subject to a penalty. If the penalty was assessed because of filing as an RDP instead of single or head of household, the penalty will be waived.

If you have clients who believe they were assessed a penalty in error, call our customer service toll-free number at **800.852.7511**, or the Tax Practitioner Hotline at **916.845.7057**. If they qualify, we will waive the penalty.

### **e-file Helps California go green**

FTB has received a record number of tax returns by e-file so far this year. The 9.6-million e-file individual tax returns represent a 10 percent increase over last year. It also shows California taxpayers' commitment to help conserve natural resources: This year alone, e-filing saved over 90 million sheets of paper.

FTB also issued nearly 4 million refunds by direct deposit. The state saved more than 150 trees by not printing those refund checks.

On the business side, e-file growth rate compared to last year is an amazing 635 percent. As of May 10, we received 128,092 business e-file tax returns. At this same time last year, we had received only 17,790 e-filed business tax returns. The nearly 130,000 returns e-filed so far this year has saved more than 20 tons of paper.

FTB offers taxpayers and tax professionals a variety of other green services online ([ftb.ca.gov](http://ftb.ca.gov)). View account information, make payments, and request payment installment plans electronically through our website.

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### **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 behaviors 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**.

### **Former collections manager sentenced in embezzlement scheme**

On April 22, a former collections manager was sentenced to four years in state prison for embezzling more than \$323,000 from his former employer.

Patrick J. Roche, 33, was also ordered to pay restitution to his former employer of \$323,962 and \$59,577 to the FTB representing the unpaid tax, penalties, interest, and the cost of the investigation. Roche was found guilty in February for grand theft with a special enhancement for a loss involving more than \$150,000. He also was found guilty of two state income tax charges. One charge of tax evasion for failing to file his 2004 tax return, and a second charge of tax fraud for filing a fraudulent 2006 income tax return. According to court documents, Roche created a fictitious company, Cal Computer Consulting Group, to embezzle from his former employer, a

Santa Barbara-based temporary employment agency, from 2001 - 2007.

Roche issued fraudulent invoices from his company, and then authorized payment as collections manager. Roche cashed the checks and used the money at restaurants, bars, adult entertainment, a kickboxing gym, online gaming, and stock purchases. In addition, Roche failed to report the \$314,000 in illegal income on his state income tax returns. All income is taxable including income from illegal sources. The embezzlement was discovered during an audit of the company's books.

### **Insurance agent charged with defrauding business owners**

On April 23, an insurance agent was arrested for defrauding 18 business owners by stealing more than \$2.5 million in money they had paid him to take out insurance policies for their businesses. Anthony David Medina, 36, was charged with 153 felony counts: 86 counts of forgery, 33 counts of transacting as an insurance company without a certificate of authority, 19 counts of grand theft, 5 counts of filing false tax returns, 4 counts of willfully failing to file a tax return, 4 counts of identity theft, 2 counts of insurance fraud, and sentencing enhancement allegations for excessive taking over \$50,000 and \$150,000. Medina was arrested at a business in Oxnard and is being held on \$2,936,000 bail. In order to post bond, he must prove that the money is from a legitimate source. Medina faces a maximum sentence of 54 years and 4 months in state prison if convicted on all counts.

Medina's wife, Vanessa Chaverri, 36, arrested at a Ladera Ranch home, is charged with five felony counts of filing a false return. She is being held on \$436,000 bail, and must prove the money is from a legitimate source before posting bail. Chaverri faces a maximum sentence of six years in state prison if convicted.

Between June 2003 and November 2007, Medina is accused of operating Prompt Insurance Agency in Newport Beach. The defendant is accused of collecting more than \$2.5 million from 18 business owners, including restaurants, plumbing and painting businesses, and other service-oriented businesses. Medina is accused of taking money from the businesses under the pretense of securing workers' compensation and general liability insurance policies for them.

Medina is accused of failing to take out insurance policies for many of the businesses and charging the victims more than the stated premiums. In some instances, he is accused of forging documents to finance insurance policy premiums instead of paying the full amount up front to the insurance company, despite the fact that the victims had paid him the total cost of the policy premium.

Medina is accused of issuing false certificates of insurance to some of his victims. The defendant is accused of creating false policy numbers or giving policy numbers to companies that actually belonged to other businesses.

Between 2003 and 2006, Medina is accused of failing to file any tax returns for Prompt Insurance Agency. Chaverri and Medina are accused of failing to report the income from the stolen monies on their personal tax returns. They are accused of failing to pay more than \$230,000 in taxes, and passing that loss of revenue on to California taxpayers. The defendant was using the stolen money for personal use on his expensive lifestyle, including cars, homes, and a boat.

The Department of Insurance (DOI) began investigating this case when an insurance company filed a report after finding a discrepancy in a financed policy taken out through Prompt Insurance Agency.

The California Franchise Tax Board, the DOI, and the Orange County District Attorney's Office jointly investigated this case.

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