Tax News

August 2008

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Deadline approaches for FTB Notice 2008-4 *Closing Agreement*

Eligible taxpayers must file Closing Agreements by September 12

Taxpayers have until September 12, 2008, to participate in Franchise Tax Board (FTB) Notice 2008-4, *Resolution of Bogus Optional Basis (BOB) Transactions and Certain Employee Stock Ownership Plan (ESOP) transactions*. See related articles in the September 2007, June 2008, and July 2008 issues of *Tax News*. Each eligible taxpayer, whose tax was reduced due to the transaction, and who wants to participate in FTB Notice 2008-4 must file a separate Notice 2008-4 *Closing Agreement*. A taxpayer who entered into more than one eligible transaction must file a separate *Closing Agreement* for each transaction.

Full payment of all taxes, penalties, and interest due in accordance with the *Closing Agreement* or payment arrangement requests with FTB are due by September 12, 2008.

Send your completed FTB Notice 2008-4 *Closing Agreement*, including all schedules and attachments, to FTB by US Mail or private carrier.

US Mail Address	**Private Carrier**
ATSU 398 O. NAYEBKHIL MS F385 FRANCHISE TAX BOARD PO BOX 1673 SACRAMENTO CA 95812-9900	ATTN: O. NAYEBKHIL EXT. #3190 ON ATSU 398 MS F385 FRANCHISE TAX BOARD SACRAMENTO CA 95827

For more information about *Closing Agreements*, see our Abusive Tax Shelter page, which includes frequently asked questions.

You may also contact our FTB Notice 2008-4 Hotline at **916.845.3030**, or email your question to taxshelter@ftb.ca.gov.

FTB is developing a California Schedule M-3

FTB will have its own version of the Schedule M-3 for the 2008 taxable year. We are currently in the form-drafting stage and would like your assistance. We will hold an Interested Parties Meeting on August 11, 2008 to get public feedback on the new California Schedule M-3. Please refer to the Announcements section on the FTB website home page for details on the time and location. We will post drafts of the Schedule M-3, *Net Income (Loss) for Corporations* (also for *S Corporations, Certain Partnerships, and Limited Liability Companies*) on our website at ftb.ca.gov for review and comments.

The California Schedule M-3 reconciles differences between financial results from operations and taxable income for each entity. We will not require a Schedule M-3 (100) for tax-exempt corporations under R&TC Section 23701 that file Form 100 to include nonexempt income.

The proposed drafts of the Schedule M-3 are similar to the federal Schedule M-3, but will require reporting California amounts. C corporations including water's-edge filers, S corporations, partnerships, and limited liability companies classified as partnerships will be required to file the form with proposed filing limitations comparable to federal filing requirements. Schedule M-3 filers will no longer file the California Schedule M-1, *Reconciliation of Income (Loss) per Books With Income per Return.*

Because our objective is to develop a form that will cause the least burden to taxpayers, we welcome your suggestions for making this form easier to complete and file. A question and answer section will soon be available on our website, and will include information about why the form is needed, filing requirements, and other issues. We will also post comments we receive during the review process.

Watch for more information on the Schedule M-3 in future issues of *Tax News*.

One of FTB's tax gap strategies - nonresident withholding audits

As part of our comprehensive campaign to reduce the tax gap, FTB is conducting compliance audits of nonresident withholding. Individuals and business entities are required to withhold on payments to nonresident independent contractors[1] for services performed in California (R&TC Section 18662(d)). We are assessing the required 7 percent nonresident withholding liability, and also assessing $100 for each FTB Form 592-B (*Nonresident Withholding Tax Statement*) informational return not filed (R&TC Section 19183).

In conducting these withholding audits, we have identified the following common errors:

- Inadequate record keeping.
- Cash payments to both residents and nonresidents. The cash payments are made to individuals or business entities categorized as independent contractors, and generally, payers are not withholding or preparing the required IRS Forms 1099-MISC or FTB Forms 592-B.
- To avoid employment taxes, cash payments to part-time or full-time employees are also frequently categorized as independent contractors. Payers are not preparing IRS Forms 1099–MISC or W-2.

After completing withholding compliance audits, we may refer these individuals or business entities to the IRS and California's Employment Development Department (EDD) for audit.

Requirements for payers

- Before paying independent contractors, require them to:
    - Complete IRS Form W-9, *Request for Taxpayer Identification Number and Certification*.

[1] Nonresident independent contractors are defined as nonresident payees receiving compensation for personal services, sales commissions, professional fees, contracted services, etc., performed in California.

  - Complete FTB Form 590, *Withholding Exemption Certificate*, if applicable (to be valid, a physical address in California and a tax ID are required).
- Withhold at the maximum rate, 7 percent, unless:
  - The independent contractor is exempt based upon a properly completed Form 590.
  - The FTB has notified the payer that a waiver or reduced withholding is approved. We will approve the waiver or reduced withholding after we receive and process the payee's request. The payee may submit Form 588, *Nonresident Withholding Waiver Request*, or FTB Form 589, *Nonresident Reduced Withholding Request*, to apply for a waiver or reduced withholding, respectively.
- Issue FTB Forms 592-B, *Nonresident Withholding Tax Statement*, informational returns, by the required due dates.
- Issue IRS Forms 1099-MISC, *Miscellaneous Income*, to independent contractors, if required, whenever payments reach $600 in the calendar year.
- Issue IRS Forms W-2, *Wage and Tax Statement*, to employees.

Recommendation for payers

- Properly categorize independent contractors and employees.

More information on nonresident withholding

- **Publications:**
  - FTB Publication 1017, *Nonresident Withholding Guidelines*
  - FTB Publication 1031, 2007 *Guidelines for Determining Resident Status*
  - IRS Publication 15-A, *Employer's Supplemental Tax Guide (*for *"Who Are Employees?"* and *"Employee or Independent Contractor?"*)
  - IRS Publication 583, *Starting A Business and Keeping Records*
- **Websites:**
  - FTB: ftb.ca.gov (see our nonresident withholding decision table)
  - EDD: edd.ca.gov
  - IRS: irs.gov
- **Telephone**

  Call our Withholding Services & Compliance staff for assistance: Toll free **888**.792.4900

Changes to state law on CTEC exemption

Effective June 23, 2008, California Senate Bill 797 (Ch. 33, Stat 2008) clarifies the definition of who **is** exempt, and who **is not** exempt from the requirement to register with the California Tax Education Council (CTEC).

In 1996, the California State Legislature passed the Tax Preparers Act (Business and Professions Code Sections 22250-22259), and subsequently established CTEC to promote competent tax preparation within the State of California.

The Tax Preparer Act identified who was required to register with CTEC, and who was exempt from this requirement. Required to register is "Any person who for a fee, assists with or prepares a State or Federal tax return, or assumes responsibility for such a return, or who offers these services." The Act also specifies that Certified Public Accountants (CPAs), Enrolled Agents (EAs), and attorneys are exempt from the CTEC registration requirement. Under certain circumstances, the law also allows exemption status for employees working under a CPA, EA, or attorney.

Allowing employee exemption was based on the reasoning that the CPA, EA, or attorney would review employees' work, and would sign the returns. However, recent CTEC visits to tax preparation offices have shown this is not always the case, and many exempt-status employees are preparing and signing returns without any supervision. Consequently, the newly revised law requires that all CPAs, EAs, and attorneys must sign the returns prepared by their exempt employees so they are held fully accountable for the employees' work. If they prefer not to sign the return prepared by the employee, then the employee must register with CTEC so he or she can legally sign the return.

In addition to clarifying employee exemptions, the revised law also expanded the definition of "tax preparation" to include data entry. California Business and Professions Code 22251 defines "tax preparer" as a person "who prepares tax returns" **or** "assists with" preparing tax returns. Since "inputting tax data" is assisting with preparing the return, the law was revised to include data entry. Individuals who input tax-related data into a computer are now required by the revised law to register as a CTEC registered tax preparer.

For more information about how to become a CTEC registered tax preparer, go to the CTEC website and check out the Q&A section.

FTB follows IRS increased mileage rates for rest of 2008

The IRS recently announced an increase in the optional standard mileage rates for the final six months of 2008. Taxpayers may use the optional standard rates to calculate the deductible costs of operating an automobile for business, charitable, medical, or moving purposes. FTB will follow the IRS in increasing the optional standard mileage rates for the remainder of 2008.

The rate will increase to 58.5 cents a mile for all business miles driven from July 1, 2008, through December 31, 2008. This is an increase of eight cents from the 50.5 cent rate in effect for the first six months of 2008, as described in IRS Rev. Proc. 2007-70.

The IRS normally updates the mileage rates once a year in the fall, for the next calendar year. The recent steep increase in the price of gasoline was a deciding factor in prompting the 2008 mid-year adjustment. Although the cost of gasoline is a significant contributor, other factors are also considered in the calculation, including depreciation, insurance, and other fixed and variable costs.

The optional business standard mileage rate is used to compute the deductible costs of operating an automobile for business use instead of tracking actual costs. This rate is also used as a benchmark by many federal and state government agencies, as well as businesses, to reimburse their employees for mileage.

The new six-month rate for computing deductible medical or moving expenses will also increase by 8 cents to 27 cents a mile, up from 19 cents for the first six months of 2008. The rate for providing services for charitable organizations is set by statute and remains at 14 cents a mile.

The IRS reports the new rates in Announcement 2008-63, in the section on the optional standard mileage rates.

Taxpayers always have the option of calculating the actual costs of using their vehicle rather than using the standard mileage rates.

Mileage Rate Changes

Purpose	Rates 1/1 through 6/30/08	Rates 7/1 through 12/31/08
Business	50.5	58.5
Medical/Moving	19	27
Charitable	14	14

IRS launches campaign to help new small businesses

The Internal Revenue Service has launched a yearlong campaign to help educate new self-employed small business owners about federal tax responsibilities, and about filing Schedule C, *Profit or Loss from Business*.

To get the latest information about the campaign, go to IRS.gov and start a free subscription to *e-News for Small Businesses*.

What else is new with exempt organizations?

Last month (July 2008) we gave you an update on the streamlined process for organizations to obtain state tax-exempt status, resulting from passage of Assembly Bill 897 (Ch. 238, Stat. 2007) in September 2007. This month, we focus on FTB Form 3500A, which has a new name.

Beginning January 1, 2008, organizations that have obtained exempt status from the IRS under Internal Revenue Code Section 501(c)(3) became automatically eligible for state tax-exempt status by submitting a copy of the federal determination letter to us, along with FTB Form 3500A, which has was renamed April 2008. Form 3500A is now titled *Submission of Exemption Request: Exemption Based on 501(c)(3) Federal Determination Letter.* Previously, it was *Affirmation of Internal Revenue Code Section 501(c)(3)*.

We send an *Exempt Acknowledgement Letter* to organizations that receive state tax-exempt status. However, we will **not** acknowledge the state tax-exempt status unless a copy of the federal determination letter is attached to the Form 3500A. There is no filing fee.

Read more about AB 897 implementation – *Issuance of Exempt Acknowledgment* letter in Notice 2008-3, on our website. For more information on state exempt status and the *Exempt Acknowledgement Letter*, go to our website and search for exempt, or call our Exempt Organization unit at 916.845.4171. And, don't forget to search for form 3500A by its new name: *Submission of Exemption Request: Exemption Based on 501(c)(3) Federal Determination Letter*.

Inside FTB

Thousands eligible for Homeowner and Renter Assistance

In early July, we began mailing forms to more than 600,000 Californians who may be eligible to receive payments from California's Homeowner and Renter Assistance (HRA) Program. State Controller and FTB Chair John Chiang noted that last year's program provided $181 million directly to blind, disabled, or elderly Californians.

The HRA program began July 1, and runs through October 15. To qualify, applicants must:

- Have household income of $44,096 or less last year.
- Be a U.S. citizen, designated alien, or qualified alien when the claim is filed.
- Be blind, disabled or over the age of 62 on December 31, 2007.
- Have owned and lived in their home at the end of 2007 (if claiming homeowner assistance).
- Have paid at least $50 a month in rent, and lived in property that was not tax-exempt (if claiming renter assistance).

Assistance payments range from $15 to $347 for renters, and $20 to $472 for homeowners, depending on the claimant's total income.

Volunteer assistance sites are available for individuals who would like free help completing a claim form. These sites helped more than 75,000 Californians last year. To find a claim form or view a list of volunteer assistance locations, visit our HRA website. Forms and information on the program are available on our website in Chinese, Korean, Russian, Spanish, and Vietnamese, in addition to English.

Qualified individuals also have the option of delaying their property tax payments through the Property Tax Postponement Program, offered through the State Controller's Office. For more information about this program, visit the State Controller's website.

Once California's state budget is signed, FTB will begin clearing HRA claims for payment.

Incorrect phone number on back of 2008 HRA booklet

A new guidelines page was included on the back page instructing claimants to call 800.868.**4717** if they moved. The phone number is incorrect. The correct phone number is 800.868**.4171.**

Claimants who may try to dial the incorrect number are connected to the following recording: "If you are trying to reach the Franchise Tax Board's Homeowner and Renter Assistance Program, please call 800.868.4171."

You can also refer your clients who are HRA claimants to our website, where they can get translated and online versions of the Homeowner and Renter Assistance claim booklets.

Correction to June 2008 *Tax News*

The article "RDPs may receive underpayment of estimated tax penalty in error" in the section "Inside FTB" on page 11 lists an incorrect phone number.

- Incorrect number: 800**.**852**.75**11.
- Correct number: 800**.**852**.57**11.

We regret any inconvenience this may have caused. Please make sure you change your records to the correct phone number.

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**.

Orland woman pleads guilty to grand theft, forgery, and state income tax charges

On June 20, 2008, an Orland woman pleaded guilty to two counts of grand theft, one count of forgery, and one count of state income tax evasion.

Jennifer Sites, 37, was formerly employed as the bookkeeper for a Chico heavy equipment company. According to court documents, Sites embezzled more than $500,000 from 2006 - 2008 by abusing her position of trust as company bookkeeper, and used the embezzled funds to purchase items from a television home shopping show. In addition, Sites failed to claim the illegal income on her state income tax return. All income is taxable including income from illegal sources. When the heavy equipment company's owner discovered the theft, he reported it to the Butte County Sheriff's Office.

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

Long Beach woman pleads guilty to embezzlement, state income tax charges

A Long Beach woman pleaded guilty on July 3, 2008, to one felony count of grand theft and one felony count of filing a false state income tax return.

Patricia A. Cruz, 46, originally pleaded not guilty in June, but changed her plea and accepted the plea agreement offered by the Los Angles County District Attorney's Office. According to court documents, Cruz wrote fraudulent checks from the corporate bank account for her personal gain. From 2003 - 2007, Cruz embezzled more than $500,000 from her former employer before the company owner discovered the theft. When confronted, Cruz admitted to the theft, and then presented a spreadsheet detailing the amount and extent of her theft. Cruz used the stolen funds to purchase personal items.

Cruz failed to claim the embezzled funds on her 2004 - 2006 state income tax returns. All income is taxable including income from illegal sources.

The plea agreement includes four years in state prison, full restitution to her former employer, and more than $90,000 to FTB, representing the unpaid tax, penalties and interest, and the cost of the investigation.

This was a joint investigation between the Los Angeles County Sheriff's Office, the Los Angeles District Attorney's Office, and FTB.

Whittier doctor guilty of state income tax evasion

A Whittier physician pleaded no contest to one felony count of state income tax evasion on July 9, 2008.

Eugene P. O'Donnell, 72, of La Mirada, is the chief executive officer of Eugene P. O'Donnell, M.D., A Professional Corporation. According to court documents, from 2001-2005 O'Donnell received more than $1.7 million in income from Medicare and other health care payers. O'Donnell failed to file his 2001- 2004 individual and corporate state income tax returns and report any of these funds.

O'Donnell faces up to three years in state prison, loss of his medical license, a $20,000 fine, and restitution in the amount of $373,597 to FTB representing the amount of unpaid tax, penalties and interest, and the cost of investigation.

O'Donnell's case was discovered by the Los Angeles County District Attorney's Fraud Interdiction Program.

Santa Ana couple guilty of state income tax evasion

A Santa Ana couple pleaded guilty to three counts of state income tax evasion on July 17, 2008.

William Greenberg, 64, and Marta S. Greenberg, 55, own and operate the New Green's Furniture store in Tustin. According to court documents, the Greenbergs failed to report more than $334,322 on their 1999-2001 state income tax returns.

FTB uncovered the case through its internal filing enforcement program. Each year FTB reviews income records from numerous sources, including the Internal Revenue Service, the California Employment Development Department, the Board of Equalization, employers, and banks. FTB compares this data with its database of tax returns filed to identify individuals who should have filed taxes but did not, or to find discrepancies between the income reported and income claimed.

William Greenberg pleaded guilty to three felony counts of state income tax evasion. Marta Greenberg pleaded guilty to three misdemeanor counts of state income tax evasion. In addition, the Greenbergs were ordered to pay FTB restitution totaling $134,495, representing the unpaid tax, penalties, interest, and the cost of the investigation.

Their sentencing is scheduled for January 2009, when they are to pay nearly $80,000.