Tax News

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LLC fee refunds based on Northwest decision

On April 14, we released FTB Notice 2008-2 to address protective claims regarding the LLC fee. This Notice relates specifically to a recent court decision on Northwest Energetic Services (NES), LLC v. Franchise Tax Board.

NES was a foreign LLC that registered with the California Secretary of State, but did no business in California. In a recent decision on this case, the California Court of Appeal, First Appellate District, held that assessing an LLC fee to an entity that had no income attributable to business conducted in California was unconstitutional as applied to NES, and the fee should be refunded.

Two additional pending court cases address the constitutionality of the LLC fee:

- Ventas Finance I, LLC – a foreign LLC registered in California that earned income inside and outside California.
- Bakersfield Mall, LLC – a foreign LLC that claims it earned income only in California.

These cases are ongoing and final decisions have not been issued.

Because the NES decision about the LLC fee is now final, it is possible to take action on claims for refund filed by LLCs that had no income attributable to activities in California. Some claims don't provide enough information, however, to determine whether the LLC that filed the claim has the same facts as those involved in NES. If you file, or have filed claims for your clients based on the facts in NES, you should provide the following information:

- The LLC's name, address, and the name and phone number of the managing member or designated contact person.
- The LLC's Secretary of State file number or Franchise Tax Board temporary LLC number (for unregistered entities), and Federal Employer Identification Number.
- Taxable Year(s) involved.
- A statement that the LLC did no business in California for each of the taxable years for which the claim is being filed.

If your client hasn't filed a claim for refund but wants to, include the above information in a letter along with the statement, "**This letter constitutes a claim for refund for (taxpayer's name) – No income attributable to California**," and the amount of claim per year. Any claim for refund must be signed by a representative with power of attorney (POA) or signed by the LLC's managing partner.

Fax all information to FTB at: 916.845.9796

Or, you may mail this information to:

ABS 389 MS: F340
Franchise Tax Board
PO Box 942867
Sacramento CA 94267-8888

Courier service delivery or private courier mail:

ABS 389 MS: F340
Franchise Tax Board
C/O FTB Notice 2008-2
Sacramento CA 95827

FTB follows IRS Notice 2007-100
For IRC section 409A

On December 3, 2007, the Internal Revenue Service (IRS) released Notice 2007-100 (available online). It allows taxpayers to correct certain operational failures of nonqualified deferred compensation plans in order to comply with IRC Section 409A. Because California Revenue and Taxation Code (Sections 17501 and 24601) conforms to IRC Section 409A, FTB is following IRS Notice 2007-100.

Service recipients or service providers, e.g. employers or employees respectively, that rely on IRS Notice 2007-100 for federal income tax relief must follow the Notice's information and reporting requirements. To follow these information and reporting requirements, service recipients and providers must attach statements to their respective **federal** income tax returns.

For California income tax purposes, however, service recipients or providers that rely upon the Notice for relief are not required to submit additional statements to FTB as attachments to their California income tax returns. We require service recipients and providers to retain a copy of the information in their records, and may request these documents at a later date.

Although FTB follows IRS Notice 2007-100, this does not relieve the service recipient of employment taxes or penalties, if applicable.

For further information, please contact Jeanne Sibert at 916.845.5554, or Deirdre O'Connor at 916.845.7335.

Updated list of top 250 income tax debts

On April 7, FTB unveiled a new list of the state's top 250 tax debtors, who collectively owe more than $123 million in income taxes.

At the top of the list is a $6.1 million corporate tax delinquency. One other corporate delinquency is in the top 10 highest tax amounts, owing $2.7 million. The remaining eight of the top 10 amounts owed are for personal income tax delinquencies, owing from $2.1 million to $4.4 million. Six of the top ten have California addresses, and four are located out of state.

FTB is required by law to post a list of the 250 state income tax debtors who owe the largest amounts greater than $100,000 in tax, after first notifying them that their delinquencies will become public. Since January 2008, the State has received approximately $4.2 million in

payments from taxpayers desiring to keep their names from being posted. More than $500,000 was collected last year when the original list was posted in October.

Taxpayers who do make the list can have their information removed by paying the tax in full, or agreeing to pay by installment. Tax liabilities under appeal, litigation, in bankruptcy proceedings, or under consideration for an Offer in Compromise are not included on the list.

Delinquent taxpayers who appear on the list can contact us at these numbers:

- Personal Income Tax: **866**.418.3702.
- Business Income Tax: **866**.914.5594.

The complete list is updated annually on our website, ftb.ca.gov. The list information was last updated on April 4, 2008, and does not reflect payments made after that date. The Board of Equalization has a similar list of the state's top sales and use tax delinquencies.

FTB requests tax returns on real estate withholding cases

In mid-April, FTB began mailing more than 9,000 *Requests for Tax Returns* (FTB 3953R or 3954R) to nonfilers who have real estate withholding credits for 2004 and 2005 tax years.

Until December 31, 2002, only nonresident sellers of California real estate were subject to withholding law. Subsequent laws amended California Revenue and Taxation Code Sections 18662 and 18668, relating to real estate withholding. AB 2065, passed in 2002, extended the withholding requirement to California residents who sell real estate, to withhold 3.3 percent of the total sales price. AB 2962, passed in 2006, gave sellers an option to withhold on the sales gain only (9.3 percent for individuals, 8.84 percent for corporations), rather than withholding 3.3 percent of the total sales price.

Real estate sellers must file a California tax return to claim the real estate withholding credit. Failure to file the tax return and report the sale within three months and 15 days (two months and 15 days for corporations) after the close of the taxable year may result in penalties.

If you have clients who receive a *Request for Return*, they must either:

- File the returns.

  Or

- Show that they do not have a filing requirement.

FTB will issue a Notice of Proposed Assessment to nonfilers that do not respond to our request for a return within 45 days.

For more information about real estate withholding, consult our **Requirements for Sale of California Real Estate** webpage.

Top 10 real estate withholding errors

Avoid these mistakes to prevent document processing and payment allocation delays.

CATEGORY	ERROR	SOLUTION
Forms	Incorrect or incomplete information provided on withholding documents	Answer all applicable fields completely and accurately. Also, include a telephone number so we can reach you directly if an error occurs.
	Incorrect form	Verify the correct form type and year of withholding before submitting. Installment sales use Form 593-I, *Real Estate Withholding Installment Sale Agreement*, and include a copy of the promissory note.
	Multiple and/or unrelated sellers on one withholding form	A separate withholding form is used for each of the sellers (other than joint filers) allocating the proportional share of withholding.
	Unnecessary paperwork sent to FTB	Cover letters, closing statements, and form instructions are generally not documents necessary to allocate withholding to taxpayers. Send in the required forms only.
	Forms 593-C and 593-E sent to FTB	Forms 593-C, *Real Estate Withholding Certificate*, and 593-E, *Real Estate Withholding – Computation of Estimated Gain or Loss*, should not be sent to FTB unless requested. Sellers should retain the 593-E for five years and escrow persons should retain the 593-C for five years.
	Incorrect person/entity listed	Withholding is done on the seller listed on the title. For trusts, see FTB Form 7429, *Do I Need to Withhold on This Trust?* for assistance in determining withholding and guidelines on the types of trusts. Make sure the identification number of the seller is included, not the trustee, beneficiary, etc.

Identification	Omitting or using an incorrect identification number	Enter the correct identification number(s) on all the withholding identification number documents. If the seller has applied for a tax identification number, but it has not been received, enter "Applied For" in the space for the seller's ID and attach a copy of the federal application. Note: Form 593-C must have an identification number to be valid.
	Non-real estate related payments	Lien or bill payments should not accompany real estate withholding payments. For additional information on payoff amounts for liens, contact our Lien Department at 916.845.4350 (not toll-free).
Payments	No information included with payment	Make sure all payments remitted include the correct withholding documents, identification number, and the exact legal name. Register for the Electronic Funds Transfer (EFT) program. For more information, visit our website at ftb.ca.gov, or call 916.845.4025 (not toll-free).
	One payment for multiple transactions that do not match submitted documents	Payments for multiple transactions should equal the total amounts of the submitted withholding documents.

For more information on real estate withholding, visit our website at ftb.ca.gov.

Reporting tax fraud, closing the tax gap

At FTB, we are committed to the fair administration of California's income tax laws. This means taxpayers pay no more and no less than the correct amount of income tax owed. We know that most taxpayers are honest, and pay their fair share. Unfortunately, there are individuals and businesses that pay $6.5 billion less in income taxes than they legally owe each year. Honest taxpayers are burdened with higher taxes because of this fraud. Below are some of the things dishonest individuals commonly do to pay less than they owe:

- Self-employed individuals fail to report all income received.
- California residents file individual income tax returns claiming to be residents of another state while actually residing in California.
- Individuals prepare documents, books, and records that understate true income or overstate business expenses.

We need your assistance to help us to stop this fraudulent activity. If you know of taxpayers who pay less than they owe, or tax preparers who follow questionable practices, you can:

- Call the Tax Informant Hotline: 800.540.3453.
- Fax the information to: 916.843.2060.
- Write to: Franchise Tax Board, PO Box 1565, Rancho Cordova, CA 95741.

Find more information about fraud and how to report it on our website at ftb.ca.gov.

Combined report, water's-edge e-filing coming in June

Corporations who file combined reports or water's-edge returns will be able to e-file their returns beginning June 16, 2008.

Business e-file began in January of 2006, allowing business taxpayers to e-file the Form 100 *California Corporation Franchise or Income Tax Return* for the first time. In January 2007, we added these forms:

- Form 565, *Partnership Return of Income.*
- Form 568, *Limited Liability Company Return of Income.*
- Form 100S, *California S Corporation Franchise or Income Tax Return.*

Adding combined reporting and the Form 100W to our business e-file program makes it possible for the largest and most complex business returns to be e-filed. The IRS already mandates e-filing for many of these returns, so this will increase convenience for those of you already e-filing the federal return.

Contact your software providers to see if they are supporting e-filing for combined reports and the Form 100W. Stay tuned to our website and to *Tax News* for more information about our Business e-file Program.

Alternative ways to pay

Your clients can take care of their FTB financial responsibilities electronically with peace of mind, knowing that we have securely received their payments. Paying electronically means your clients don't have to spend time writing and mailing checks, and their payments are quickly applied to their accounts. The various ways your clients can pay electronically are described below, and on our website, ftb.ca.gov.

Web Pay: Your clients can use an online account transaction at any time to pay any FTB liability, including:

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

- Any bill.

To make a payment, your clients can simply choose the payment amount, and the date the funds should be transferred from their checking or savings accounts. A built-in verification process for bank account and routing numbers helps taxpayers avoid entering incorrect banking information.

Electronic funds withdrawal: Your clients can also pay when they e-file a balance due return, and not worry about having to remember to mail a check. They can choose the amount they want to pay, as well as the date they want the funds to be transferred from either their checking or savings account. They can even schedule electronic withdrawal for their next year's estimated tax payments when they e-file.

Credit Card: Your clients can use their credit cards to pay any bill when they make a payment through Official Payments Corporation. Official Payments Corporation charges a convenience fee of 2.5 percent (minimum $1), and accepts the following cards:

- Discover/NOVUS.
- MasterCard.
- Visa.
- American Express.

Installment Agreement: If your clients are unable to pay their balances in full, encourage them to apply for an installment agreement online. Generally, your clients will qualify if they:

- Owe a balance of $10,000 or less.
- Agree to pay their balance in 36 months or less.
- Have filed all personal income tax returns.

We also accept installment agreement applications for balances up to $25,000, and for payment periods up to 60 months. If you have clients who owe balances between $10,000 and $25,000, they need to call us at 800.689.4776, to discuss setting up an installment agreement.

Inside FTB

Error on state tax form for IRA income phase out amount

Specifically, FTB corrected instructions to Schedule CA (form 540) line 32 regarding the income phase-outs for traditional IRA deductions for joint and qualifying widow(er) tax filers. To find the corrected instructions, visit the FTB website at ftb.ca.gov and search for "540 CA Instructions."

Taxpayers who make IRA contributions can take a state tax deduction if they meet certain requirements. For individuals who are covered by an employer retirement plan, the IRA deduction is reduced (phased-out) when income exceeds certain limits. For the joint and qualifying widow(er) filing status, the correct adjusted gross income phase-out amount range is

$80,000-$100,000. Before February 28, 2008, Schedule CA incorrectly listed the phase-out income range at $75,000-$85,000.

When we discovered the error, we immediately updated forms and instructions on the website, noted the error on the forms update page, and alerted all computerized tax processors who work with tax preparation professionals.

Taxpayers who take this deduction need to make sure they use the corrected form instructions, which show~~s~~ a revision date of February 2008 or later, or check with their tax professional or preparation software. Anyone who filed and missed taking this deduction due to the error should file an amended state tax return.

It's always a good idea to check for updates or corrections to any form that pertains to your clients. As updates and corrections are made to California tax forms, we post the changes on our website. To find our Tax Forms Updates webpage, go to our website at ftb.ca.gov and search for "forms updates."

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.

Sacramento woman guilty of grand theft, state tax fraud

On April 3, A Sacramento woman pleaded no contest to one count of grand theft with an enhancement for a theft involving more than $150,000 and three counts of filing false state income tax returns.

Jill L. Platt, 36, pleaded no contest to the charges in a plea agreement. According to court documents, Platt embezzled more than $150,000 from her former employer, a local engineering firm. Platt had access to the company's credit card and used it from September 2004 to October 2006 for personal items such as food, beverages, and entertainment. Platt also failed to claim the credit card purchases as income on her 2004, 2005, and 2006 state income tax returns. All income is taxable including income from illegal sources.

Platt faces a maximum of five years in state prison if sentenced to the full term under the plea agreement.

Platt's sentencing and restitution determination are scheduled for May 30, 2008, in a department to be assigned. She was released on her own recognizance.

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

Martinez woman arrested on suspicion of tax evasion

State and local investigators arrested a Martinez woman on April 7, on suspicion of state income tax evasion after she failed to appear in court on an unrelated matter.

Nanette Conley, 54, is the owner of Allstate Glass Centers Inc. The Franchise Tax Board alleges that she failed to pay $50,000 in personal income taxes between 2001 and 2003. She also is alleged to have filed a fraudulent 2004 state income tax return failing to claim the income she received from her business. According to the tax board, Allstate Glass Centers did not file 2002, 2003, and 2004 corporate tax returns.

A bench warrant was issued for Conley, also known as Nanette Ujdur, on April 7 after she failed to appear in court on an unrelated matter.

Contra Costa sheriff's deputies arrested her at her home on the bench warrant and another alleging tax evasion.

She was booked into County Jail and held on $75,000 bail on the tax charges, and $10,000 bail on the failure to appear warrant. Each felony tax count carries a maximum term of 3 years in state prison.

Upland man arrested April 15 on state income tax charges

On "tax day," April 15, an Upland man was arrested on felony charges of filing false state income tax returns.

Jose Alberto Garcia, Jr., 28, is the owner and operator of *Mi Oficina* Income Tax, a.k.a. My Office Income Tax, a tax preparation business. According to FTB investigators, Garcia allegedly filed false tax returns for 2001 – 2004, failing to claim the nearly $968,000 in unreported income he earned during these years. The failure to claim the income was first discovered by FTB's Fraud Prevention and Detection Unit. This program targets people who earned California income, but did not claim the income on their tax return. An earlier search warrant executed on Garcia's bank account revealed the additional income. After today's arrest, FTB investigators executed eight more search warrants on Garcia's eight tax preparation businesses. *Mi Oficina* Income Tax offices are located in La Puente, Los Angeles, Ontario, Riverside, San Bernardino, Santa Ana, and Temple City.

Each felony tax count carries a three-year maximum term in state prison. All income is taxable, including income from illegal sources. Garcia owes the state more than $85,000 in unpaid tax on the unreported money. Penalties, interest, and the cost of the investigation will be added to the FTB's restitution request.

Garcia was booked into the West Valley Detention Center in Rancho Cucamonga. Bail was set at $100,000, and his next court date has not been set.