taxnews

Tax News
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10 Tips to Complete the LLC Income Worksheet

We compiled a list of common errors we see on the LLC Income Worksheet. The following is a top ten list to help you file correctly:

1. The FTB 568w, Limited Liability Company Income Worksheet is based on "total income derived from or attributable to California," not worldwide income. It includes income from all sources, such as income from trade or business activities, rentals, interest, and dividends. When completing the LLC income worksheet, only include California amounts. If your LLC is a multimember LLC that operates only in California, you will transfer the amount from Form 568, Schedule B, line 3 to the worksheet, line 1a. However, if the LLC operates inside and outside California, line 1a of the LLC income worksheet will not be the same as Form 568, Schedule B, line 3, so only include California amounts from Schedule B, line 3 on the worksheet, on line 1a. Single-Member LLC (SMLLCs) that are disregarded entities for income tax purposes will generally enter California amounts based on their books and records on their LLC Income Worksheet for the purpose of determining their fee. (Only SMLLCs whose income meets certain threshold amounts are required to complete Schedules B and K.) For more information on "total income from all sources derived from or attributable to California," see the instructions for the LLC income worksheet on page 12 of the 2009 Form 568, Limited Liability Company Tax Booklet.

2. Do not forget to subtract out the lower tier LLC gross receipts when computing the upper tier LLC's fee. An LLC is allowed to back out the gross receipts from a lower tiered LLC that were already subject to the fee. The lower tier's gross receipts must be included on the worksheet, usually on line 3a through line 3c. The upper tier LLC backs out the gross receipts from a lower tier LLC on line 3d. It is important that the upper tier LLC include the receipts of a lower tier LLC on the worksheet, and then back out the receipt already subject to the fee on line 3d. Keep in mind, receipts received from a lower tiered **partnership** that are **not** LLCs are **not** backed out on line 3d.

3. Form 568, line 1 **must** match the amount from LLC Income Worksheet, line 17. A very common error is to enter Form 568, Schedule B, line 23 on Form 568, line 1, which in many cases causes us to increase the LLC fee amount when processing Form 568. Sometimes when transferring the amount from the LLC worksheet, line 17 to Form 568, line 1, LLCs will make adjustments.

4. A SMLLC doing business in California must file its own return, and pay its own $800 annual tax and LLC fee based on its own income. Each LLC, regardless of whether it is a multiple-member LLC (MMLLC), or a SMLLC must calculate total income and pay the fee at its level. Many times a parent LLC will incorrectly include total income from a lower-tiered SMLLC without also backing it out, and

pay the fee only at the parent level. As discussed above, the parent can back out receipts that were already subject to the fee.

5. The LLC Income Worksheet must be attached to the Form 568. If the LLC worksheet is not attached, all income is considered California income. The LLC will be assessed a fee based on total gross receipts.

6. All apportioning LLCs, except SMLLCs, must include Schedule R, Allocation and Apportionment of Income, to Form 568.

7. Schedule B does not have to reconcile with the LLC Income Worksheet. The worksheet includes only income derived from or attributable to California. Schedule B includes total worldwide income. Schedule B amounts are adjusted for differences between state and federal law, such as differences for depreciation and deductible taxes.

8. **California rental real estate**. In computing California rental real estate income, line 8a is the rental real estate gross income from real estate held directly by a MMLLC, and lines 8b and 8c are used to compute the gross rental income received by the MMLLC from other pass-though entities. Line 8b is the pass-though rental income or loss from the Schedule K-1, received from other LLCs, partnerships, estates and trusts and S corporations. Line 8c is total rental expenses deducted from the amount on line 20a federal Form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation. The LLC will have to contact the pass-through entity to get the necessary information for line 8c. Line 8c **must** be entered as a positive number.

9. The following lines of the LLC worksheet **cannot** be entered as a negative number: 1b, 2b, 3b, 3c, 4, 8c, and 17.

10. Cancellation of debt is included in gross income for purposes of calculating the LLC fee (IRC 61(a)(12). California requires the income be reported in the year the debt was reduced.

New IRS Tax Preparer Requirements

Effective January 1, 2011, the IRS will require **all paid tax preparers** who sign federal tax returns to have a Preparer Tax Identification Number (PTIN).

IRS online registration for tax preparers will start September 1, 2010. Tax preparers will need to register with the IRS and obtain a valid PTIN **no later than December 31, 2010***.* Tax preparers who already have a PTIN will be reissued their current PTIN when they register online.

Currently, there is no application fee for PTINs; however, the IRS does plan to charge a PTIN fee (new and renewing applicants) once registration starts September 1, 2010.

In addition to the PTIN requirement, paid tax preparers who are not attorneys, certified public accountants or enrolled agents will have to pass an IRS competency exam and complete continuing education requirements. Tax preparers registered with the California Tax Education Council (CTEC) **will not** be exempt from the new IRS mandate.

Nonexempt tax preparers will be required to:

- Obtain a PTIN.
- Complete 15 hours of continuing education on federal tax laws each year.
- Renew IRS registration every three years from the date of initial registration.
- Within three years of initial registration, pass a competency exam from the IRS.

Starting January 1, 2011, nonexempt tax preparers who fail to meet the December 31, 2010 registration deadline will have to pass the IRS competency exam **before** they can be issued a PTIN.

Exempt tax preparers (attorneys, certified public accountants and enrolled agents) can still register after December 31, 2010; however, they cannot prepare or sign federal tax returns until they register with the IRS and obtain a valid PTIN.

Competency Test
Nonexempt tax preparers will have three years from the date of initial registration to pass two levels of IRS examination. The test can be taken as many times as needed; however, a fee will be charged each time. Once the practitioner passes the test, the requirement is filled, and the test doesn't have to be taken yearly.

Continuing Education
Nonexempt tax preparers will have to complete 15 hours of continuing education on federal tax laws each year. The hours must be completed from an IRS-approved education provider and include:

- 3 hours of federal tax law updates.
- 2 hours of tax ethics.
- 10 hours of other federal tax law topics.

IRS continuing education requirements for nonexempt tax preparers take effect January 1, 2011. Any federal education completed in 2010 will not count toward the new IRS mandate.

Right now there is no IRS qualifying education prerequisite; however, CTEC will continue enforcing its 60-hour qualifying education requirement for new CTEC registered tax preparers (CRTP). Also, CTEC plans to conform its federal continuing education requirement to the IRS', so CRTPs are not forced to fulfill "double" federal education requirements.

As for the 2010/2011 CTEC registration cycle, CRTPs are still required to complete 20 hours of continuing education (12 hours federal, 4 hours state, 2 hours of ethics, and 2 hours federal and/or state), and renew their registration by October 31, 2010.

Tax Preparer Enforcement
The IRS plans to implement an enforcement strategy for the 2011 tax season. Our enforcement program to identify and penalize unregistered tax preparers will remain intact for California. All CRTPs will be required to complete IRS and CTEC requirements in order to be legally qualified to prepare state and federal tax returns.
To learn more about the new IRS requirements, go to irs.gov.

New Penalty Chart

As promised at the 2009 Taxpayer Bill of Rights Hearing, we completed the FTB 1024, Penalty Reference Chart . We list the penalty codes numerically by Revenue and Taxation Code (R&TC) sections. These penalties reflect the law enacted prior to January 1, 2010.

To view or print the chart, go to ftb.ca.gov and search for 1024 or penalty chart.

Statutes of Limitations on Claims for Refund or Credit

This is the second in a series of four articles on Statutes of Limitations (SOLs) that relate to California tax law. This month's article addresses common SOLs for claims for refund or credit that are unrelated to federal action. Future articles will cover SOLs for assessments resulting from federal actions, and refund/credit claims resulting from federal actions and miscellaneous SOLs for assessment and refund/credit.

1. What is the general SOL for a taxpayer to claim a refund or credit?
R&TC section 19306 specifies that a claim for refund or credit must be filed no later than (a) four years from the original due date of the return or (b) four years from the date the return is filed if the return was filed within the "automatic extension" period. Additionally, a claim for refund or credit is timely with respect to payments made within one year of the claim filing date (the "look back" provision).

The postmarked date of the claim is the date it is considered "filed," and the taxpayer has the burden of proving the claim is timely filed.

2. How does the "look back" provision work?
The following example illustrates the "look back" provision of R&TC Section 19306. An individual taxpayer files a claim for refund for tax year 2003 on May 12, 2010. Since the taxpayer filed the claim more than four years after the original due date of the taxpayer's return (April 15, 2004), and more than four years after the latest date the taxpayer could have filed his return during the automatic extension period (October 15, 2004), the claim could not be allowed under the "four year" provision. However, if the taxpayer made any payments for tax year 2003 during the year prior to the date the claim for refund was filed, the claim, if meritorious, could be allowed to the extent of payments made during that one year period.

3. What is an "informal claim for refund?" How does the statute of limitations apply to an "informal claim for refund?"
Generally, a taxpayer must pay all tax and interest for a tax year before filing a claim for refund. If, however, a taxpayer files a claim for refund before all tax and interest for that tax year are fully paid, the claim may be considered an "informal claim for refund." (R&TC Section 19322.1). The statute of limitations will be tolled (paused) as of the date the informal claim is filed. The claim will not be deemed "perfected" and filed until all of the tax and interest for that year are paid. If the informal claim is perfected, the amount of a refund or credit is limited to the total payments made within seven years of the date the claim is "perfected."

4. Are there any other circumstances under which the statute of limitations for claims for refund or credit will be tolled?
Yes. An individual taxpayer who (a) suffers from a medical condition that is either terminal or expected to last at least one year, and (b) is unable to manage his financial affairs, and (c) has not authorized anyone to act on his behalf may be considered a "financially disabled" taxpayer. If a taxpayer has established that he or she is "financially disabled," the statute of limitations will be tolled during the period of the taxpayer's financial disability. (R&TC section 19316.) The taxpayer must submit documentation of the condition, along with a physician's statement, to meet his burden of proof as to financial disability. This statute applies to claims for refund where the statute of limitations had not expired by September 23, 2002. FTB 1564, Financially Disabled – Suspension of the Statue of Limitations, provides more detailed information and forms concerning financial disability.

RDPs Must Now Use Community Property Rules to File Federal Return

On May 28, 2010, the IRS released Chief Counsel Advice (CCA) 201021050[1] which changes the federal tax treatment of California registered domestic partners' (RDP) community income. The IRS concluded that a California RDP must report one-half of the community property income on the federal returns.

The federal advice is based on the California law changes, effective beginning January 1, 2007, that treats earned income of a registered domestic partnership as community property for state income tax purposes. Previously, the IRS did not recognize this community property treatment; however, the IRS has now decided to extend full community property treatment to registered domestic partners in California. In another Chief Counsel Advice memo, CCA 201021049[2], the IRS also explained that it can consider the assets of a taxpayer's registered domestic partner when determining the reasonable collection potential of a taxpayer's offer in compromise under IRC Section 7122, since California law provides both partners have an equal interest and liability in the community property.

According to CCA 201021050, "Applying the principle that federal law respects state law property characterizations, the federal tax treatment of community property should apply to California registered domestic partners. Consequently, for tax years beginning after December 31, 2006, a California registered domestic partner must report one-half of the community income, whether received in the form of compensation for personal services or income from property, on his or her federal income tax return."

CCA 201021050 also clarifies that for tax years beginning before June 1, 2010, registered domestic partners may, but are not required to, amend their returns to report income in accordance with CCA 201021050.

California provides guidance to RDPs in FTB 737, Tax Information for Registered Domestic Partners, including how to make RDP adjustments for differences between state and federal law. This publication will be updated by mid-December to take into account federal changes in recognition of California community property law.

[1] **http://www.irs.gov/pub/irs-wd/1021050.pdf**
[2] **http://www.irs.gov/pub/irs-wd/1021049.pdf**

IRS Nationwide Tax Forums Registration Available!

Join tax professionals from across the country for three days of the latest tax law information, hands-on workshops, networking opportunities, and exhibits of the latest tax products and financial services to improve your business.

In 2010, the Nationwide Tax Forums sites include Atlanta, GA, Chicago, IL, Orlando, FL, New York, NY, Las Vegas, NV, and finally San Diego, CA.

Take advantage of this great opportunity to receive CPE credits, learn from subject matter experts, and network with your peers. You can also take advantage of IRS electronic services, and obtain assistance on your most difficult tax case. More forum dates and information is available on our website. To register, go to the IRS Nationwide Tax Forum at irstaxforum.com.

State's First-Time Buyer Credit Almost Gone

As of June 15, 2010, we estimated receiving more than 15,000 applications claiming more than $78 million. Because many of these applications are duplicates or invalid, we plan to accept at least 28,000 applications to ensure all $100 million is credited.

We will announce the cut-off date on our website, giving at least 24-hours notice for applicants to fax their documentation. The credit will be allocated on a first-come, first-served basis using the date and time stamp on the fax. But, submission before the cutoff does not guarantee a credit; we will stop allocating credits once the $100 million is exhausted.

The First-Time Buyer Credit is expected to assist roughly 17,500 qualified buyers who purchase a qualified principal residence. A first-time buyer is someone who did not own a principal residence for the preceding three years. The home must be purchased (close escrow) on or after May 1, 2010. The buyer must reside in the home for at least two years immediately following the purchase date. This credit is equal to the lesser of five percent of the purchase price or $10,000.

To apply, Form 3549-A, Application for New Home / First-Time Buyer Credit, must be completed by the buyer and faxed, along with the final settlement statement, to us at **916.855.5577** within two weeks (14 calendar days) after the close of escrow.

California homebuyers still have time to qualify for the state's other $100 million home tax credit for the purchase of a new home. The New Home Credit is available for taxpayers who purchase (close escrow) a new home after May 1, 2010, and before August 1, 2011, as long as they enter into an enforceable contract executed before

January 1, 2011. The seller must certify that the home has never been previously occupied.

For more information, go to ftb.ca.gov and search for **2010 Home Credit**.

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In 2010, the Nationwide Tax Forums sites include Atlanta, GA, Chicago, IL, Orlando, FL, New York, NY, Las Vegas, NV, and finally San Diego, CA.

Take advantage of this great opportunity to receive CPE credits, learn from subject matter experts, and network with your peers. You can also take advantage of IRS electronic services, and obtain assistance on your most difficult tax case. More forum dates and information are available on our website. To register, go to the IRS Nationwide Tax Forum at irstaxforum.com.

Small Business

New Reporting Requirements for Small Tax-Exempt Organizations Begins 2011

Beginning January 1, 2011, California conforms to the 2006 federal law that requires smaller tax-exempt organizations with normal gross receipts of $25,000 or less annually, other than churches and church-related organizations, to electronically file an annual informational notice with us under R&TC Section 23772.

Annually, these smaller tax-exempt organizations must provide us with the following information in electronic form:

- Organization’s legal name.
- Any name under which the organization operates or does business.
- Organization's mailing address.
- Internet website address, if applicable.

- Organization's taxpayer identification number (both federal and state).
- Name and address of a principal officer.
- Total gross receipts for the year.
- Tax year begin and end dates.
- Contact person name and phone number.
- If the organization has terminated or gone out of business.

Smaller tax-exempt organizations subject to this new filing requirement have the same due date for state and federal purposes — by the 15th day of the fifth month after an organization’s tax year ends. Therefore, calendar year organizations must file by May 15.

If the organization does not file on time, we will send a reminder notice, but will not assess a penalty for late filing.

Although there is no monetary penalty for failure to file the notice, any organization that fails to file for three consecutive years automatically loses its California tax-exempt status.

Under existing law, we may revoke an organization’s state tax-exempt status if the IRS suspends or revokes the organization’s tax-exempt status.

If an organization loses its California tax-exempt status, it must reapply using the FTB 3500, Exemption Application, and have approval to regain its tax-exempt status. Any income received between the revocation date and renewed exemption date may be taxable.

For more information, contact our Exempt Organizations Unit at **916.845.4171**.

Ask the Advocate

Staff Introductions

The Taxpayers' Rights Advocate is a legislatively mandated position under R&TC Section 21004. The Taxpayers' Rights Advocate's Office identifies systemic problems and find solutions in a cooperative effort while protecting taxpayers' rights and recognizing the goals of our audit, collection, and filing programs. We report our findings to the legislature in the Annual Report to the Legislature by December 1 of each year.

We also coordinate the resolution of taxpayer complaints and problems when you are unable to resolve them under the normal process, including complaints regarding unsatisfactory treatment of taxpayers by employees. We promote integrity and responsibility, so our customers can rely on quality information and efficient service. Also, we coordinate and provide education and outreach to the tax practitioner and small business communities for the department.

I'd like to take this opportunity to introduce my staff:

Alvaro Hernandez – Small Business Liaison. He makes presentations and provides educational information to businesses. Also, he develops publications and other products to assist business owners with their filing requirements.

Kelly Bluth – Technical Assistant. She provides technical support on all issues relating to the Advocate's office. She works on special projects, department teams, performs R&TC research, and provides support on systemic issues and tax practitioner issues. She also presents as part of the education and outreach effort. She is an expert in the enterprise zones and business entities subject matters.

Susan Maples – Tax Practitioner Liaison. She handles all trade media inquiries and correspondence. She assists me in handling practitioner issues, systemic issues, and she presents as part of the education and outreach effort. Susan is a CPA.

Elinor Bickell – Tax News Editor. Tax News is our monthly online publication designed to inform tax professionals and small business owners about state income tax laws, our regulations, policies, and procedures. We also publish events that are of interest to the professional community.

Terri Isedeh – Trend & Issue Specialist. She tracks and coordinates the resolution of systemic issues reported to us. She supports our education and outreach efforts, and she plans my liaison meetings with California Society of Enrolled Agents and CalCPA, and the annual Advisory Board meeting.

Shelly Nanda – Operations Support. She supports all the functions of the Advocate's office. She maintains the speakers' database, and assists with developing publications, research, and analysis.

In addition, the **Executive Liaison Section staff** serves as my designee and coordinates the resolution of taxpayer complaints and problems. If you are unable to solve your clients' problems through normal channels, you may write to me at:

> Executive Liaison Section MS A381
> Franchise Tax Board
> PO Box 157
> Rancho Cordova, CA 95741-0157

Steve Sims, EA
Taxpayers' Rights Advocate

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Inside FTB

Business Entities on Web Pay

Starting September 2010, business entities can make payments electronically at our website with Web Pay. After a one-time online registration, business entities can make immediate payments or schedule payments up to a year in advance. This online service will be available 24 hours a day, 7 days a week at **ftb.ca.gov**. More information will be available in the next issue of Tax News.

Tax News' New Look

We launched our new logo this month. We moved Tax News to an online only product several years ago, but our logo still depicted a printed product. This new logo represents its online-only format, as well as our other products like audio presentations, social media, and future products.

Criminal Corner

Broker Commits Real Estate Fraud by Purchasing Homes Using Stolen Identities and Intentionally Defaulting on Loans

A real estate broker in Westminster was convicted of conspiring with her boyfriend and his brother to commit $17.5 million in real estate fraud by purchasing 35 properties using stolen identities and intentionally defaulting on loans in order to steal the loan money.

Kathy Chen, 49, Westminster, was found guilty by a jury of 136 felony counts; including one count of conspiracy, 47 counts of grand theft, one count of attempted grand theft, 37 counts of forgery, 27 counts of recording false documents, 15 counts of identity theft, one count of elder financial exploitation, four counts of forging an official seal, and three counts of filing false tax returns. The sentencing enhancements for causing loss in excess of $2.5 million and $100,000 were found true. Chen faces a sentence up to 111 years in state prison at her sentencing July 9, 2010, in Department W-9, West Justice Center, Westminster.

Chen's boyfriend, Richard Salgado Gonzalez, 60, and his brother, Daniel Gonzalez, 57, face the same charges and sentence as Chen. Fugitives Richard and Daniel Gonzalez have outstanding arrest warrants. Both may currently be living in Puerto Vallarta, Mexico.

The People presented the following information to the jury during the trial against Chen: Chen worked as a real estate broker and owned several businesses, including Chen Financial, Western Escrow, Nationwide Tax Services, and SBC Financial. She conspired with her then-boyfriend, Richard Gonzalez, and his brother, Daniel Gonzalez, to commit over $17.5 million in fraud by using the identities of unsuspecting or unqualified victims to obtain mortgage loans for the purchase of multiple properties. Chen and her co-defendants recruited these victims in order to hide their own identities. These victims often spoke little or no English, were unemployed, or had limited incomes, and had no intention of ever residing in or repaying any loan on properties in their names.

Between January 13, 2005, and July 10, 2007, the defendants obtained 47 fraudulent loans from 13 lenders on 35 properties in excess of $17.5 million through the use of the fraudulently obtained identities. These properties included 13 in Orange County, 16 in San Bernardino County, and six in Kern County. The defendants are being prosecuted in Orange County for all 35 properties.

The defendants used the fraudulently obtained personal and credit information of some of the fake buyers, including a 92-year-old woman, on several occasions without their knowledge or consent. Chen, Richard Gonzalez, and Daniel Gonzalez acquired city business licenses using the stolen identities for nonexistent businesses in order to

obtain higher income loans. They fabricated loan applications to reflect higher incomes for the fake buyers, forged the fake buyers' names and signatures on various deeds and loan documents, and forged seals and notary stamps on a variety of notarized documents and deeds. They fraudulently filed these fabricated and forged documents with the Orange County Clerk-Recorder's Department.
Acting as the escrow company, the defendants made some monthly payments on the loans to prevent suspicion by the lender. They then defaulted on the loan and kept the remaining loan money.

This case was investigated by the Orange County District Attorney's Office. We assisted in the investigation by looking into the filing of false tax returns.