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Advisory Board Recognizes Dedication

At the FTB Advisory Board October meeting, we presented David Doerr, Chief Tax Consultant for the California Taxpayer's Association, with a certificate of appreciation recognizing his 50 years of service to California taxpayers.



Selvi Stanislaus presented Mr. Doerr the award acknowledging his "50 years of tireless service in representing the interests of three generations of California taxpayers." Selvi added, "In fact, Dave has never missed an FTB Advisory Board Meeting or an FTB Board Meeting."

Hired as an intern by the Assembly in 1959, Mr. Doerr eventually became chief consultant to the Assembly Revenue and Taxation Committee. During his 24 year tenure as chief consultant to this committee, Mr. Doerr significantly contributed to the crafting of California tax policy. Upon his retirement, he began a second career at the California Taxpayer's Association as their chief tax consultant.

The FTB Advisory Board was created as a method for taxpayer representatives to work directly with our management to resolve issues of mutual concern. Representatives include members from the Senate and Assembly Revenue and Taxation Committees, the CSEA, the California Society of CPAs, and other organizations.

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540X Easy Reply Amended Return Pilot Program

We will soon begin a pilot program giving certain taxpayers the option of quickly concluding an audit when first contacted by us, if the taxpayer agrees with the proposed adjustments to their return. The 540X Easy Reply Amended Return Program is being introduced by the Tax Practitioner Unit, which focuses its efforts on less complex or single-issue audits.

The Tax Practitioner Unit currently begins most of its audits with a self-compliance letter explaining the:

- Issue(s) being audited.
- Applicable law.
- Proposed adjustment(s).
- Additional information a taxpayer can provide to us if they disagree with the proposed adjustments.

We will now include with our self-compliance letter a completed Form 540X showing the proposed adjustments, additional tax due, and any penalties. This gives a taxpayer the option of immediately concluding an audit simply by signing and returning the 540X Easy Reply Amended Return. Immediate payment is not required to participate in this program; however, taxpayers can reduce the amount of interest due by including payment when they return the Easy Reply Form 540X. Of course, if a taxpayer disagrees with the proposed adjustments, they still have the option of providing the additional information needed to show the correctness of their return.

By implementing the 540X Easy Reply Program, we hope to reduce the time and cost involved in completing an audit, both for taxpayers and us. This 540X Easy Reply Program is being introduced later this year. Based on the results, we will consider expanding this program to other types of audits.

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Useful Information Found on MyFTB Account – Tell Your Clients!

MyFTB Account is a resource that's available for your clients to access useful tax information 24/7.

Here are just some of the things your clients can find on MyFTB Account:

- **Estimated Tax Payments:** Dates and amounts of payments made.
- **Refund Transfers:** Amount of 2008 refund transferred to 2009.
- **Employer Reported CA Wage and Withholding Information.**
- **FTB Issued 1099s:** Refund or interest that needs to be reported to the IRS.

To access [MyFTB Account](#) go to ftb.ca.gov. You can also access this same information with your client's permission.

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Documents, Second Mortgages, Tax Reporting – How to Handle a Foreclosed Home for Tax Purposes

In our July 2009, [Foreclosure and Short Sales](#), and October 2009, [Business Foreclosures or Short Sales](#), issues of *Tax News* we addressed some of the questions we received related to a foreclosure. Three questions that deserve further explanations are:

- What documents will taxpayers get on foreclosed homes for tax filing purposes?
- What happens if there is a second or third mortgage?

- Are there two types of tax reporting - one for the capital gain on the house and the other for forgiveness of debt?

What documents will taxpayers get on foreclosed homes for tax filing purposes?

Depending on the facts and circumstances, a taxpayer can either receive one statement or multiple statements.

Lenders are required to file informational returns with the IRS and provide copies to each borrower.

Form 1099A, **Acquisition or Abandonment of Secured Property**, is issued when a borrower abandons secured property, or when a lender acquires property in full or partial satisfaction of a debt and the property was used as security for the debt.

Form 1099C, **Cancellation of Debt**, is issued if the creditor abandons its right to collect a balance due from the debtor of \$600 or more.

If both occur in the same calendar year, the creditor can file just Form 1099C.

What happens if there is a second or third mortgage?

If more than one person lends money secured by property and one lender forecloses or otherwise acquires an interest in the property, and the sale or other acquisition terminates, reduces, or otherwise impairs the other lenders' security interests in the property, the other lenders must file Form 1099A for each of their loans. For example, if a first trust holder forecloses on a building, and the second trust holder knows or has reason to know of such foreclosure, the second trust holder must file Form 1099-A for the second trust, even though no part of the second trust was satisfied by the proceeds of the foreclosure sale.

If a debt is owned (or treated as owned for federal income tax purposes) by more than one creditor, each creditor that meets the requirement to file must issue a Form 1099-C if that creditor's part of the canceled debt is \$600 or more.

Are there two types of tax reporting - one for the capital gain on the house and the other for forgiveness of debt?

Generally, if you have property that is used as security for a debt and that property is taken by the lender in full or partial satisfaction of the debt, you are treated as having sold the property. This may generate either a gain or a loss, and in some cases there may also be cancellation of debt (COD) income.

If the loan used to acquire the home is nonrecourse, then the lender's only remedy is to repossess the property used as collateral. You will only have a "deemed sale."

If the loan was recourse, then the lender(s) can pursue the full amount from the borrower (the loan document normally states they are personally liable for the full amount of the loan). In this case, you will have both a deemed sale and COD income.

In some cases a taxpayer may have both a nonrecourse loan (their first mortgage) and a recourse loan (their second mortgage).

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FTB/CSEA Liaison Meeting a Success

On September 25, we attended the California Society of Enrolled Agents (CSEA) Annual Liaison meeting. To kick off this meeting, our Executive Officer Selvi Stanislaus was honored to receive their President's Award for excellence. Our division chiefs gave updates on legislation, our filing season, and audit matters. We also participated in a question and answer session on emerging issues. The following are some of the questions and answers discussed at the meeting:

- 1) In recent months, our employees in the "Collection Resolution/Installment Agreement" and "Complex Account Resolution" units have increasingly disallowed expenses claimed on Form 3561 (Financial Statement) used to determine hardship, stating that the taxpayer has an "extravagant lifestyle," but will not be specific as to which expenses seem excessive. The form has an "FTB use only" column, but agency personnel are unwilling to divulge what amounts/limits are being used for any of the claimed line items. Without guidance on maximum allowable living expenses, the process of obtaining a Withholding Order modification is extremely arbitrary. What are the current policies for analysis of Form 3561?**

Financial Statements (Form 3561) are used to evaluate the taxpayer's ability to pay and offer payment options based on their true and complete financial condition. Analysis focuses on determining those expenses necessary to maintain the health, welfare and living expenses of the taxpayer and paying the debt within the most reasonable period of time.

Analysis of a taxpayer's financial condition provides us with a basis to make one or more of the following decisions:

- Approve an installment agreement.
- Allow an extension of time to pay.
- Require partial or full payment from available assets.

To assist in determining allowable expenses, FTB staff uses the Internal Revenue Service's expense allowance tables as a general guide. If an expense is not allowed or is reduced to an allowable amount, the taxpayer or representative is informed of the change and given the opportunity to justify the higher expense.

Given that installment agreement information is now entered online, the "FTB Use Only" column on the Form 3561 is no longer a required field to be used by the collector. In the past, this column was used for administrative purposes to make notes.

- 2) It is our understanding that the alternative withholding on real estate sales increased .25 percent with the increase in the maximum personal income tax rate.**

It was previously 9.3 percent, and now is 9.55 percent. Did the withholding rate on distributions to nonresident partners and shareholders increase from 7 percent?

The withholding rate for real estate, nonresidents, nonresident partners, members, and shareholders remains the same. What changed due to the increase in the personal income tax rate are the rates based on the maximum personal income tax rate such as:

- Partnership or limited liability company (LLC) income or gain allocable to foreign (non-U.S.) partners or members. For foreign partners or members, the withholding rate is the maximum California tax rate applicable to the partner (corporations 8.84 percent, banks 10.84 percent, and foreign partners 9.55 percent that are not corporations or banks).
- The alternative optional gain on sale of California real estate withholding rate for individuals, partners, members and S corporation shareholders is based on the maximum personal income tax rate.

3) Now that responsibility for collecting child support obligations has transferred to the Department of Child Support Services as authorized by 2008 legislation, it is our understanding that you will resume collection of delinquent income tax from taxpayers who owe both child support and tax. We frequently encounter taxpayers who are behind on both with no resolution in sight, and are concerned that this change will make it more difficult to work out arrangements when two agencies of state government are involved, especially in the current economy. How should we approach these cases?

We will continue to collect accounts as we have in the past. We expect each taxpayer to file all missing tax returns and pay the balance they owe. We are aware it may be more difficult to collect cases with a liability from both Department of Child Support Services (DCSS) and us, and many of the cases may be considered hardship cases.

If the taxpayer indicates they are unable to pay in full because they have a financial hardship, they should contact us to make an arrangement to enter into an installment agreement to pay their liability or request a delay in our actions to collect their debt. We will evaluate the case, taking into account the priority of their child support debt, and act accordingly in establishing an appropriate resolution to their situation.

4) It is our understanding that you will begin imposing the frivolous submission penalties authorized by R&TC Section 19179(d). The penalty is \$5000. How many of these penalties have been imposed in 2009, and what is your anticipated number of penalties for 2009, based on your statistics on the average number of frivolous submissions received per year? In other words, how frequently do you receive a return considered to be frivolous?

We notified the public on our website that we would begin to impose the frivolous submission penalty on or after July 20, 2009. In addition, we will notify the taxpayer in writing of the frivolous submission determination and allow the taxpayer 30 days to withdraw that submission. No frivolous submission penalties have been imposed as of yet.

We do not have statistics on the number of “frivolous submissions” to use as a basis for an estimate of the anticipated number of frivolous submission penalties that may be imposed in 2009. However, we do not expect to issue many penalties. The purpose of the penalty is to discourage taxpayers from submitting frivolous information. We hope to bring taxpayers into compliance by notifying them of the frivolous submission and allowing a 30-day period to withdraw their submission.

Identified frivolous returns for fiscal year 2008/2009 totaled 278. The frivolous submission penalty is not intended for frivolous returns. We impose a \$500 frivolous return penalty for frivolous returns, as authorized under Revenue and Taxation Code Section 19179.

5) In our June 2009 Tax News, there was a long article that included examples as to how a single member LLC (SMLLC) should calculate California business credits when the SMLLC’s owner is either a C corporation or an S corporation. Many of our members work with SMLLCs, but more often in the individual context, rather than the corporate context. In other words, the owner of the SMLLC is an individual rather than a corporation, and as a disregarded entity, the income, losses, deductions, and credits of the SMLLC are reported on the individual’s state tax return, Form 540. Should the method illustrated in the article, which was demonstrating that business credits are limited to the actual portion of the owner’s income that is reflective of the income of the SMLLC, be utilized in the individual context as well?

Yes. If the owner of the disregarded entity is an individual and is, therefore, treated as a sole proprietor, the amount of credit attributable to the disregarded entity that the owner may claim for the taxable year 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.

6) CSEA applauds the new Systemic Issue Management System (SIMS) program for resolution of various issues encountered in tax administration and that an issue can be reported on your website. Will you include your responses and progress on issues on the website as well?

At this time, we do not plan to update responses and progress on the website, because it was designed as a reporting system only. We modeled our SIMS after the IRS’ Systemic Advocacy Management System (SAMS). However, we are using Tax News, which is our free online publication designed to inform tax professionals about state income tax laws, our regulations, policies, and procedures. Periodically, we will feature reported systemic issues

and their outcomes in the “Ask the Advocate” section. If you do not currently subscribe to Tax News, visit ftb.ca.gov and click the “Tax Professionals” tab for a link to Tax News.

7) Please update us on the implementation of the External Authentication for Secure e-file (EASE) application? Will practitioners have updated authentication and resources that the present “MyFTB Account” has for the 2010 tax filing season?

EASE is an authentication method that will allow customers and their representatives to register and establish a self-managed user ID and password, which they will use to access secure online services. Due to the budget crisis, the hardware/software purchase was delayed, and EASE will not be available until after the 2010 primary filing season. Prior to viewing their clients’ accounts, practitioners will need to establish an online account. While practitioners will not have any additional access rights or functionality upon the initial implementation of EASE, the enhanced authentication will provide taxpayers who establish an account with an online change of address feature. Also, with the implementation of EASE, we plan to implement a new business entity online payment application. The online payment application is similar to our current personal income tax Web Pay application, and will allow corporations, partnerships, or LLCs to make payments online.

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540NR Booklet Mass Mailing Elimination

We decided to eliminate the mass mailing of our **Nonresident or Part-Year Resident Income Tax Booklet California 540NR** directly to taxpayers. Our decision to discontinue this service is due to the decreased use of this booklet, our efforts to cut government spending, as well as our commitment to the environment. This effort will affect approximately 340,000 nonresident taxpayers with a cost savings to the State of \$259,000. On January 1, 2010, we will mail a letter to explain this change and encourage these taxpayers to e-file instead of mailing a paper tax return.

Advantages of e-filing your tax returns are:

- Secure online transmission.
- Quick confirmation of our receipt of your tax return.
- Current software with up-to-date tax law.
- Personal paper copy for your files.
- Fast refund with direct deposit.

For more e-file information, go to ftb.ca.gov and search for **efile options**. You can also find other online services such as the status of your e-file tax return, MyFTB Account, and Check Your Refund Status.

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Small Business

Announcing the California Child Support Guide for Business

DCSS announces the [California Child Support – A Guide for Business](#) — a complete step-by-step web-based guide designed to help employers meet child support requirements in California.

Developed by DCSS, the guide, designed in a user-friendly format with links to critical forms and websites, includes procedures on:

- New hire reporting.
- Remitting payments electronically.
- Income withholding procedures.
- Frequently asked questions.

To find the guide, go to childsup.ca.gov/Employers in the DCSS Employer Resource section. For questions, contact us at DCSSEmployerUpdate@dcss.ca.gov.

By working together, California's child support program and the employer community can help families attain and sustain financial independence. On behalf of California's Child Support Program and the families we serve, thank you.

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Ask the Advocate



Taxpayers' Rights Advocate Role

As the Taxpayers' Rights Advocate, I continue to be pro-active, visible, and accessible to taxpayers. I maintain constant interaction with the tax practitioner community and with taxpayers through the many presentations I participate in. My presentations are to a variety of tax practitioner, community, and government groups throughout California. Meeting with these groups and the taxpayers has allowed me to hear firsthand what issues, concerns, and challenges taxpayers are facing, and the impact that tax legislation has had on them. More importantly, I hear about the effects our policies, processes, and procedures have on taxpayers.

My goal is to ensure that taxpayers' rights are protected. One of my responsibilities is to improve the communication and services that we provide. I coordinate the resolution of taxpayer complaints and problems, including complaints regarding unsatisfactory treatment by our employees.

Early this year, my staff worked on the development of SIMS, a web-based application where taxpayers and tax practitioners can provide comments on our processes, procedures, laws, and legislation that create a burden for taxpayers. This system allows us to keep track and identify systemic problems and recommend solutions.

Steve Sims, EA
Taxpayers' Rights Advocate

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

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Inside FTB

Information Return Filing

We no longer accept tapes, diskettes, or CDs containing information returns such as Forms 1099, 1098, W-2G. To conform to IRS, we only accept information returns that are filed electronically. For more information, go to ftb.ca.gov and search for [Electronic Filing of Information Returns](#).

The Public Counter Hours at Our Field Offices Are Changing

The public counter hours at our field offices are changing on Monday, November 2, due to budget constraints. The new hours are Monday through Friday, 8 a.m. to 4 p.m., closing one hour earlier than the previous 8 a.m. to 5 p.m.

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Criminal Corner

Man Arrested at Sacramento Superior Court on State Income Tax Evasion Charges

A Rancho Cordova man was arrested on five felony charges of state income tax evasion, we announced on September 30, 2009.

Owen D. Mosburg, 52, was in Department 4 of the Sacramento County Superior Court for an unrelated court appearance on charges of grand theft. According to our special agents, Mosburg allegedly filed fraudulent 2003 and 2004 state income tax returns and failed to file his 2005 through 2007 state income tax returns. During the years under

investigation, Mosburg was employed by a Rancho Cordova building products company and earned more than \$352,000. Mosburg owes the state more than \$11,900 in unpaid tax. Penalties, interest, and the cost of the investigation will be added to this amount.

Each tax count carries a maximum term of three years in state prison.

Every year we contact individuals who may have a filing requirement, but have not filed a tax return. These individuals have 30 days to file their state tax return or show why one is not due. We contacted Mosburg numerous times to file his delinquent returns.

The failure to file tax returns is part of the \$6.5 billion tax gap California faces each year. The tax gap is defined as the difference between the tax that is owed and the tax that is due.

Mosburg was taken into immediate custody and his bail is set at \$25,000. His next court appearance has not been set.