



Tax News

September 2011

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Head of Household Audits

From July to December, we plan to mail approximately 135,000 audit letters to taxpayers to verify their Head of Household (HOH) filing status on their 2010 state tax return.

If your clients do not qualify, we reassessed the tax at either a single or married-filing-separate filing status. Nearly 34,000 taxpayers who used this status last year did not meet its requirements and were issued more than \$35 million in tax assessments.

Each year we review tax returns of taxpayers who claim the HOH filing status because taxpayers commonly misunderstand the qualifications. This filing status generally results in lower tax liabilities for unmarried taxpayers who care for a dependent. To qualify, the taxpayer must provide care for more than one-half of the year and pay more than one-half the cost of maintaining their home. The qualifying person must be related to the taxpayer and meet the requirements to be a [qualifying child](#) or relative. More than 2 million California taxpayers use this filing status each year.

We advise taxpayers who receive an HOH letter to respond promptly by completing the enclosed questionnaire. Failure to respond could result in a tax assessment and penalty. Questionnaires can be submitted by any of these methods:

- Respond electronically at ftb.ca.gov. Use [HOH Audit Letter Web Response](#) page.
- Respond by fax at **866.223.8195**.
- Respond by mail using the pre-addressed envelope provided with the audit letter.

We provide the following tools on our website to assist taxpayers:

- Head of Household [self-test](#).
- Answers to [frequently asked questions](#).

[Publication 1540](#), CA Head of Household Filing Status, in English and Spanish.

2011 State Income Tax Rate Schedules Adjusted

We released the 2011 state tax brackets. Brackets are “indexed” each year by adjusting them to reflect changes in the California Consumer Price Index (CPI).

Filing requirement thresholds, the standard deduction, and certain credits were adjusted along with income tax brackets based on the inflation rate of 2.7 percent, as measured by the California CPI for all urban consumers from June 2010 to June 2011. Last year California had an inflation rate that measured 0.9 percent.

Below are some of the changes to various items:

	2011 Amounts	2010 Amounts
Standard deduction for single or “married filing separate” taxpayers	\$3,769	\$3,670
Standard deduction for joint, surviving spouse, or head of household taxpayers	\$7,538	\$7,340
Personal exemption credit amount for single, separate, and head of household taxpayers	\$102	\$99
Personal exemption credit amount for joint filers or surviving spouses	\$204	\$198
Dependent exemption credit	\$315	\$99*
Renter’s Credit is available for single filers with adjusted gross incomes	\$35,659 or less	\$34,722 or less
Renter’s Credit is available for joint filers with adjusted gross incomes	\$71,318 or less	\$69,443 or less

* A temporary tax law (AB X3 3 Ch. 18 2009) reduced the dependent exemption credit for tax years 2009 and 2010 to the indexed personal exemption credit amount.

In addition, we provide minimum filing requirement thresholds to ensure that most people who will not owe taxes are not required to file a tax return. We adjust these tables each year to include the added senior exemption and the dependent exemption credits. For example, most single people under 65 years old with no dependents would not need to file a state return until they have adjusted gross income of \$12,122 or more compared to last year’s threshold of \$11,803 or more.

Other tax credits affected by indexing include the Joint Custody Head of Household Credit, Dependent Parent Credit, and Qualified Senior Head of Household Credit.

More information about the 2011 tax rates and exemptions and other tax amounts will be posted on our website at ftb.ca.gov sometime next month.

Schedule CA (540), California Adjustments - Residents Real Estate Tax Deduction

We are in the process of updating the [2011 Schedule CA \(540\)](#), California Adjustments - Residents. We added line items to the schedule and updated the instructions to help taxpayers compute the correct deduction amount for real estate tax. We also are developing a [web page](#) to provide additional information.

Real estate tax is an allowable itemized deduction for both federal and state income tax. In general, the allowable deduction amount should be based only on the assessed value of the taxpayers' property. Special assessments included in the property tax bill, such as Mello-Roos or for various service charges provided to specific properties, are generally not allowable deductions for income tax purposes.

California differs from most other states in that many California property tax bills include large special assessments that are not allowable deductions. However, California does conform to federal law regarding the real estate tax deduction. Therefore, taxpayers should use the same real estate deduction amount on both their federal and state tax returns. This new information reporting is intended to help taxpayers properly report their real estate tax deduction.

You may provide [your comments or suggestions about this schedule](#) by September 30, 2011, at ftb.ca.gov.

Development of FTB Strategic Plan for 2012-2016

With our current five year strategic plan ending December 2011, we began developing the next strategic plan to guide us over the next five years. In December 2010, we began to analyze the challenges, risks, and opportunities facing us, including future, demographic, and economic climate, our workforce issues, and information technology advancement. This approach generated a new direction of thought and a new mission statement, goals, and strategies that stretch our service to reach for higher levels of excellence for California taxpayers and their representatives. In addition, for the first time our executive leadership team included our stakeholders in the development of this plan. We followed this new approach because we value the insights and perspectives of our customers. We expect to provide more transparency of our daily responsibilities and programs and enhance the partnership between us and those who interact with us. In late July and early August, we conducted four Stakeholder Focus Groups. The groups represented were:

- More than 60 staff from various areas and classifications.
- Certified public accountants, enrolled agents, and tax professionals.
- California Tax Education Council and California Bar Association members.
- Chamber of Commerce and large and small business representatives.
- Government advocates, federal, state, and local agencies.

We encouraged each group to discuss any concerns and suggestions among their peers/associates in the room. The strategic planning team reviewed the feedback and uncovered themes to use as they rework the plan's components. In addition, the team is developing performance measures we will use to ensure business processes achieve the desired results described in our mission statement, goals, and strategies. Our next step is to present to our Board in the fall, attain approval, and make the 2012/2016 Strategic Plan available on our website by January 2012.

We learned many benefits in the development of this next five year plan. The most important was to take the time and examine all factors that influence our ability to carry out our mission and include our stakeholders in the development process. We believe we produced our most innovative, forward thinking, vigorous, and transparent plan.

Mandatory Password Change for MyFTB Account

Federal regulations require annual changes to passwords used to access federal tax data. We receive tax information from the IRS and must follow their security requirements.

If you registered an account with us to view your clients' MyFTB Account data, you will need to change your password 12 months after the date you registered or last changed your password.

To remind you of this requirement, we will send a message 30 days before your password expires to the email address you used when you registered. You can either change your password at that time or wait until the next time you login.

Changing your password is easy:

- Login with your current user name and password.
- From the Online Services for Tax Professionals page select the "Change my password, email address, security questions, or the security image." link.
- Enter your new password and save your changes.
- Make sure you remember your new password.

Tax News Flashes

The following articles where news flashes sent throughout the month of August:

Flashed August 3, 2011:

California's Voluntary Compliance Initiative 2 (VCI 2) has Begun

The filing period for amended returns and participation agreements started August 1 and will continue through October 31. Taxpayers involved in Abusive Tax Avoidance Transactions or Offshore Financial Arrangements should take advantage of this opportunity to file amended returns without harsh penalties. Go to ftb.ca.gov and search for **VCI 2** to download your participation agreement now.

Flashed August 9, 2011:

Proposed Table 3 Schedule K-1 (565), Partner's Share of Cost of Goods Sold, Deductions, and Rental Income

We are proposing to add [Table 3, Partner's Share of Cost of Goods Sold, Deductions, and Rental Income](#) to Schedule K-1 (565). Table 3 will enable partnerships to report proportional cost of goods sold, ordinary deductions, real estate rental income, and other rental income to all partnerships. Limited liability companies (LLC) are unable to correctly compute the LLC fee because these items are not found on Schedule K-1 (565) because the Schedule K-1 is designed to report pass-through net income. Table 3 gathers information from the pass-through entity's own return as well as other Table 3s the entity receives, facilitating the path of reporting to an LLC subject to the LLC fee that will ultimately use the information to complete the LLC Income Worksheet. The proposed Table 3 benefits both us and business entities requirements by:

1. Enhancing the ability of partnerships to accurately report their proportionate shares of aggregate gross receipts to other partnerships and LLCs subject to the LLC fee.
2. Providing a new table for partnerships and LLCs to report their pass-through entity interests.
3. Enabling LLCs subject to the LLC fee to more easily compute their correct total income from California sources.
4. LLCs subject to the LLC fee will have the necessary information readily available to complete the LLC Income Worksheet, reducing their reporting burden and ease in tax preparation.
5. We will significantly decrease the number of Return Information Notices (RINs) we issue each year for incorrect LLC total income computations. Fewer RINs will mean reduced telephone traffic for our Taxpayer Services Center, shortening the response time for taxpayers contacting the FTB for assistance.

Give [your comments or suggestions about the form](#) by August 31, 2011.

Flashed August 9, 2011:
California Schedule EO (565/568) - Pass-Through Entity Ownership

Beginning with the 2011 taxable year, partnerships and limited liability companies (LLC) will use the proposed [California Schedule EO, Pass-Through Entity Ownership](#), for reporting pass-through entity ownership interests in entities that file federal Form 1065 or that are disregarded. In the past, we asked for that information in the form of a statement from the taxpayer. The proposed Schedule EO asks the taxpayer to identify by name, Secretary of State number, and Federal Employee Identification Number for all partnerships (including LLCs taxable as partnerships), in which the taxpayer holds a partial interest and for disregarded entities in which the taxpayer has full ownership. In addition, we ask the taxpayer to indicate which entities received California source income, and to provide the profit and loss sharing percentages used to compute the amount of income received by the owner. We will use that information to validate returns during processing, significantly reducing processing time and errors. The Schedule EO will benefit us and pass-through entities by providing a Schedule for partnerships and LLCs to report their pass-through entity interests.

Give [your comments or suggestions about the form](#) by August 31, 2011.

Flashed on August 17, 2011:
CSEA-IRS Federal Representation Workshop 2011:
The Basics of IRS Compliance Processes and Representation

All tax practitioners – this is your opportunity to learn the basics about IRS procedures regarding compliance processes and representation.

This all-day workshop has been expanded to four convenient locations...

Registration: 8:00 AM – 8:30 AM

Seminar: 8:30 AM – 4:30 PM

August 22, LAGUNA NIGUEL, CA

IRS Office, Oceanside/Riverside Room, 2nd floor, 24000 Avila Road, Laguna Niguel, CA

August 23, CARSON, CA (LA area)

Carson Center, Community Hall A, 801 East Carson Street, Carson, CA

August 29, OAKLAND, CA

Elihu M. Harris State Building, Room 1, Second Floor, 1515 Clay Street, Oakland, CA

August 29, SACRAMENTO, CA

Franchise Tax Board, Town Center, Gerald Goldberg Auditorium, 9646 Butterfield Way, Sacramento, CA

***locations subject to change**

COST: \$105/Members; \$125/non-Members

CPE Credits: IRS, CSEA/NAEA, CTEC # 1001-CE-6838, and California Board of Accountancy: 8 federal hours. State Bar of California MCLE: 7 hours.

SPACE IS LIMITED, [REGISTER TODAY](#)

800/777-2732 phone

916/366-6674 fax

www.csea.org

Flashed on August 29, 2011:

Resident, Nonresident, and Real Estate Withholding Form and Processing Changes Begin August 29, 2011.

The processing of resident, nonresident, and real estate withholding forms and payments will change to accommodate our new, automated withholding system. The new system will result in fast and accurate processing of withholding forms and payments.

Read and carefully apply the following guidelines and changes to avoid errors that could result in the assessment of penalties and interest.

Get ready to submit Form 589 online

Beginning August 29, 2011, we can no longer process a faxed Form 589, Nonresident Reduced Withholding Request. You must submit Form 589 online or by mail.

When submitting an online 589, if you also need to submit any type of documentation (such as: IRS 8804-C, Schedule E, expense breakdowns, etc.), you must fax the documentation to us at 916.845.9512. On your faxed documentation, include your name, taxpayer ID number, and the date of your online 589 submission.

We will process online requests within 10 business days.

We will process forms received by mail within 21 business days.

Withholding Information Notice

Beginning August 29, 2011, we will issue you a notice when you submit withholding [Forms 592](#), Resident, and Nonresident Withholding Statement, [592E](#), Foreign Partner or Member Annual Return, or [593](#), Real Estate Withholding Tax Statement, and there is a mistake, an underpayment, or an overpayment. We will include a description of any errors or balances, and how you can contact us with your questions.

If you have a balance due, we will mail a separate billing statement indicating the amount due.

Amending Forms 592 and 593

Also beginning August 29, 2011, there are new guidelines on how to amend a previously submitted Form 592, 592F, or Form 593. Mail a new form with the correct information. Check the "Amended" box at the top of the form and include a letter explaining what changes were made and why.

For more information on processing changes for withholding forms and payments, go to: [Processing Changes for Withholding Forms and Payments](#).

Ask the Advocate



California Community Property Rules for Registered Domestic Partners and Same-Sex Married Couples

Last year, the IRS issued [Chief Counsel Advice](#) that requires each California registered domestic partner to report one-half of their community income on their individual federal tax returns filed after January 1, 2010. This new rule also applies to California same-sex married couples.

While this new federal requirement does not change how these couples file for California income tax purposes, we have been receiving many questions about California's community property tax rules.

California taxpayers who choose to file separate rather than joint returns must follow the California community property tax laws. These laws are found in the [California Family Code](#) law, and case law.

So, while we cannot provide guidance on how to file federal income tax returns, registered domestic partners and same-sex married couples may find answers to many of their community property questions in the following publications:

- [FTB Publication 737](#), Tax Information for Registered Domestic Partners.
- [FTB Publication 776](#), Tax Information for Same-sex Married Couples.
- [FTB Publication 1051A](#), Guidelines for Married/RDP Filing Separate Returns.
- [IRS Publication 555](#), Community Property.

Our publications are available online at ftb.ca.gov, or you may order by phone by calling 800.338.0505. The IRS Publication is available online at irs.gov.

Recorded information is available by calling 800.338.0505, and you may speak with one of our representative by calling 800.852.5711.

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			
September 2011			
Date	Event Association	Subject Matter	Location
14	Alameda County Regional Small Businesses	FTB Business Requirements	Alameda
19	Internal Revenue Services	Register Domestic Partners	Emeryville
21	Internal Revenue Services	Register Domestic Partners	Fresno
22	Internal Revenue Services	Register Domestic Partners	Sacramento
22	National Association of Tax Professionals	CA Tax Update	San Diego
22	City of San Bernardino	Taxpayers' Rights Advocate	San Bernardino
27	CA Society of Tax Consultants	Federal vs. State Law	Sacramento
October 2011			
Date	Event Association	Subject Matter	Location
4	Board of Equalization	Forms of Ownership	Mission Viejo
6	Internal Revenue Services	Filing - Employee vs. Contractor	Oxnard
18	CalCPA Central Coast Chapter	CA Tax Update	San Luis Obispo

24	CA Society of Enrolled Agents	Military Tax Issues	San Diego
25	KS Bookkeeping & Technical Services	Taxpayers' Rights Advocate	San Diego
November 2011			
Date	Event Association	Subject Matter	Location
10	CA Society of Enrolled Agents – Golden Gate Chapter	CA Tax Update	Burlingame
16	CA Society of CPAs	CA Tax Update	San Diego

Inside FTB



In July, we launched the Enterprise Data to Revenue (EDR) project; the largest tax project we have ever undertaken. The EDR Project is a 66 - month effort that results in better service for our stakeholders, a higher level of transparency than we provide currently, and more revenue---about \$1 billion dollars annually.

The EDR Project implementation includes reengineering our document processing systems, creating an enterprise data warehouse, and developing an online Taxpayer Folder for taxpayers and their representatives.

While a key project benefit is revenue - EDR will also provide better customer service to taxpayers and their representatives. EDR will allow us to process returns, payments, and other documents faster and more accurately. Notices will be easier to understand and taxpayers and their representatives will have delivery options for information regarding their accounts, like email and text message.

The Taxpayer Folder will provide an online suite of information and services designed to allow stakeholders to access the account information they need, when they need it. Planned Taxpayer Folder services and functions include:

- View return, payment, notice, collection, and audit history.
- Request extensions.
- Calculate penalties.
- Protest audits, grant power of attorney.
- Request an installment arrangement.

In June 2011, the Department of General Services awarded contract services to CGI Technologies and Solutions, Inc., as the prime solution provider for the project. We have worked with CGI on other important projects over the past decade and have built a very successful relationship with them. This fall, we will provide important information about the EDR Project on our website, ftb.ca.gov.

Watch our project video:

<http://www.youtube.com/watch?v=8Dk11KrGSwA>.

Criminal Corner

Brentwood Couple Sentenced for State Income Tax Evasion and Concealing Property

A Brentwood man pleaded no contest to one felony count of state income tax evasion and one felony count of concealing property with intent to evade the collection of tax. His wife pleaded no contest to one misdemeanor count of state income tax evasion.

John Meza, 37, was sentenced to serve 120 days in county jail; pay us nearly \$163,000 restitution representing the unpaid tax, interest, penalties, and cost of investigation; and serve three years formal probation. Jessica Meza, 40, was sentenced to serve two years probation; 200 community service hours; and is jointly and severally liable for the restitution with John Meza.

The couple immediately provided us a check for \$50,000 towards the restitution.

According to court documents, the couple owned and operated seven sandwich shops and a newspaper distribution business in the Bay Area. They failed to file state income tax returns for the 2004 through 2007 tax years and failed to report more than \$800,000 in taxable income. We initiated the investigation after the couple failed to respond to numerous notices demanding they file their delinquent California personal income tax returns.

In addition, in 2006, the couple opened a bank account using false social security numbers and deposited checks into this account in order to evade or defeat collection of their personal income tax due.

Contra Costa County Superior Court Judge William Kolin handed down the sentence in Department 18 of the Walnut Creek Superior Court. The case was prosecuted by Contra Costa County Deputy District Attorney Stacey Grassini.

Our criminal investigation program identifies and investigates cases of tax evasion and tax fraud to encourage compliance with California income tax laws and maintain the public trust.

Big Business

Do We Dissolve, Surrender, or Cancel Our Business Entity?

We continue to receive inquiries from business owners about terminating their business and whether they need to dissolve, surrender, or cancel their business entity. Depending on the type of business entity, they may dissolve, surrender, or cancel doing business in California through the [Secretary of State \(SOS\)](#).

Corporations that originally incorporated in California, referred to as Domestic Corporations, may legally **dissolve** when they cease doing business. For those corporations that originally incorporated outside of California, referred to as Foreign Corporations, they may legally **surrender** doing business in California. For limited liability companies and partnerships, both domestic and foreign, they may legally **cancel** doing business in California.

The following are the steps required to dissolve, surrender, or cancel a business entity:

- File any delinquent tax returns.
- File the final/current year tax return. On this tax return's first page, write **FINAL** at the top of the page and check the box labeled "**Final Return.**"
- Pay all tax balances, including any penalties, fees, and interest.
- File the appropriate form(s) to dissolve, surrender, or cancel the business entity with the SOS within 12 months of filing your business' final tax return. To get the correct forms, go to sos.ca.gov, or call SOS at 916.657.5448.

Until the business entity formally terminates their legal existence, the entity continues to exist. Likewise, their filing and annual tax requirements continue to exist. Often, the business owner does not formally terminate their entity with SOS even though they stop

doing business and stop fulfilling their tax filing requirements. Not filing timely tax returns or paying the annual tax usually leads to the business entity being suspended or forfeited by us, penalties and fees being assessed, and interest accruing until the entity is formally terminated.

If a business entity is suspended or forfeited, SOS cannot accept termination documents. The business owner must complete all of the following requirements before submitting termination documents to SOS:

- Pay all outstanding balances due.
- File any delinquent tax returns.
- File [FTB 3557 BC](#), Application for Certificate of Revivor, (Banks and Corporations), [FTB 3557 LLC](#), Application for Certificate of Revivor, (LLCs), or [FTB 3557 E](#), Application for Certificate of Revivor, (Tax-Exempt Corporations).

Exception - Nonprofit tax-exempt corporations are required to file a final tax return on [Form 199](#), California Exempt Organization Annual Information Return, [FTB 199N](#), Annual Electronic Filing Requirements for Small Exempt Organizations (California e-Postcard), or [Form 109](#), Exempt Organization Business Income Tax Return, whichever is appropriate.

Public, religious, and mutual benefit corporations holding charitable assets in a trust must obtain a Dissolution Waiver from the [California Office of the Attorney General](#) and submit to SOS, along with other required documents, to complete their dissolution. For more information, go to [sos.ca.gov](#).

An entity may avoid the minimum franchise or annual tax for current and subsequent taxable years if all of the following requirements are met:

- Timely filed the final franchise or annual tax return, including extension, for the preceding taxable year.
- Conducted no business after the last day of the preceding taxable year.
- Filed the appropriate documents with SOS within 12 months of the filing date of your final tax return.

For more information, see [FTB Pub. 1038](#), Guide to Dissolve, Surrender, or Cancel a California Business Entity at [ftb.ca.gov](#).