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Coming Soon – Resident, Nonresident, and Real Estate Withholding Form and Processing Changes Begin in 2010

Effective January 1, 2010, we will be implementing changes for withholding forms and payments. The new process will result in fast, accurate processing of withholding forms and payments. You must use our updated forms and procedures to report and pay amounts you have withheld on California source income. Some highlights of the changes are:

- **Payment vouchers** – You must now send all withholding information returns and payments with a payment voucher. Do not send more than one voucher per payment.
- Use form **592-V, Payment Voucher for Resident and Nonresident Withholding Electronic Submission** when submitting a payment for resident and nonresident withholding.
- Use form **593-V, Payment Voucher for Real Estate Withholding Electronic Submission** when submitting a payment for real estate withholding.

The new payment vouchers will be available on our website in January 2010.

- **Faxed forms** - We can no longer process withholding forms sent by fax. Please refer to each form's instructions for submission time frames.
- **Substitute or scannable tax forms** – We will only be able to process FTB forms or FTB approved forms from tax software vendors. For more information, contact our Substitute Forms Program at 916.845.4522, or refer to the [FTB Publication 1098](#), *Annual Requirements and Specifications for the Development and Use of Substitute, Scannable, and Reproduced Tax Forms*.
- **Form 592, Resident and Nonresident Withholding Statement** – We no longer process payee information listed on a separate spreadsheet submitted with FTB Form 592. If side 2 of Form 592 does not accommodate all your payees, you must use additional copies of Side 2 until all payees are listed.

Please visit our website frequently for the most current forms and information regarding withholding at ftb.ca.gov and search for **withholding**.

Adjusted Interest Rate for January 2010 to June 2010

Pursuant to Revenue and Taxation Code Section (R&TC) 19521 (formerly 19269), the adjusted interest rate has been determined for the period January 1, 2010, through June 30, 2010. The adjusted interest rate is four percent. This is the rate compounded daily that accrues with respect to various state taxes including: personal income, corporate income, and franchise. The rate for corporation tax overpayments for the period is zero percent. If you are interested in viewing the previous interest and estimate penalty rates, go to ftb.ca.gov and search for [interest rates](#).

Thousands of Businesses Need to File State Tax Returns

On September 14, 2009, we began contacting more than 35,000 companies that did business in California in 2007, but failed to file a state tax return for that year.

We annually review more than 5 million income records from government agencies and financial institutions, and match them against tax records filed to determine whether some businesses have yet to file. As part of this annual effort, we collected approximately \$31 million last year from businesses that failed to file tax returns.

Businesses contacted by us have 30 days to file their delinquent tax return or show why one is not due. If no action is taken, we will issue a tax assessment that may include penalties and fees.

Failure to file tax returns is one part of the tax gap that is defined as the difference between taxes owed and taxes paid. California estimates its annual tax gap to be \$6.5 billion per year.

For those receiving notices, information is available by calling 866.204.7902. Callers should be prepared to provide the 15-digit notice number.

In March 2009, we began a similar program with individual taxpayers, contacting more than 900,000 individuals who earned California income, but failed to file state income tax returns last year.

We identify nonfilers by using more than 350 million income records we receive annually from third parties such as the IRS, banks, employers, state departments, and other sources. In addition, we use occupational licenses and mortgage interest payment information to detect individuals who have not yet filed.

Last year, we collected more than \$550 million in revenue through these efforts.

For those receiving notices, go to ftb.ca.gov, and search for **Request/Demand for Tax Return**. Taxpayers can request more time to respond, retrieve information that can assist them in filing a tax return, request tax forms, learn about payment options, sign up to receive an email reminder to file, and much more. Individuals can also call us at 866.204.7902 to get information.

Form 540 Gets a Mini-Makeover

Each year our forms section revises the previous year forms and publications to reflect the new tax year, new information, and law changes. As we get ready for the 2010 filing season, California needs even more lines on the California Form 540 to accommodate recent legislation. As a result, the Form 540 must grow beyond its standard two pages to fit all the lines necessary. As a practitioner, the biggest change you'll see is that the Form 540 is three pages instead of two.

First of all, you'll probably notice that the signature box is now on page one of the computer-generated (scannable) 540. Line numbers also changed for many items. Lines added to the return include information for reporting the New Jobs Credit and Voluntary Contributions.

The forms for the 2009 tax year are still in review and are not finalized. Certain legislation is still pending and, of course, there is always the possibility that late state and federal legislation could impact our forms. Do you have suggestions for improving our forms, such as ideas for making them simpler or easier to understand? Go to ftb.ca.gov and search for **draft forms**.

IRS Tax Calendar

The **Tax Calendar for Small Businesses and Self-Employed** (Pub 1518, Catalog Number 12350Z) is now available. This 12-month wall calendar is filled with useful information on general business taxes, IRS and SSA customer assistance, electronic filing and paying options, retirement plans, business publications and forms, and common tax-filing dates. Each page highlights different tax issues and tips that may be relevant to small business owners with room on each month to add notes, state tax dates, or business appointments.

If you pre-order your copy (up to five free) now, the [2010 Tax Calendar](#) will be shipped on November 1.

It's Official! California Backup Withholding Begins January 1, 2010

Beginning January 1, 2010, with certain limited exceptions, payers that are required to withhold and remit backup withholding to the Internal Revenue Service (IRS) are also required to withhold and remit seven percent of the payment to FTB.

Assembly Bill X4 18 requires California backup withholding when federal backup withholding is required. If a payer issues a payment to a payee that is subject to federal backup withholding,

and the payee is a resident of California, or if the payee is a nonresident of California and the payment is sourced to California, California backup withholding is required, except for:

- Payments of interest and dividends.
- Any release of loan funds made by a financial institution in the normal course of business.

California Forms, Instructions, and Publications

For information on filing, remitting, or reporting California backup withholding, go to ftb.ca.gov and search for **backup withholding**. Our following forms will be updated and available on or after December 15, 2009:

- 592, *Resident and Nonresident Withholding Statement*.
- 592-A, *Payment Voucher for Foreign Partner or Member Withholding*.
- 592-B, *Resident and Nonresident Withholding Tax Statement*.
- 592-V, *Payment Voucher for Resident and Nonresident Withholding*.
- 1023S, *Resident and Nonresident Withholding Electronic Submission Requirements*.

Additional Information

For additional information about federal backup withholding, refer to irs.gov and the following IRS products:

- [Form W-9](#), *Request for Taxpayer Identification Number and Certification*.
- [IRS Publication 1281](#), *Backup Withholding for Missing and Incorrect Name/TIN(s)*.
- [IRS Publication 505](#), *Tax Withholding and Estimate Tax*.
- [IRS Topic 307](#), *Backup Withholding*.

Contact Us

Call 888.792.4900 within the U.S.
916.845.4900 outside the U.S.

Fax 916.845.9512

Email wscs.gen@ftb.ca.gov

This is not a secure email address. Please do not send confidential information. Enter "backup withholding" in the subject line.

Small Business

What Does Conformity Mean to the Small Business Owner?

California conformity to federal tax law is an area of interest for California taxpayers and small business owners. The complex rules or documentation procedures are a common source of tax complexity, and require more record keeping by taxpayers and small business owners. Conformity to certain federal tax provisions can reduce complexity by allowing taxpayers to use the same calculations for both their federal and state tax returns.

Many will agree with the notion that taxes should be simpler. Simpler tax law could reduce taxpayers' costs of complying with the tax system in terms of time, money, and mental anguish. The basic problem is that every year the disparity between California law and federal law grows.

This year, Assembly Bill (AB) 1580 was introduced to reduce the disparity between federal and state law. If AB 1580 is enacted, its aim to change California law to conform to most of the federal law changes made between January 1, 2005, and January 1, 2009. AB 1580 also identifies areas where we will not conform or where we would have a modified conformity. Though this bill has not yet been chaptered, it's received much attention and could bring us just a little bit closer to reducing complexity for taxpayers and small business owners. For the latest on this bill, go to leginfo.ca.gov and search for **1580**.

California has been out of conformity since 2005. Without the passage of AB 1580, California will continue to be out of conformity resulting in increased state adjustments for taxpayers for the differences between federal and California tax law. In addition, AB1580 provides a number of benefits to provide some economic relief to California taxpayers, including active military personnel, safety workers, and seniors.

Ask the Advocate



Indexing Tables

I have received a number of questions through our Systemic Issue Management System on indexing since California released its indexing tables in August. This month, in my *Ask the Advocate* column, I'd like to address one question I think most practitioners are interested in:

As a California practitioner, I am frustrated every year that you do not publish the current-year tax rates until that year is almost over. This makes it difficult for me to advise my client on how to withhold state taxes accurately. It would be very helpful if you would announce the upcoming year's tax rates and brackets at the start of the year. The IRS does this for federal taxes, so I'm not sure why it's not possible for California.

To create California's indexing table for the current year, we are required by law (R&TC 17041) to use the California consumer price index (CPI) change between June of the preceding year and June of the current year as transmitted by the Department of Industrial Relations to us by August 1. The inflation adjustment is then applied to the "preceding taxable year income tax brackets" to arrive at the current year brackets. This prevents us from releasing the indexed brackets before August 1. For instance, the June 2008 – June 2009 CPI change is applied to the 2008 tax brackets (the "preceding taxable year") to give us the 2009 taxable year brackets.

The IRS times it differently (based on the federal tax code). They use the August to August CPI change for the "preceding" year to determine the tax brackets for the current taxable year. So the IRS would apply the August 2007 – August 2008 CPI change (the "preceding" year) to the 2008 tax brackets to arrive at the 2009 taxable year brackets. By the end of 2008, they can publish the 2009 brackets.

Each August, as soon as we have the new index rates ready, we publish and post a News Release to our website to let taxpayers and practitioners know the new rates as soon as possible. Please see this year's release, [2009 State Income Tax Rates Adjusted](#), for specifics on the 2009 rates.

**Steve Sims, EA
FTB Advocate**

Inside FTB

In our public outreach efforts, we offer different forums for CPAs, enrolled agents, attorneys, corporate tax personnel, and all other tax professionals to have the opportunity to discuss cutting-edge tax topics, provide input, while earning Continuing Professional Education credits. Listed below are two upcoming events for you to become involved.

FTB's Advisory Board Meeting

The Advisory Board meeting is October 6, 2009, at our Central Office from 10 a.m. to 3 p.m. Some of the suggested discussion topics for this meeting are:

- Water's-edge filing simplification.
- Apportionment issues.
- Substantial authority.
- Public information on the single sales factor.

This meeting provides an opportunity for the tax professional community to offer advice and ask questions.

California Tax Policy Conference

The State Bar of California Taxation Section, the State Board of Equalization, and us sponsor the 2009 Annual Meeting of the California Tax Bar and California Tax Policy Conference.

On November 12-14, your colleagues will convene in San Diego at the Sheraton Harbor Island to attend the premier California tax event. All tax professionals are invited to attend.

This year's conference features 12 state and local tax programs. The timely topics that will be discussed in the interactive programs include:

- Bank and financial allocation and apportionment.
- California litigation advancements.
- New state strict liability penalties.
- Adoption of the Streamlined Sales and Use Tax Agreement.
- California settlement procedures and strategies.
- California legislative developments.
- Nationwide sales and use tax updates.
- Property tax appeals.

To **register now** and see a complete listing and description of the state tax programs being held at this year's event, see the [conference flier](#).

Criminal Corner

Richmond Businessman Arrested for State Income Tax Evasion

A Richmond businessman was arrested on three felony charges of state income tax evasion, we announced on September 1, 2009.

Philip Leech, 46, is the chief executive officer, secretary and chief financial officer of In & Out Designs, Inc. located in Pleasant Hill. According to our special agents, In & Out Designs allegedly earned more than \$1.3 million in taxable income in 2001–2003, but Leech failed to file the corporation's state income tax returns for any of these years. The corporation owes the state more than \$122,000 in tax. As chief executive officer and chief financial officer, it is Leech's responsibility to ensure the corporation's taxes are filed. Leech allegedly ignored our notices to file the delinquent returns.

Penalties, interest, and the cost of the investigation will be added to this figure. Each tax count carries a maximum term of three years in state prison.

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 paid.

In & Out Designs, Inc. is owned by Rick Alvin Powers, 55, who, along with his wife, Cathy Powers, 55, pleaded no contest earlier this year to felony charges of diversion of construction funds and state income tax evasion. Their sentencing is still pending.

Leech was booked into the Contra Costa County Main Jail. His bail is set at \$20,000 and his arraignment is still pending.

Big Business

Business Foreclosures or Short Sales

In our July 2009 Tax News, we addressed some of the questions we had been receiving related to a foreclosure or a short sale of a personal residence. The other question we have received asks, "What if the foreclosure is on my rental property?"

Generally, when there is either a foreclosure or a short sale, a taxpayer will receive a federal Form 1099-A, *Acquisition or Abandonment of Secured Property*, and a Form 1099-C, *Cancellation of Debt*, (in some cases the lender may issue just a Form 1099-C) from the lender which contains information to compute gain or loss, including whether the taxpayer was personally liable for the debt.

The 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.

The 1099C, *Cancellation of Debt*, is issued once the creditor abandons their right to collect a balance due from the debtor of \$600 or more, and there is an identifiable event.

If both occur in the same calendar year, the creditor can file just the Form 1099-C, *Cancellation of Debt*.

If a borrower abandons secured property, or a lender forecloses on the property, the abandonment or lender foreclosure is treated as a disposition of property. The effect of the disposition will depend on the type of property (business or personal), the type of loan (recourse or non-recourse), the loan balance, the taxpayer's adjusted basis in the property, and the fair market value (FMV) of the property foreclosed.

Depending on the type of loan, you use the taxpayer's adjusted basis or the loan balance at the date of foreclosure and the FMV of the property.

If the loan on the rental property is a recourse loan, then depending on the facts, you may have cancellation of debt (COD) income, and potentially a reportable gain, in which case you would want to determine if one of the provisions in IRC 108 would apply, allowing the COD income from the discharge of indebtedness to be excluded.

If the foreclosure occurred outside of bankruptcy, the taxpayer is determined to be solvent, and is not a C corporation; they may elect to exclude cancellation of Qualified Real Property Business Indebtedness (QRPBI) income if certain requirements are met (IRC section 108(c)). Under California law, if a taxpayer makes an election for federal income tax purposes that election is binding for California income tax purposes and no separate California election is allowed.

If you make an election to exclude canceled qualified real property business debt from income, you must reduce the basis of your depreciable real property (but not below zero) by the amount of canceled qualified real property business debt excluded from income. The basis reduction is made at the beginning of the year. However, if you dispose of your depreciable real property before the beginning of the year, you must reduce the basis of the depreciable real property (but not below zero) immediately before the disposition.

The Internal Revenue Service has issued several informative articles and publications on foreclosures/short-sales available at irs.gov you may want to refer to.