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No Change to Adjusted Interest Rate for July to December 2009

The new adjusted interest rate for the period July 1, 2009, to December 31, 2009, is five percent, the same rate that is in effect for January 1 through June 30, 2009.

The interest rate¹ is compounded daily, and accrues for personal income tax, corporate income tax, and franchise tax. The rate for corporation tax overpayments for the period is zero percent.

To find [adjusted interest rates](#), both current and past, go to ftb.ca.gov and search for **interest rates**.

FTB Collects on Accounts the Owe Both Child Support and Taxes

On May 11, 2009, we started collecting on child support dual liability cases. Previously, we did not pursue collection actions on taxpayers who also owed a child support obligation. Other than the annual notice, these taxpayers have not been contacted about their tax debt. In some cases, the taxpayer accounts have been flagged, protected from collections due to a Child Support flag, for more than five years. We anticipate this will affect 145,000 taxpayers.

Revenue and Taxation Code Section 19271 and 19276 provided that our obligation to collect child support delinquency takes priority over the collection of delinquent income tax liabilities until all the following occurs:

- The California Child Support Automation System is operational with all 58 counties on board. The Department of Child Support Services created this new collection system, so they could pursue collections separately.
- A Letter of Revocation is received from the Department of Child Support Services and they no longer require our assistance on collecting child support debt.
- It must be January 1 following receipt of Letter of the Revocation.

The new child support system is working with the 58 counties. Also, we received the Letter of Revocation on December 17, 2008, which allows us to resume collecting income tax debts beginning January 1, 2009.

First, taxpayers will receive a Change of Liability notice once the Child Support flag is removed. If we don't receive a response, collection actions will begin. Two additional notices, Income Tax Due and Final Notice, will be issued before any levies are sent to an employer.

If a client receives a collection notice for delinquent income tax liabilities, your client may go to ftb.ca.gov and search for **payment options**.

¹ Revenue and Taxation Code Section 19521, formerly Section 19269.

FTB Penalizes Frivolous Submissions

We will begin imposing a \$5,000 penalty in response to a specified frivolous submission pursuant to R&TC Section 19179(d).

The law provides for the imposition of a penalty for "specified frivolous submissions." A frivolous submission is based on an identified frivolous position or it reflects a desire to delay or impede the administration of federal or state income tax laws.

Any person who submits a "specified frivolous submission" must pay a \$5,000 penalty, unless the person withdraws the submission in writing within 30 days of our notice that the submission is a "specified frivolous submission."

When a frivolous submission is identified, we send a letter (FTB 9931) to the taxpayer stating that we determined the specified frivolous submission.

If the specified frivolous submission is withdrawn in writing within 30 days after the notice is sent, the penalty imposed under 19179(d) does not apply with respect to that submission.

If it is not withdrawn in writing, and the penalty is imposed, a taxpayer can contest the frivolous submission penalty either, or both, of the following ways:

- Request relief from the penalty by submitting [FTB 626](#), *Request for Chief Counsel to Relieve Penalties*.
- Pay the penalty in full and file a claim for refund, provided the claim for refund is filed within the statute of limitations.

This penalty is in addition to any other penalty provided by law and applies to returns filed or submitted on or after January 1, 2005.

To find out more about frivolous submissions, go to ftb.ca.gov and search for **frivolous submissions**. Currently, we are developing a website with additional information.

You or your clients may call us at **916.845.7790** (not toll free) Monday through Friday, 8 a.m. to 5 p.m.

Is Your Client a Victim of Identity Theft?

In April 2009, the IRS released a new form for taxpayers who have experienced, or are at risk of harm from, identity theft. Form 14039, *IRS Identity Theft Affidavit*, is used to report identity theft

to the IRS. While we do not have a similar form, we do have internal procedures to help victims who contact us. First and foremost, we want the taxpayer or their representative to contact us as soon as they think something is wrong with their tax account, regardless of whether it was ID theft or not. When a taxpayer receives an FTB notice e.g., billing, refund reduction, e-file rejection that a taxpayer/victim believes is attributable to identity theft, their contact is given priority handling. We then focus on the following issues for the taxpayer:

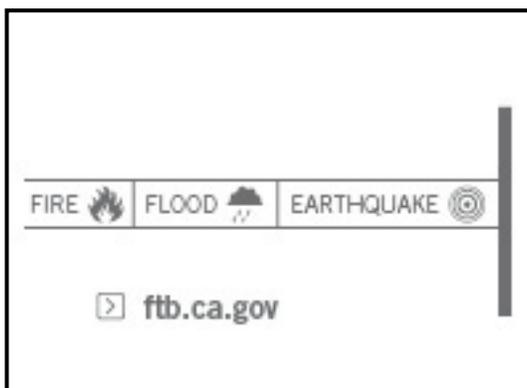
- Ensure the victim is held harmless, i.e., they get their full and correct refund.
- Minimize the burden on the victim in resolving their identity theft-related tax problem.
- Minimize the time to resolve the case, usually within two weeks to two months depending on the complexity.

We can also flag the account to block the automated processing of tax returns to a victim's account. Anything that comes in after we flag an account would be manually processed for verification. We limit use of this specifically designating ID theft contacts flag.

The sooner the ID theft is reported, the easier it is to get the taxpayer's account back in order. Remind your clients that if they suspect something is wrong with their tax account or if they have been a victim of ID theft to let you know, so that you can make the proper notifications.

For more information about how identity theft may affect your client's tax records, go to ftb.ca.gov and search for **identity theft**.

Disaster Publication Gets a Makeover



Odds are, with the number of disasters to hit the State of California; one of your clients has claimed a disaster loss on their California tax return. Recently, we revised our disaster publication, [FTB Pub 1034](#), *Disaster Loss: How to Claim a State Tax Deduction for Your Disaster Loss* to help you better understand which disasters are eligible for which tax treatments. You can find information specific to your disaster on page 6 of this publication or our publication series, FTB Pub. 1034A, California Disaster Relief Tax Provisions.

Credit Limits for Limited Liability Companies

If you are the owner of a disregarded entity, including a single member Limited Liability Company (LLC), the amount of credit you can claim may be limited.

Utilization of the credits attributable to the activities of a disregarded entity which are otherwise allowed is limited to the increase in the owner's regular tax, (tax before reduction by any credits), that results from including the income and expenses attributable to the disregarded entity. Determining the credit limitation requires several steps. First, the owner computes its regular tax on all its income, by including in its income the income and expenses attributable to the disregarded entity. Second, the owner then recalculates its regular tax excluding the income and expenses attributable to the disregarded entity, and subtracts this amount from the first amount. The positive difference between the first and second amounts of tax, if any, is the limitation on the amount of credits of the disregarded entity that the owner may use for the tax year. If the second number is greater than the first number, the owner is not allowed to use any credits from the disregarded entity.

Example 1

The SMLLC generated an enterprise zone hiring credit of \$25,000. The single member is either a C corporation or an S corporation with total net income, including the income (loss) attributable to the activities of the SMLLC, of \$50,000. The income of the corporation excluding the income (loss) of the SMLLC, however, is \$100,000. In other words, the SMLLC generated a loss of (\$50,000). Assume the tax rate on the C corporation is the regular 8.84%, and the tax rate on the S corporation is 1.5%. The minimum corporate franchise tax is \$800.

Tax including income	C corporation	S corporation
Net income of SMLLC	(\$50,000)	(\$50,000)
Net income of member excluding LLC's net income	\$100,000	\$100,000
Total net income reported by member	\$50,000	\$50,000
Tax	\$4,420	\$800
Total net income of member excluding income/loss attributable to SMLLC	\$100,000	\$100,000
Tax	\$8,840	\$1,500
Credit allowable	0	0

In this case, no credit from the disregarded LLC can be claimed, since the member's regular tax including the disregarded LLC is less than the member's regular tax excluding the income attributable to the disregarded LLC.

Example 2

The SMLLC generated an enterprise zone hiring credit of \$25,000. The single member is either a C corporation or an S corporation with total net income, including the income attributable to the SMLLC, of zero. The income (loss) of the corporation excluding the income of the SMLLC, however, is (\$100,000). In other words, the income attributable to the SMLLC is \$100,000.

Tax including income	C corporation	S corporation
Net income of SMLLC	\$100,000	\$100,000
Net income of member excluding SMLLC's net income	(\$100,000)	(\$100,000)
Total net income reported by member	\$0	\$0
Tax	\$800	\$800
Total net income of member excluding income/loss attributable to SMLLC	(\$100,000)	(\$100,000)
Tax	\$800	\$800
Credit allowable	0	0

In this case, no credit from the disregarded LLC can be claimed, since the member's regular tax including net income of the disregarded LLC is not any more than the member's regular tax excluding the net income attributable to the disregarded LLC.

Example 3

The SMLLC generated an enterprise zone hiring credit of \$25,000. The single member is either a C corporation or an S corporation with total net income, including the income attributable to the SMLLC, of \$50,000. The income of the corporation excluding the income of the SMLLC, however, is (\$50,000). In other words, the net income attributable to the SMLLC is \$100,000.

Tax including income	C corporation	S corporation
Net income of SMLLC	\$100,000	\$100,000
Net income of member excluding SMLLC's net income	(\$50,000)	(\$50,000)
Total net income reported by member	\$50,000	\$50,000
Tax	\$4,420	\$800
Total net income of member excluding income/loss attributable to SMLLC	(\$50,000)	(\$50,000)
Tax	\$800	\$800
Credit allowable	\$3,620	0

In this case, for the member that is a C corporation the allowable amount of the credit is \$3,620 provided the corporation's tax attributable to the zone is equal to or greater than the \$3,620. However, under the enterprise zone rules there may be an additional limitation. The member that is the S corporation would not be allowed to use any credit to reduce the S corporation's minimum tax, since no credits can reduce tax below the minimum amount.

The shareholders of the S corporation will also have run the numbers to determine their limitations on use of the credit, since the limitation also applies to indirect owners to whom credits flow. Consider example 2 above. If member X owned the S corporation that owned SMLLC 100 percent, member X would receive a schedule K-1 reporting \$0 (no income/no loss). When you run the numbers excluding the SMLLC income of \$100,000, however, the schedule K-1 would have reported a loss of (\$100,000). To the extent that including the \$100,000 income of the SMLLC in the income on the S corporation increases member X's own regular tax, the credit that passes through would be allowable to member X. Depending on member X's other reported income, you would think in Example 2 that the total regular tax liability computed by excluding the SMLLC's income would be less than the original reported tax, since the total taxable income should be less. However, depending on passive activity loss limitations and the other limitations on reporting S corporation losses, the taxable income, and therefore the tax, might not be less.

Are You Familiar With California's Enterprise Zones?

The Enterprise Zone (EZ) tax incentive program was created in 1986 to help local businesses, and encourage outside businesses to locate in economically depressed areas. The federal government does not have a comparable economic development program or business tax incentives.

The EZ program has been around for quite some time, but there have been changes to the program that could affect your clients' businesses.

Between October 2006 and March 2009, 34 California's enterprise zones expired. Many of these jurisdictions chose to apply again with the California Department of Housing and Community Development (HCD) for a new designation along with new jurisdictions. Today there are 42 active or conditional designated enterprise zones. For a listing of expired, active, and conditional enterprise zones, go to hcd.ca.gov and search for **EDA**.

The re-designated zones are treated as two zones, the “Old Zone” that expired and the “New Zone.” In some cases, the jurisdictions added new geographic areas to the “New Zone” and in other cases, the jurisdictions removed areas that were once in the “Old Zone.” The following five business-related tax incentives are potentially available to a taxpayer doing business in an enterprise zone, so you may need to see if your client is doing business within one of these new geographic areas.

- Hiring credit.
- Sales or use tax credit.
- Business expense deduction.
- Net operating loss deduction.
- Net interest deduction for lenders.

Enterprise zone tax incentives apply only to business activities and investments that take place after an enterprise zone has received final designation.

For more information on the EZ Credit, please visit ftb.ca.gov.

Small Business

Striking Gold in California

The Striking Gold in California publication can help you inform your clients about starting up a small business. The IRS and California state tax agencies work together to educate small business owners about business tax obligations and direct them to appropriate sources within each agency for accurate information.

Every year in California, thousands of small businesses start up. Unfortunately, thousands of small businesses also go out of business each year. With this publication, you can inform your clients of what they need to know about taxes and their small business. The publication covers taxes and your client’s small business income, if your client has employees, if your client sells merchandise, and small business resources for your client.

The publication will be available soon. Go to boe.ca.gov and search for **Striking Gold**. For more information about starting and running a small business, visit the California Tax Service Center at taxes.ca.gov.

Ask the Advocate



Systemic Issue Management System (SIMS) at Work

This month I wanted to share some of the efforts we are taking in regards to the SIMS inquires. Through this new system, we have received many comments and suggestions.

Part of our process is to determine whether or not the issue is systemic and, if so, what steps and business areas we need to take to resolve the issue.

The following are just two issues that we are looking into:

1. Federal and state laws differ with regards to filing requirements for LPs that convert to LLC in mid-year, and LLCs that convert to LP. Conversion between an LP and LLC entity designation mid year can present filing problems if a return for each entity type must be filed at year-end. This could create confusion especially if for California there are two returns and two sets of K-1's, while federal rules may consider the entity a partnership for the entire year. We are currently reviewing our forms and return filing processes and will provide an update on this issue in an upcoming addition of tax news.

2. Filing instructions for Form 541 for a Qualified Subchapter S Trust (QSST). Should the 541 instructions be changed, to allow QSSTs to file the 541 by completing the entity portion and then attach a statement, similar to the way they file their 1041?

Periodically, I will post of the progress and changes your suggestions and comments have given us. Thank you for your support.

Steve Sims, EA
Taxpayers' Rights Advocate

Inside FTB

FTB Notices Delayed

Beginning June 1, 2009, we mailed 40,000 notices per day for a total of 200,000 notices per week to taxpayers who either owe money on their 2008 return or adjusted their 2008 return. In 2009, for individual taxpayers, we delayed sending Statement of Tax Due Notices (STDs) on e-filed and paper-filed returns, and Return Information Notices (RINs) on e-filed returns until May 29, so that payments mailed on or before April 15, could post

to the account. In recent years, taxpayers received notices that caused confusion over whether we received a timely payment and caused taxpayers to call their representatives during the busy filing season. As a result, we implemented a pilot project to hold notices. This project began last season and extended in 2009. Beginning June 1, 2009, we released the STDs and RINs that were held as a result of this program. We expect that this delay affected approximately 435,000 notices.

Notice Hold Periods		
Notice	2008	2009
e-file STDs	1/01 - 5/3	1/01 - 5/29
paper STDs	3/21 - 5/3	3/20 - 5/29
e-file RINs	4/10 - 5/3	3/20 - 5/29

The notice hold periods are only applicable for PIT returns and not business entities. We mailed STDs to business entities that e-filed returns early and then mailed a check on or just before April 15, for their balance due. As a result, your business client may have already received a STD despite having made a timely payment. This problem was brought to our attention and we made changes to prevent tax due notices from being sent on early-filed business returns in the future.

Taxpayers who receive notices should make payments quickly to avoid any further interest and penalties. We offer a variety of payment options for your clients; however, paying electronically is the quickest, and it's surprisingly simple. To help your clients take advantage of e-pay check out our [e-pay tool kit](#) online.

This tool kit makes it easy for you to promote the electronic payment options. With instant access to taxpayer information and service available 24 hours a day, the electronic payment options will save your clients time and hassle. Plus, paying electronically is another way to save natural resources—like trees. Encourage your clients to pay their taxes electronically and get into saving!

Criminal Corner

Ex-bookkeeper Sentenced to Three Years, \$367,000 in Payback, Taxes

The former bookkeeper of a small Sacramento company was sentenced May 8, 2009, to three years in prison after she pleaded no contest to embezzlement, a District Attorney's office news release states.

Anne Asperger was ordered to pay \$333,103.30 to her former employer in reimbursement and \$33,926 to FTB for the taxes owed on the embezzled money.

Starting in 2001, Asperger issued herself 68 checks by forging the company president's signature, and then manipulated the bookkeeping system to hide the loss. Employees noticed the discrepancy in fall of 2006.

Big Business

LLC Fee Refunds Based on the *Ventas* Decision

Ventas Finance I, LLC (*Ventas*) was a foreign LLC that registered with the California Secretary of State and earned income within and outside California. In *Ventas Finance I, LLC v. FTB*, the California Court of Appeal, First Appellate District, held that former Revenue and Taxation Code section 17942 was unconstitutional as applied to *Ventas* because the LLC fee was based on *Ventas*' total income from all sources and was not limited to income derived from, or attributable to, California.

Because the decision in *Ventas* is now final, action can be taken on claims for refund filed by LLCs with substantially the same factual situation (i.e., LLCs that earned income within and outside of California). The FTB Notice 2009-04 describes how FTB will process LLC fee claims for refund as a result of *Ventas*. FTB will process claims for refund using the **Default Method**, unless an LLC informs FTB by August 20, 2009, that it wishes to use the **Alternative Method**, described below.

1. **Default Method:** FTB will use the LLC's [Schedule R](#), *Apportionment and Allocation of Income*, filed with [Form 568](#), *Limited Liability Company Return of Income*. LLCs that did not attach a Schedule R to the originally filed Form 568 must submit a Schedule R. FTB will calculate the revised LLC fee and the refund amount, if any.
2. **Alternative Method:** The LLC must complete and submit the LLC Income Worksheet from the 2008 [Form 568](#), *Limited Liability Company Tax Booklet*, with the respective information for each tax year that a claim for refund is filed. Based on the information provided by the LLC, FTB will then calculate the revised LLC fee and the refund amount, if any.

If you want to use the **Default Method** to calculate your refund, but did not attach a Schedule R, or you choose to have the refund calculated using the **Alternative Method**, you must provide the following information:

1. The LLC's name, address, including the name and phone number of the managing member or designated contact person.
2. The LLC's Secretary of State file number or Franchise Tax Board temporary LLC number (for unregistered entities) and Federal Employer Identification Number.
3. Tax years involved.
4. The LLC must choose either "(a)" or "(b)":

- (a) For the **Default Method**: a completed Schedule R, if the LLC did not attach a Schedule R to the original Form 568 filed for each tax year that a claim for refund is filed.
- (b) For the **Alternative Method**: a completed 2008 LLC Income Worksheet with the respective information for each tax year that a claim for refund is filed.

If you have not filed a claim for refund, but want to and the statute of limitation remains open, you may include the above-mentioned information in a letter along with the statement, "*This letter constitutes a claim for refund for (taxpayer's name) – Income Earned Within and Outside California.*" Any claim for refund must be signed by a representative with a power of attorney or signed by the LLC's managing member. For more information, you may refer to FTB Notice 2009-04.

Fax all information to FTB at: **916.845.9796**

Or, you may mail this information to:

ABS 389 MS F340
C/O FTB NOTICE 2009-04
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 2009-04
SACRAMENTO CA 95827