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Legislative Wrap-up 2009

Here is our annual summary of tax-related legislation enacted this session.

Assembly Bills:

AB 5 (Evans, Stats. 2009, Ch. 5): Expands existing discovery procedures for a demand for inspection to include copying, testing, or sampling documents or electronically-stored information.

AB 11 (De Leon, Stats. 2009, Ch. 401): Provides that IRS Notice 2008-83, (2008-42 I.R.B. 905), issued October 20, 2008, shall not be applicable for California tax law purposes with respect to any ownership change occurring at any time.

AB 94 (Evans, Stats. 2009, Ch. 220): Does the following:

- Reactivates the Natural Heritage Preservation Tax Credit Act within the Public Resources Code and reestablishes the related tax credits within the Revenue and Taxation Code (R&TC).
- Allows the Wildlife Conservation Board to award the Natural Heritage Preservation tax credit without monetary limit, as specified.

AB 129 (Ma, Stats. 2009, Ch. 411): Provides a taxpayer the same protections of confidentiality with respect to the tax advice given by any “federally authorized tax practitioner” as the taxpayer would have if the advising individual were an attorney for any noncriminal matter before the State Board of Equalization or us.

AB 292 (Yamada, Stats. 2009, Ch. 232): Extends the repeal date of the Alzheimer’s Disease and Related Disorders Research voluntary contribution check-off fund from January 1, 2010, to January 1, 2015.

AB 404 (Eng, Stats. 2009, Ch. 504): Eliminates requirements for certain tax exempt entities that are granted federal group exemption to apply separately for state tax exemption.

AB 563 (Cook, Stats. 2009, Ch. 451): Makes changes to the California Military Family Relief Fund related to the allocation of the funds and revises the minimum contribution amount required for calendar year 2009 to remain on the personal income tax return.

AB 1046 (Anderson, et al., Stats. 2009, Ch. 499): Does the following:

- Requires the Judicial Council to calculate the amount of homestead exemption increases.
- Requires the Legislature's approval on the increased amounts.
- Increases the homestead exemption amounts by \$25,000.

AB 1164 (Tran, Stats. 2009, Ch. 140): Makes numerous technical, non-substantive changes, including punctuation, grammar, and reference corrections, as a matter of code maintenance, to various California codes, including the R&TC.

AB 1175 (Torlakson, Stats. 2009, Ch. 515): Allows debts owed for nonpayment of bridge tolls or high occupancy toll lane fees to be referred for collection through the Interagency Offset Program that we administer on behalf of the State Controller's Office (SCO).

AB 1494 (Eng, Stats. 2009, Ch. 150): Prohibits a majority of members of a state body from using a series of communications, except during an authorized meeting, to discuss, deliberate, or take action on any item of business that is within the subject matter of that state body.

AB 1546 (Assembly Revenue & Taxation Committee, Stats. 2009, Ch. 544):
Does the following:

- Requires a canceled domestic limited partnership to pay outstanding fees, to file missing tax returns, and to pay a service fee for expedited revival requests, in addition to the current requirements to revive.
- Cleans up provisions from the recently enacted budget provisions in ABX3 3 (Evans, Stats. 2009, Third Extraordinary Session, Ch. 18) and SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17).

AB 1568 (Salas, Stats. 2009, Ch. 299): Allows disaster loss treatment for losses sustained as a result of the wildfires that occurred during October and November 2008, and May 2009, in specified counties.

ABX3 3 (Assembly Budget Committee, Stats. 2009, Ch. 18): Addresses the fiscal emergency declared by the Governor on December 19, 2008, by doing the following:

- Increasing the Personal Income Tax rate by 0.25 percent for taxable years 2009 and 2010.
- Increasing the Alternative Minimum Tax rate.
- Decreasing the Dependent Exemption Credit from \$309 to \$98.

ABX3 15 (Assembly Budget Committee, Stats. 2009, Ch. 10): Makes the following changes:

- Provides a \$3000 tax credit for each additional qualified full-time employee hired by a qualified employer, as defined, limited to a cumulative total credit of \$400 million.
- Creates a tax credit for the production of a qualified motion picture in California.
- Allows specific entities to elect to use a sales only formula to apportion income starting January 1, 2011, along with the following implementation rules:
 - Creates a bright-line test for establishing that a taxpayer is doing business in California.
 - Defines gross receipts.
 - Modifies rules for assigning sales of both tangible and intangible personal property to the sales factor.

ABX4 17 (Assembly Budget Committee, Stats. 2009, Ch. 15): Among other things, makes the following changes:

- Increases the withholding rate on wages by 10 percent for wages paid on or after November 1, 2009. This provision also increases the fixed rate of tax withheld from supplemental wages from 6 percent to 6.6 percent, and increases the fixed rate withheld from stock options and bonus payments from 9.3 percent to 10.23 percent for amounts paid on or after November 1, 2009.
- Modifies estimated tax payment percentages from 25 percent per quarter to 30 percent, 30 percent, 20 percent, and 20 percent until January 1, 2010, and then to 30 percent, 40 percent, 0, and 30 percent for taxable years beginning on or after January 1, 2010.

ABX4 18 (Assembly Budget Committee, Stats. 2009, Ch. 16): Makes the following changes:

- Requires the social security number or other taxpayer identification number of the recipient of income to be furnished upon demand by the person paying the income.
- Provides conformity, with modifications, between California tax law and the federal backup withholding regime to require withholding at a rate of 7 percent on reportable payments made on or after January 1, 2010. Interest, dividends, and any release of loan funds made by a financial institution in the normal course of business are specifically excluded from California backup withholding.

Senate Bills:

SB 37 (Strickland, Stats. 2009, Ch. 329): Requires electronic distribution of wage and earning statements for state employees who receive direct deposit of wages unless a paper statement was specifically requested by the employee.

SB 40 (Correa, Stats. 2009, Ch. 522): Provides that any document created on or after January 1, 2010, containing more than four digits of a social security number is not entitled to be recorded when presented to a county recorder's office.

SB 91 (Correa, Stats. 2009, Ch. 29): Extends the repeal date of the California Fund for Senior Citizens voluntary contribution check-off from January 1, 2010, to January 1, 2015.

SB 314 (Calderon, Stats. 2009, Ch. 578): Revises the priority for refund offsets, placing the nonpayment of penalties owed to the Restitution Fund in a higher priority than benefit overpayment accounts administered by the Employment Development Department and amounts owed to other state agencies.

SB 556 (Assembly Judiciary Committee, Stats. 2009, Ch. 596): Adds bail as a class of debts that may be referred by a superior court to us for collection.

SBX2 15 (Ashburn, Stats. 2009, Ch. 11): Provides a tax credit to an individual who purchases a qualified principal residence equal to the lesser of 5 percent of the purchase price of the qualified principal residence or \$10,000. The credit is operative for purchases of qualified principal residences made on or after March 1, 2009, and before March 1, 2010, and is limited to a cumulative total credit of \$100 million.

SBX3 15 (Calderon, Stats. 2009, Ch. 17): Does the following:

- Provides a \$3000 tax credit for each additional qualified full-time employee hired by a qualified employer, as defined, limited to a cumulative total credit of \$400 million.
- Creates a tax credit for the production of a qualified motion picture in California.
- Allows specific entities to elect a sales only formula to apportion its income subject to franchise or income tax.
- Provides a bright-line test for when an entity is doing business in California.
- Provides a definition for "what is a sale."
- Modifies the rules for assigning certain receipts for inclusion in the sales factor.

SBX4 16 (Ducheny, Stats. 2009, Ch. 23): Does the following:

- Provides a penalty to be imposed on a state agency or the SCO when a state agency or SCO fails to make payment of an undisputed invoice within 45 days.
- Increases the threshold for discharging delinquent accounts receivables to \$500 and releases state agencies from the responsibility of collecting amounts owed that are less than \$500.
- Authorizes state agencies to assess a collection fee to recover costs of collecting accounts receivables and requires state agencies to submit to SCO an annual report of its accounts receivables and discharged accounts.

Free Backup Withholding Webinar

California conforms to Federal Backup Withholding beginning January 1, 2010.

We will be hosting a free webinar on backup withholding on Tuesday, December 15, 2009, at 10 a.m. (PST). This backup withholding webinar is developed for individuals, businesses, and government entities. Participants attending this webinar will receive an overview of the following topics:

- Requirements
- Reporting and remitting
- Forms and publications
- Frequently asked questions (FAQs)

Registration takes only a few minutes. To reserve your space, go to ftb.ca.gov and search for [backup withholding](#). Space is limited.

Corporation Tax Law Changes in California

Recently enacted California legislation adopted new statutes and amended existing statutes that result in major changes to how corporations are taxed in California. These changes to the R&TC are applicable for taxable years beginning January 1, 2011. The changes are as follows:

- R&TC Section 23101 – Modifies the definition of "doing business" in California.
- R&TC Section 25120 – Provides a definition of "gross receipts."
- R&TC Section 25128.5 – Allows specific entities to elect to utilize a sales only formula to apportion income subject to the franchise or income tax.
- R&TC Section 25135 – Adopts the "Finnigan" rule in assigning sales from tangible personal property.
- R&TC Section 25136 – Modifies the rules for assigning sales from other than tangible personal property.

We established a team to ensure a successful and smooth implementation of these law changes. Arrangements are being made for informal interested parties meetings to be held at our Sacramento office beginning with R&TC Sections 25128.5 and 25136. We anticipate that the interested parties meetings will occur early in 2010. If you have any

questions, comments, or suggestions pertaining to the above five statutes, please send your email to 2011corplawchanges@ftb.ca.gov.

Find Forms Faster and Easier With Our Form Locator

On December 15, 2009, we will have a new search tool on our [Forms](#) webpage; it is called the Form Locator.

How the Form Locator works

The Form Locator will help taxpayers find forms faster and easier. It will also let them exclude most of the form results that they do not want. For example, taxpayers will be able to find:

- A specific form (or a range of forms).
- All forms for a specific taxpayer type.
- All forms for a specific form type.
- All forms we provide.

Other enhancements to the Forms webpage

We also:

- Created a **Get help finding forms** feature to help taxpayers find our forms.
- Added more links to web content that taxpayers may need to file forms.
- Organized our web content so it is easier to see everything at a glance.

Why these changes are better

Before, when taxpayers looked for our forms, they receive 327 form results -- over 24 pages of web content. These form results combine **tax forms** and **nontax forms** for:

- Individuals
- Corporations
- Limited liability companies
- Partnerships
- Estates and trusts
- Exempt organizations

If a taxpayer needs several tax forms, they may have to sort through all 327 forms to find them. However, most taxpayers only want the form results that apply to them. With our new forms locator, they don't see every tax form and nontax form that we have.

Benefits to taxpayers

The Form Locator will:

- Make it faster and easier to find our forms online.
- Reduce the need for taxpayers to call us to get forms, wait to be helped, and wait weeks to get the forms.
- Decrease call wait times for other tax matters since fewer taxpayers would be calling for forms.

Benefits to California

The Form Locator will enable us to do much more with fewer resources. It will decrease our costs for:

- Website maintenance
- Call center resources
- Form printing
- Warehouse resources
- Mail postage

Provisional Payment Plan Pilot Begins December 2009

Our Collection Response and Resolution Section will begin to offer a Provisional Payment Plan for taxpayers who do not qualify for an installment agreement. Currently, taxpayers are required to have the last five years of tax returns filed to be eligible for an installment agreement.

A Provisional Payment Plan will allow taxpayers to make payments towards their tax liability without involuntary collection action taking place, while they prepare their missing valid personal income tax returns for us.

Taxpayers must:

- Owe a balance of \$25,000 or less.
- Respond to billing notices prior to their account going into an involuntary collection state.
- File all their missing valid personal income tax returns within 30 days.
- Agree to be compliant for all future tax years.
- Not have any legal actions in process or pending.

If a taxpayer fails to file the missing valid personal income tax returns, we will default the Provisional Payment Plan and collection actions will continue.

If there is a balance due once the missing valid personal income tax returns are filed, the taxpayer will be placed in an installment agreement. The installment agreement will continue as long as the taxpayer continues to make their payments timely and no additional liabilities are applied.

Top 10 Personal Income Tax Errors That Delay Return Processing – 2009

Category	Error	Solution
Income	Incorrect adjusted gross income amount (Rank 5/10).	Check adjusted gross income amount on Line 16 of Form 540 2EZ, Line 17 of Form 540A, 540, or 540NR to ensure correct amount is used or computed correctly.
Deductions	Incorrect standard or itemized deduction amount used based on filing status (Rank 2/10).	See Line 18 of Form 540A, 540, or 540NR for correct standard deduction amount or instructions and worksheet for correct itemized deduction amount.
Tax	Incorrect total tax amount computed which can affect computation on any applicable schedule (Rank 3/10).	Check total tax amount on Line 21 of Form 540 2EZ, Line 64 of Form 540A or 540, or Line 74 of Form 540NR to ensure amount is computed correctly. Check any affected schedule to ensure amount is transferred correctly.
	Incorrect total tax amount computed because of an error in calculating total tax or total credits (Rank 4/10).	1) Check total tax amount on Line 21 of Form 540 2EZ, Line 64 of Form 540A or 540, or Line 74 of Form 540NR to ensure amount is computed correctly. 2) Check total credits on Line 20 of Form 540 2EZ, Line 47 of Form 540A or 540, or Line 62 of Form 540NR (long form) to ensure amount is computed correctly.

Payments and Credits	Estimated tax payment amount claimed is different from total amount received (Rank 1/10).	Check personal tax records for estimated tax payments made to the Franchise Tax Board (FTB) . Also, check Line 46 on last year's 2008 Form 540A or 540, or Line 53 of Form 540NR (long form) to verify amount requested to be applied to this year's estimated tax is correct. Corrections made to last year's state tax return can affect total amount paid for this year. Refer to any FTB notice received that shows these adjustments. Go to ftb.ca.gov under My FTB Account to verify estimated tax payments.
	Incorrect total tax amount used based on incorrect total exemption amount transferred, incorrect exemption number or amount computed, or incorrect total exemption amount claimed based on adjusted gross income (Rank 6/10).	<p>1) Check exemption credit amount on Line 32 of Form 540A or 540 to ensure correct amount is transferred from Line 11 of same form. Form 540NR: Check prorated exemption credit amount on Line 39 to ensure amount is computed correctly by using exemption amount on Line 11 and exemption credit percentage on Line 38 of Form 540NR.</p> <p>2) Check exemptions to ensure correct number is used and check amount on Line 11 of Form 540A, 540, or 540NR to ensure amount is computed correctly.</p> <p>3) If federal AGI amount on Line 13 of Form 540A, 540, or 540NR (long form) is greater than \$160,739, see instructions for Line 32 of Form 540A or 540, or Line 39 of Form 540NR (long form) to claim correct amount.</p>
	Incorrect total tax amount computed based on filing status, dependents, or adjusted gross income (Rank 7/10).	<p>1) Confirm correct filing status is used.</p> <p>2) Check dependents claimed on Line 10 of Form 540A, 540, or 540NR to ensure correct number of dependents is used, all names are listed, and amount is computed correctly.</p> <p>3) Check CA adjusted gross income Line 17 of Form 540A, 540, or 540NR to ensure amount is computed correctly.</p>
	Withholding amount claimed is different than total amount shown on Form W-2 or other wage document attached to return (Rank 9/10).	See instructions for Line 22 of Form 540 2EZ, Line 71 of Form 540A or 540, or Line 81 of Form 540NR. Confirm only California income tax withheld is claimed and that the amount is computed correctly. Attach appropriate documents to support amount claimed. Go to ftb.ca.gov under My FTB Account to verify withholding amount.
	Excess State Disability Insurance or Voluntary Plan Disability Insurance amount claimed is not supported based on Form W-2 or other wage document attached to return (Rank 10/10).	See instructions for Line 74 of Form 540A or 540, or Line 84 of Form 540NR (long form). Determine if excess State Disability Insurance or Voluntary Plan Disability Insurance applies. If yes, attach appropriate documents to support amount claimed.

Nonresident Return	Incorrect California taxable income amount used based on incorrect amount computed or transferred, incorrect deduction percentage computed, or percentage incorrectly applied to the deduction (Rank 8/10).	Check California taxable income on Line 35 of Form 540NR (long form) to ensure correct amount is computed and transferred from Line 49, Part IV of Schedule CA (540NR). Or, check Line 35 of Form 540NR (short form) to ensure Line 33 deduction percentage and Line 34 prorated deduction amount on 540NR (short form) are computed correctly.
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Top 10 Business Entity Errors That Delay Return Processing – 2009

Category	Error	Solution
Forms	Incorrect math calculations or incomplete or missing documents (Rank 2/10).	Verify all math calculations when completing forms, schedules, or worksheets. Attach appropriate documents. Calculation errors and missing documents can delay tax return processing.
	Return accounting periods overlap (Rank 3/10).	Always use the same accounting period. We or the Internal Revenue Service, must directly approve period changes in most cases.
	Multiple tax returns filed for the same accounting period (Rank 4/10).	Check business records before sending duplicates of the original return. File only one original return for each accounting period. Allow three to six months to process original returns. If filing an amended return, use Form 100X to amend Form 100, 100W, or 100S, or mark the Amended Return box in the upper right corner on Form 565 or 568.
	Incorrect business start date used (Rank 6/10).	Do not use a business start date that is prior to the Secretary of State (SOS) formation date, for a domestic California entity.
	Amended returns not clearly identified as amended (Rank 7/10).	Use Form 100X to amend Form 100, 100W, or 100S, or mark the Amended Return box in the upper right corner on Form 565 or 568.
	Incorrect form used for the tax year accounting period indicated on the return (Rank 8/10).	Use the correct tax year form for the tax year filed. Fiscal filers: Use the form for the year the fiscal period began, i.e., use the 2009 form if the fiscal year began in 2009.

	Amended return filed before the original return (Rank 9/10).	Always file an original return before the amended return, to avoid tax return processing delays.
Identification	Incomplete entity name used (Rank 1/10).	Use the exact legal entity name used to incorporate, qualify, or register with the SOS. If not registered with SOS, use the full legal entity name on all documents and also include <i>Doing Business As (DBA)</i> , if applicable. Use exact entity name as listed on documents previously sent to us. Include all periods, commas, spacing, etc., in name.
	Omitted or incorrect entity identification numbers used (Rank 5/10).	Corporations: Use either the seven-digit California Corporation Number or the seven-digit Franchise Tax Board (FTB) assigned number and nine-digit Federal Employer Identification Number (FEIN). Partnerships: Use the FEIN. Limited Liability Companies: Use either the 12-digit SOS File Number or the nine-digit FTB assigned number and FEIN.
Payments	One lump sum payment sent for multiple entities, or multiple payments sent in the same package/envelope (Rank 10/10).	Mail all payments individually for separate entities and accounting periods. Ensure all payments include the correct entity identification number, exact legal entity name, and accounting period for the payment.

Small Business

Will Your Client Qualify for the New Jobs Credit?

Newly enacted state law, ABX3 15 (Assembly Budget Committee, Stats. 2009 Third Extraordinary Session, Ch. 10) allows a potential income tax credit of \$3,000 to a qualified taxpayer for each additional full-time employee hired. The total amount of the credit available to taxpayers is capped at \$400 million.

This credit will not be subject to the 50 percent limitation for business credits in 2009. This credit does have an eight year carryover provision.

The credit must be claimed on a timely-filed original return received by us before the cut-off date. This cut-off date is defined as the last day of the calendar quarter within which we estimate the \$400 million limit will be reached. The cut-off date has not yet been determined.

This credit is allowed for taxable years beginning on or after January 1, 2009.

An employer qualifies for the credit if both apply:

- They employed a total of 20 or fewer employees on the last day of the preceding taxable year (for Calendar taxpayers this would be December 31, 2008).
- They have a net increase in qualified full-time employees compared to the number of full-time employees employed in the preceding taxable year.

We would like to address some of the questions we have been receiving regarding this credit.

If my client starts a new business in 2009, will they qualify for this credit?

For taxpayers who start doing business in California during the current taxable year, the number of qualified full-time employees employed in the preceding year would generally be zero, unless certain special rules apply.

Does the employee have to work for the taxpayer the entire year?

No. Taxpayers who hired employees throughout the year can qualify for this credit. The credit is, however, limited by being prorated on an annual full-time equivalent basis for employees employed less than one full year. This is done by taking the total number of hours each less-than-full year employee work (not more than 2000 hours for each employee) and dividing by 2000. Salaried employees are based on weeks worked. So if your client, who otherwise meets the requirements for this credit, hired a new employee in June and that employee worked 1,000 hours, your client could qualify for a \$1500 credit.

Can my client claim this credit on their fiscal 2009 return?

This credit is only allowed for taxable years beginning on January 1, 2009, which means taxpayers that file for fiscal year 2009 will have to wait to see if there is any credit left available to claim on their returns filed for years ending in 2010.

What if my client converts their business from a partnership to an S corporation? Would the S corporation be consider a new business or need to count the employees the partnership had in 2008 as prior year employees?

The answer to your question will depend on the facts and circumstances of each taxpayer; certain special rules apply. But if the client just changed the business form, they would need to count the partnership employees as prior year employees.

A **new** credit form 3527, New Jobs Credit is currently being developed and will be available in December 2009. For more information about this credit, go to ftb.ca.gov and search for [new jobs tax credit](#).

Ask the Advocate



Communication Guidelines

Quite often we receive questions from taxpayers and practitioners on issues relating to the interpretation of provisions of the R&TC as well as policies and procedures of our department. We receive these questions through our various telephone call centers and when we are present at public engagements. We routinely get questions as to what level of reliance does the taxpayer have that the answer provided will be accepted should the taxpayer's position become questioned. I state, "If you want guaranteed reliance you need to get it in writing." Now the big question, what do I mean get it in writing?

On October 12, 2009, we issued two FTB Notices, [2009-08](#), Franchise Tax Board Ruling Guidelines, and [2009-09](#), Reliance upon Written Advice – Relief under Taxpayers' Bill of Rights. These notices were issued to update communications on guidelines relating to the issuance of written advice by us and reliance upon that written advice under the Taxpayers' Bill of Rights.

We provide the following types of guidance:

1. Chief Counsel Rulings – Taxpayer specific and must be requested by the taxpayer in writing using the required procedures set forth in FTB Notice 2009-08.
2. Legal Ruling – A Legal Ruling is issued by our Legal Division and interprets California law and is the equivalent to an IRS Revenue Ruling.
3. FTB Notices – An FTB Notice is issued by the Legal Division and may be a written statement regarding procedures that affect taxpayers, it may provide information regarding statutes or court decisions, or it may provide information about other matters that should be brought to the attention of the public. Notices are equivalent to an IRS Revenue Procedure or IRS Notice or Announcement.
4. Other Guidance – News releases, *Tax News*, responses to media inquires, and similar matters published by us involving an explanation of California tax laws, decisions, or other events. These are not issued by the Legal Division or the Chief Counsel and cannot be relied upon as substantive guidance.

5. Verbal Advice – Our personnel are available to discuss verbally a variety of issues. Such discussion, however, will not be binding on us in general or on the Legal Division and cannot be relied upon as a basis to obtain relief where that verbal advice was relied upon.

In general, if you relied on erroneous written advice from us, we may, in some cases, relieve you of tax, interest, penalties, or additions to tax. For tax, interest, penalties, or additions to tax to be waived, certain conditions must be satisfied, including, but not limited to:

- You or your client made a written request for advice from us as to whether a particular activity or transaction is subject to tax.
- We responded in writing with our advice.
- You reasonably relied on that advice.
- You did not remit the tax due.

If such abatement is requested, then you must provide all of the following:

- A copy of the original written request and a copy of our written advice.
- A statement made under penalty of perjury that outlines the facts on which the claim for abatement is based.
- Any other information we may require.

We will not, however, abate tax, interest, penalties, or additions to tax where there was a misrepresentation or omission of material facts.

For further details on relief when taxpayers rely upon written advice from us, please refer to FTB Notice 2009-09. To obtain this notice, go to ftb.ca.gov and search for **Notice 2009-09**, or write to us at:

REQUEST FOR WRITTEN ADVICE
FRANCHISE TAX BOARD
PO BOX 1720
RANCHO CORDOVA CA 95741-1720

The request should specify “Taxpayers’ Bill of Rights - Request for Written Advice.” While this is just a brief write-up on the issue, I encourage you to read FTB Notices 2009-08 and 2009-09.

Steve Sims, EA
Taxpayers’ Rights Advocate

Follow our FTB Advocate on Twitter at twitter.com/FTBAdvocate.

Inside FTB

Military Spouses Residency Relief Act

The Military Spouses Residency Relief Act (MSRRA) (Public Law 111-97) was signed into law on November 11, 2009 and may affect the California income tax filing requirements for spouses of military personnel. This new law is effective for taxable year 2009. The MSRRA allows the same residency benefits permitted to military personnel under the Servicemembers Civil Relief Act (SCRA) to also apply to a military spouse's non-military service income, under certain circumstances.

We are currently updating Publication 1032 (Tax Information for Military Personnel) with guidelines on the impacts of the MSRRA. The revised Publication 1032 is expected before the end of 2009.

Criminal Corner

Chino Hills Tax Preparers Found Guilty of State Income Tax Fraud

A Chino Hills couple was found guilty of four felony counts of state income tax fraud, we announced on November 16, 2009.

Aloysius (Al) Vivo, 55, and Rachel Vivo, 47, operate a tax preparation business, Vivo-Cota & Associates aka Vivo & Associates. According to court documents, the pair fraudulently filed their tax year 2000 personal tax return by falsely claiming the Child and Dependent Care (CDC) credit and understating their gross receipts. The Vivos claimed the CDC credit for expenses that were never paid on a child whose age made him ineligible for the credit. They also filed fraudulent tax year 2000 returns for three of the cappers they hired to locate new clients. The Vivos again claimed fraudulent CDC credits for each capper and failed to report the income they paid to each capper. The couple faces a maximum state prison term of five years in state prison.

The Vivos are also currently under prosecution in San Bernardino County Superior Court on criminal charges of allegedly filing fraudulent 2001 - 2002 personal income tax returns. Their next scheduled court appearance is December 21. Charges were filed in both counties due to the Vivo's move from Riverside County to San Bernardino County.

While the majority of tax preparers provide excellent service to their clients, this case raised almost every red flag listed in the Internal Revenue Service's and our brochure, How to Select an Income Tax Return Preparer, FTB 982:

- Clients never met the Vivos. The three contractors handled the delivery of all forms.
- The Vivos did not sign the returns as required by law.
- The Vivos directed the IRS and us to mail clients' tax refund checks to their personal address or those of the cappers. The Vivos illegally cashed these refund checks.
- Clients were not provided a copy of their returns until after payment was received limiting the time clients had to review the returns for accuracy.

Riverside County Superior Court Judge Larrie R. Brainard accepted the verdict Tuesday, November 10, in Division C1 of the Corona Superior Court. Riverside County Deputy District Attorney Homan Hosseinioun prosecuted the case. The Vivos' sentencing is scheduled for January 8, 2010, in Department C1 of the Corona Superior Court.

With the tax season only a few weeks away, we remind taxpayers to make sure the preparer they choose is a licensed CPA, public accountant, enrolled agent, attorney, or is a registered tax preparer with the California Tax Education Council. It is important to know that even if someone else prepares your return, you are ultimately responsible for all the information on the tax return.

Big Business

Gross Receipts Fees Discussed at CalCPA

On October 28, we attended the CalCPA Committee on Taxation, our annual liaison meeting. We shared legislative updates affecting us, changes to our auditing and collections, and new communication products available to our taxpayers and tax professionals. Also, we participated in a question and answer session on emerging issues. The following is a question asked by the CalCPA members and our response from the meeting:

Question:

Under the calculation of "gross receipts" for the LLC, one can exclude allocations, distributions, or gains from another LLC that was already subject to the gross receipts fee. If one LLC pays a consulting or management fee to another related LLC, can the

second LLC exclude this income from its gross receipts since the first LLC paid a gross receipts fee?

Answer:

R&TC Section 17942(b)(1)(A) provides, in relevant part:

For purposes of this section, "total income from all sources derived from or attributable to this state" means gross income, as defined in Section 24271, plus the cost of goods sold that are paid or incurred in connection with the trade or business of the taxpayer.

However, "total income from all sources derived from or attributable to this state" shall **not** include allocation or attribution of income or gain or distributions made to a limited liability company in its capacity as a member of, or holder of an economic interest in, another limited liability company if the allocation or attribution of income or gain or distributions are directly or indirectly attributable to income that is subject to the payment of the fee described in this section.

The consulting or management fee paid to the second limited liability company by the first limited liability company, as posed in the question, is clearly not within the meaning of "allocation or attribution of income or gain." However, the facts of the question are not clear as to the capacity in which the second limited liability company has provided services to the first limited liability company. Therefore, at least a potential issue exists as to whether the consulting or management fee payment may be a "distribution" described in Section 17942(b)(1)(A), and may be excludable to the extent it is attributable to income subject to the payment of the fee by another limited liability company, i.e., the first limited liability company.

Regardless of whether the second limited liability company is directly a member of, or holder of an economic interest in, the first limited liability company, if:

- (1) The payment of a consulting or management fee by one limited liability company to a second limited liability company is a payment to the second limited liability company in the second limited liability company's capacity as other than a member of, or holder of an economic interest in, the first limited liability company, (such as in the second limited liability company's capacity as operating a separate trade or business), or
- (2) The payment is treated under a provision of the R&TC, (such as Section 17851, incorporating by reference Internal Revenue Code Section 707(c)), as a payment to the second limited liability company other than in its capacity as a member of, or holder of an economic interest in, the first limited liability company for purposes of determining the gross income of the second limited liability company,

then the fee payment is not a “distribution” described in Section 17942(b)(1)(A), and is not excluded from the total income of the second limited liability company under Section 17942(b)(1)(A) for purposes of computing its annual fee. The determination of whether a member is acting in a nonmember capacity, e.g., conducting a separate trade or business when providing services to another limited liability company depends on the particular facts and circumstances. Similarly, whether a payment for services made to a member acting in its member capacity must be treated as made to a member acting in a nonmember capacity also depends on the particular facts and circumstances.

A transcript of all the questions submitted by CalCPA members and respective answers from us will be available in early 2010 and posted to calcpa.org/tax.