# Tax News

## May 2011

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## Follow 'Tax News' on Twitter

To quickly notify you of urgent, time-sensitive information, we created an FTB Twitter account. Via Twitter, we will inform you when the monthly 'Tax News' is available and other important topics.

## 2010 Tax Season Stats

### Personal Income Tax Returns

Another busy filing season is well underway. As of April 16, 2011, there were nearly 12 million current year personal income tax returns filed, which is down slightly compared to the same time last year. Electronic filing continues to increase, with over ten million returns received so far this year. At this point, almost 90 percent of all PIT returns processed are filed electronically. This percentage will decrease as we process paper returns.

### Business Entity Tax Returns

Business returns are coming in steadily too, with over 600,000 business tax returns filed; this is almost eight percent higher compared to the same time last year. Conversion to electronic filing is up; almost 45 percent of all business entity returns filed electronically.

### Electronic Services

As the year progresses, do not forget to take advantage of our 24x7 electronic services.

- Access your clients' MyFTB Account information. To use this application, login with your user name and password and enter your clients' secrets (information you already have). You should obtain your clients' permission to view their tax account information using our new form, FTB 743, Online Account View Access Authorization. Keep the authorization form signed by you and your client for your records. Do not mail the form to us.

- Paying electronically means your clients do not have to spend time writing and mailing a check. It also ensures that their payment is quickly applied to their account. We encourage them to use one of the many options we offer on our website for electronic payments. Your clients can schedule their estimated

payments up to a year in advance or subscribe to our estimated tax payment email reminder service and never miss a due date.

Your business entity clients can make online payments too. Corporations, limited liability companies, and partnerships use information from their most recently filed tax return to register for Web Pay. They can schedule payments up to a year in advance. It is free and easy. For more information, go to ftb.ca.gov and search for **Web Pay**.

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## New Legislation May Affect Your Clients

Senate Bill 86 became law on March 24, 2011. This bill included several items which may affect your clients' tax return preparation next year. The provisions of this bill included the following:

**Use Tax Lookup Table:** We will revise the income tax forms and instructions to include a use tax table to allow taxpayers to determine the amount of use tax they owe. This provision is operative for purchases of tangible personal property made on or after January 1, 2011, in taxable years beginning on or after January 1, 2011.

**Child and Dependent Care Credit:** The credit is no longer refundable. This provision is operative for taxable years beginning on or after January 1, 2011.

**Voluntary Compliance Initiative:** This bill authorizes a new voluntary compliance initiative (VCI) permitting taxpayers to file amended returns and pay the tax and interest associated with abusive tax avoidance transactions (ATATs) or unreported offshore income. Participants will avoid criminal prosecution and certain penalties. Please see the article in the Big Business section of this issue of Tax News for more information.

**Financial Institutions Record Match:** Establishes a record match process between financial institution customer records and our debtor records. We will use the match information, which is more current than information that we have now, to collect delinquent state income tax debts and non tax debts. This provision is operative 120 days after the effective date. The first data exchange occurs no earlier than April 1, 2012.

This bill is a budget bill and is effective immediately upon enactment.

## Audit, Protest, Appeals Updated

We recently revised our publication 985, Audit, Protest, Appeals. This publication provides a general overview of the audit, protest, and appeals process, and your rights during the process.

We hope you find this publication useful in assisting your clients with questions they may have about these processes.

## California Conforms to Federal Health Care Coverage

*We sent the following article as a Tax News Flash on April 13, 2011:*

On April 7, 2011, California state law conforms to federal law that provides a new category of excludable or deductible medical care expenses for a child who has not attained age 27 as of the end of the taxable year.

The federal health care Acts of 2010 made numerous changes to the health care system. One provision that became effective in 2010 requires group health plans and health insurance issuers that offer group or individual health insurance coverage, and that provide dependent coverage of children, to extend that coverage to children under age 27. For federal law, these benefits are excludable.

AB 36 adopts only this specific provision of federal health care Acts. It is effective immediately and applies to taxpayers filing their 2010 tax returns due April 18, 2011.

Taxpayers whose Form W-2 includes the amount of medical coverage for children under age 27 in California wages, should request that their employer issue Form W-2C excluding the amount from California wages. If this is not possible, taxpayers can use form FTB 3525 as a substitute for Form W-2C. Taxpayers should use the

corrected wage form to file their state tax return to exclude from taxable income the value of this employer-provided medical coverage.

Self-employed individuals may deduct the health insurance premium paid for children under age 27. No adjustment from the federal tax return is needed.

Taxpayers who have already filed their 2010 state tax return reporting the amount of medical coverage for their children under age 27 in their California wages, should file a Form 540X, Amended Individual Tax Return, to exclude this income and claim a refund. The same applies for self-employed individuals who reported a California adjustment including the health insurance premium paid for children under age 27.

For more information, see Affordable Care Act.

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## Liens and Installment Agreements

Generally, one option available to a taxpayer to resolve a balance due is to enter into an installment agreement. If the balance exceeds $25,000 or will take longer than five years to resolve, we will file a Notice of State Tax Lien to secure the state's interest in any real property held in the county where the lien is filed. If the balance is under $25,000 and would be paid within a five year payment plan, we will generally not file a lien on the outstanding balance as long as the taxpayer stays in compliance with the installment agreement. One condition for an installment agreement is that the taxpayer incurs no new liability during the installment agreement period. If a new liability arises or the taxpayer fails to make the agreed upon payments, then we will cancel the installment agreement.

If the taxpayer wants to continue the installment agreement after defaulting, and the new liability puts the balance due on the account over $25,000 or would require the repayment period to exceed five years, we will file a Notice of State Tax Lien.

Also, if the account reflects a history of noncompliance, even though the balance due may be less than $25,000 or the repayment plan is within the five year period, we may file a lien as a condition of continuing the installment agreement. A history of noncompliance includes either a combination of three or more broken promises (non-payments/dishonored payment) or three continuous accruals of additional liabilities during the life of the existing Installment agreement.

## Top 250 Tax Debtors List Updated

We updated our California's 250 largest unpaid state income tax delinquencies list.

State law requires us to post an annual list of the 250 largest state income tax debtors who owe more than $100,000. Earlier this year, we began mailing letters to individuals and businesses who met the criteria to be listed. So far this year, we collected more than $13 million in payments from taxpayers seeking to prevent their names from being publicly posted on this list. We collected more than $78 million since the list was first posted in October 2007.

We will remove taxpayers on the Top 250 list once they paid the tax or agree to pay under an approved installment agreement. Tax liabilities under appeal, in litigation, in bankruptcy proceedings, or under consideration for an offer in compromise are not included on the list.

Individual taxpayers on the list can contact us at 866.418.3702 to resolve their accounts. Business taxpayers can call 866.914.5594.

The top state income tax delinquencies list is updated annually at ftb.ca.gov. The Board of Equalization has a similar list of the state's top sales and use tax delinquencies, which is updated quarterly.

## How Do We Measure Up?

Tax season is behind us, but we still face the ongoing fiscal shortfalls within the State of California. At Franchise Tax Board, we commit to excellence and efficiency in responsibly managing the $500 million budget entrusted to us by California taxpayers. Like all state agencies, we track our budget carefully to make sure we follow all laws, policies, and procedures. But more important than staying within budget, we are dedicated to use our resources in the most cost-effective manner possible. While we deliver services that Californians value and need to meet their tax obligations, we ensure that we collect revenues to fund government programs and services. To hold ourselves accountable to our mission, we developed a series of performance measures to report the:

- Number of taxpayers we served to help meet their tax obligation.
- Methods and service that we provided.
- Cost associated with our methods and service.

- Revenue achieved for California.

The following table defines five balancing measures we use to evaluate our overall performance and why they are important.

| Measure | Why is this important? |
|---|---|
| 1. Number of "closed tax years" produced | A closed tax year is produced when an individual taxpayer has met his or her tax obligation. When this (unit) is produced, we know that the taxpayer has successfully met their tax obligation of filing, filing accurately, and paying the correct amount due. |
| 2. Average number of days to produce a "closed tax year" | This provides the average length of time it took for us to help the taxpayer meet their tax obligation. |
| 3. Average cost to produce a "closed tax year" | This calculates the average cost per unit produced. |
| 4. Percent of taxpayers meeting their obligation of filing, filing accurately, and paying the correct amount due | This measure tells us how successful we are at helping the maximum number of taxpayers meet their tax obligation. |
| 5. Percent of dollars collected to dollars available to collect | This measure tells us how effective we are at collecting the right amount of tax. |

So, how are we doing? In calendar year 2010 (inclusive of the 2005 – 2009 tax years):

- **Measure #1** – We produced **16.2 million** closed tax years.
- **Measure #2** – The average production rate (number of days to close) was **34.19** days per tax year.
    - Taxpayers who filed timely, accurately, and paid the correct amount – Average of 7.34 days per tax year closed.
    - Taxpayers who filed late, or were incorrect, or did not pay the correct amount – Average of 186.44 days per tax year closed.
- **Measure #3** – The average cost per tax year closed was **$18.78**.
- **Measure #4** – A total of **94.21 percent** of taxpayers met their obligation to file, file accurately, and pay the correct amount due.
- **Measure #5** - We collected **97.81 percent** of the total dollars available to collect.

For measures 2 and 3 (time and cost), our goal is to reduce the number through more efficient processes and better services. Measures 4 and 5 shows our effectiveness at collecting the right amount of tax – the higher the number, the better.

# Small Business

## LLC Estimated Fee Due June 15th

For most calendar year LLCs, June 15 is the date that their 2011 estimated LLC fee is due. For fiscal year LLCs, the estimated fee is due on the 15th day of the sixth month of the current taxable year. LLCs should use Form 3536, Estimated Fee for LLCs, to make their estimated fee payments. LLCs can also use our Web Pay feature to make your estimate fee payment, go to ftb.ca.gov, and click on Payment Options.

The estimated fee requirement is 100 percent of the current taxable year fee. If your payment is late or less than the amount owed, we will assess a ten percent of the underpaid fee penalty. The underpaid fee is the difference between the current taxable year LLC fee, and the estimated fee paid on or before the estimated fee due date.

LLCs can avoid the penalty if their estimated fee payment is equal to or greater than their prior year's LLC fee. Unlike the corporation's estimated-tax prior tax-year exception, there is no requirement that the prior tax year be a full 12 months. Also, there is no penalty for the LLC's first year filing in California. We cannot waive the penalty for reasonable cause.

### Short Period LLC Returns

Sometimes, when a LLC is required to file short period returns such as a technical termination. Each short period is considered a taxable year (R&TC 17010) and subject to both the $800 annual tax and LLC fee. In addition, if the LLC is going to owe a LLC fee in the current tax year, it is required to make an estimated LLC fee payment. Let us look at an example:

Lemon Pie LLC, a calendar year filer, reported a fee of $900 on its 2009 return. Lemon Pie had a technical termination on July 31, 2010. On June 15, 2010, Lemon Pie made a $900 timely estimated fee payment. Lemon Pie filed its first short period return ending July 31, 2010 and reported a $2,500 LLC fee. Lemon Pie does not have an estimated LLC fee underpayment penalty. The LLC meets the prior year exception.

On its second short period return for August 1, 2010 through December 31, 2010, Lemon Pie reported a fee of $11,790. Lemon Pie has no estimate payment requirement for this short period, because the 15th day of the sixth month after the beginning of the tax year (January 15, 2011) is not included within its tax year (August 1, 2009 to December 31, 2010).

# Ask the Advocate

## Taxpayers' Concerns after Filing Their Tax Returns

As the end of filing season approaches, taxpayers contact us with questions or concerns they have after filing their tax return. Here is some information that can help you answer those questions or concerns too.

**You filed a paper return for your clients and they forgot to sign the return.**
We attempt to process the return with the information available to us. If we are unable to complete processing, which can take up to eight weeks, we will request additional information.

**Your client receives a W-2 after filling their return.**
If your client receives a Form W-2 after filing the tax return, complete form FTB 3525, Substitute Withholding Statement. Also, if the information differs from the information reported on the tax return, your client will need to amend the tax return by filing Form 540X, Amended Individual Income Tax Return.

**When can my client expect their refund?**
**e-file** - Refunds from e-file returns are usually issued within seven to ten business days from the date the return is accepted. Your client can also request to have the refund directly deposited into a bank account usually within five to seven business days.

**Paper returns** - Direct deposit of refunds for paper returns are deposited in six to eight weeks about the same time it takes to issue a paper warrant.

**How can my client check their refund status?**
Your client can check the status of their current year refunds online or calling 800.852.5711. This service is also available in Spanish.

**Your client lost their refund check.**
Your client can call 800.852.5711 and we will put a trace on the refund check.

**Does a refund check expire?**
Yes. A refund check, also known as a refund warrant is valid for one year from the issue date. The warrant is considered out dated after these periods have elapsed. An out dated warrant is not negotiable, but the taxpayer may request a replacement check.

**My client sent the check without the payment voucher.**
We will cross reference and accept the check, but if this is the first time the taxpayer is filing the tax return, we might need to contact the taxpayer.

**My client cannot pay what is owed on the tax return.**
If your client is unable to pay the tax owed in full, the taxpayer can make a request for monthly payments. However, interest accrues and an underpayment penalty may be charged on the tax not paid by April 15, 2011, even if the request for monthly payments is approved. To make monthly payments, complete form FTB 3567, Installment Agreement Request, online or mail it to the address on the form.

**My client has an underpayment penalty, but did not know how to calculate the amount.** The penalty is five percent of the unpaid tax plus 0.5 percent for each month or part of a month that the tax remains unpaid not to exceed 40 months. The maximum penalty is 25 percent of the unpaid tax. The penalty is imposed regardless of an extension of time to file.

**My client is due a refund for this year, but has a balance due from a prior year or a nontax debt being collected by FTB; will my client get the refund?**
No. All refunds are subject to intercept. Refunds from joint returns may be applied to the debts of either the taxpayer or spouse.

**My client is currently on an installment agreement (IA) for taxes due from a prior year and owes again for 2010. What will happen with the IA? Can my client get a second IA?**
No. If the additional liability causes the current installment agreement to drop out of criteria, they will receive an intent-to-cancel notice. The taxpayer has 45 days to call us to modify the installment agreement, or the installment agreement will automatically cancel.

**Steve Sims, EA**
**Taxpayers' Rights Advocate**

*Follow me on Twitter at twitter.com/FTBAdvocate.*

# Event Calendar

As part of education and outreach to our tax professional community, we participate in many different presentations and fairs. We provided this calendar to show the events we are attending.

| Education and Outreach | | | |
|---|---|---|---|
| **Speaking Engagements and Small Business Fairs** | | | |
| | | | |
| **May 2011** | | | |
| | | | |
| **Date** | **Event Association** | **Subject Matter** | **Location** |
| May 5 | Sacramento Stakeholder Liaison | Practitioner Liaison Meeting | El Camino |
| May 5 | Sierra Economic Development Corporation | Forms of Ownership | Placerville |
| May 6 | Board of Equalization | Small Business Fair | West Covina |
| May 10 | CA Society of Enrolled Agents | Collection Overview | San Diego |
| May 10 | Board of Equalization | Small Business Fair | San Francisco |
| May 12 | CA National Association of Tax Professionals | CA Tax Update | Palm Springs |
| May 19 | Internal Revenue Service | Entertainment Industry Roundtable | Glendale |
| May 24 | Greater Riverside Chambers of Commerce | Small Business Fair | Riverside |
| May 25 | CA Society of Certified Public Accountants | CA Tax Update | Los Angeles |
| May 25 | SCORE | Small Business Fair | Oxnard |
| May 26 | Small Business Administration | Small Business Resource Summit | Sacramento |
| | | | |
| **June 2011** | | | |
| | | | |
| **Date** | **Event Association** | **Subject Matter** | **Location** |
| June 06 | Board of Equalization | Small Business Fair | Sacramento |
| June 15 | Central Coast Chapter of California Society of Enrolled Agents | Taxpayers' Rights Advocate | Pismo Beach |
| June 23 | CA Certified Public Accountants | Taxpayers' Rights Advocate | Sacramento |

| | | | |
|---|---|---|---|
| June 28 | CA Society of Accounting & Tax Professionals | Non Resident Tax Issues | Oakland |
| | | | |
| **July 2011** | | | |
| | | | |
| **Date** | **Event Association** | **Subject Matter** | **Location** |
| No events scheduled for July. | | | |

# Inside FTB

## Tax Practitioner Hotline and Electronic Correspondence Changes

Due to budget constraints, beginning April 19, we changed to our tax practitioner phone and electronic correspondence (correspondence by fax) services. However, we remain dedicated to providing quality customer service to you and your clients. Our website provides cost-effective, self-service tools which allow immediate access to specific information for you and your clients. In the chart below, we explain the changes and the self service option you can use to access your client's information.

| Tax Practitioner Hotline Service Change | Web Self Service Options ftb.ca.gov |
|---|---|

**Phone Service**

Hotline staff can help you with one client per phone call. If the call involves a personal and business entity account for the same client we will continue to assist you with both accounts.

**Electronic Correspondence**

All correspondence (both electronic and paper) will be worked on a first-come, first-serve basis to ensure we are providing the best possible service for all our customers.

Our normal processing time for correspondence is 10 weeks; however it may take longer during peak periods.

**View Payment Information– Business Entities**

Use MyFTB Account for businesses to view:

**Corporations:**

- Estimated tax payments
- Extension payments
- Estimate transfers applied from a prior year

**LLCs:**

- Annual tax payments
- Estimated fee payments
- Estimate transfers applied from a prior year

**Partnerships:**

- Extension payments
- Estimate transfers applied from a prior year

**View Payment Information – Individuals**

Use MyFTB Account for Individuals to view up to:

- 25 Estimated tax payments
- 25 Estimated transfers applied from a prior year
- 25 Extension payments
- 60 most recent payments applied to a balance due

**View Account Information (Transcript) – Individuals Only**

Use MyFTB Account for Individuals to view:

- A summary of up to 10 tax years with a balance and the total amount due.
- A summary of **each** tax year with a balance due.
- Up to 4 years of California wage and withholding information.
- Up to 3 years of FTB-issued 1099-G and 1099-INT information.

# Criminal Corner

## Norwalk Physician Pays Big for State Income Tax Fraud Conviction

A Norwalk physician and his wife, who pleaded guilty to felony counts of filing false state income tax returns, were sentenced to five years probation and ordered to pay us $2.7 million in restitution.

According to court documents, during 2001 – 2007, John Han, 63, received more than $14 million in Medicare and Medi-Cal payments. Han and Sonya Han, 58, underreported the income on their 2002 – 2007 personal income tax returns by more than $5 million. Han also filed false returns for his corporation, John S. Han, MD, Inc., for the same years and underreported the corporation's income by more than $7 million.

John S. Han and Sonya Han were arrested in early 2009 during the execution of a search warrant related to a joint criminal investigation between the Los Angeles County District Attorney's Office (LADA), United States Department of Health and Human Services, Office of the Inspector General (DHHS OIG), and us.

The $514,000 in cash seized during the search warrant, plus an additional $248,000 frozen in his bank account will be used to reduce the amount of restitution ordered.

This is another prosecution by the Los Angeles County District Attorney's Fraud Interdiction Program. The program is a unique program designed to more effectively deal with the crisis of health care fraud. A large percentage of suspects involved in health care provider fraud are either non-filers or grossly under reporting their income. Using FTB's tax charges resulted in quicker investigations and convictions.

Los Angeles County Superior Court Judge Alex Ricciardulli handed down the sentence Wednesday, March 16, at the Clara Shortridge Folz Criminal Justice Center in Department 121.

Los Angeles County District Attorney Amy Suehiro prosecuted the case. This was a joint investigation between the District Attorney's Office, DHHS OIG, and FTB.

# Big Business

## Abusive Tax Avoidance Transaction Recap

California's tax system is based on voluntary compliance with the tax laws and the principle that everyone should pay their fair share of taxes. We are dedicated to finding those who do not. Some taxpayers participate in the most complex and convoluted tax avoidance schemes to reduce their taxes. Such tax schemes are often abusive, falling within the definition of abusive tax avoidance transactions (ATATs). With improvements in technology, data sharing, and increased resources, we find it easier to identify these taxpayers.

Since 2003, the Legislature enacted anti-abuse tax shelter statutes, which included penalties and other provisions to help curtail the use of these abusive transactions. We have aggressively pursued tax shelters and those taxpayers who used these transactions to avoid paying their taxes. We conformed to federal regulations, with modifications, requiring the disclosure of “reportable transactions" and penalties for failure to do so. In addition, the Legislature provided the noneconomic substance transaction (NEST) penalty (a penalty equal to 40 percent of understatements from transactions with no economic substance) and the interest based penalty (a penalty equal to 100 percent of the interest on a deficiency from an applicable transaction) and an increase in the statute of limitations from four years to eight years. And, let us not forget, about our partnerships with other federal and state agencies which we share knowledge and information about ATATs, or our hotline, which allows informants to provide information anonymously.

Now in 2011, new legislation enhances our tools used to combat ATATs. The law broadens the definition of ATATs, provides for a 50-percent interest-based penalty for amended returns filed after we contact a taxpayer about an ATAT, and increases the statute of limitations on ATAT cases from eight to twelve years. We also can now impose the NEST penalty on any California understatement resulting from a transaction that the IRS examines and determines lacks economic substance. Taxpayers we audit and determine to have a tax deficiency resulting from an ATAT could pay nearly three times more than they would without the use of the ATAT. For those taxpayers, the risks outweigh the benefits and the Voluntary Compliance Initiative recently enacted under SB 86 could not come at a better time. Next month, we will explain how taxpayers can resolve past tax transactions involving ATATs and unreported offshore income and avoid penalties and criminal prosecution.