Tax News
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Head of Household Guidelines

The filing season is just around the corner and some of your clients may inquire about claiming the head of household filing status. This filing status provides a lower tax liability and a higher standard deduction than the single filing status. Although many of your clients may think of themselves as the head of their household, they may not qualify for this filing status under state and federal tax laws.

To qualify for this filing status, the taxpayer must meet all of the following requirements:

- The taxpayer was unmarried and not a registered domestic partner (RDP), or met the requirements to be considered unmarried or considered not in a registered domestic partnership as of the last day of the tax year.
- The taxpayer paid more than one-half the costs of keeping up his or her home for the year.
- The taxpayer's home was the main home for the taxpayer and a qualifying person who lived with the taxpayer for more than one-half the year. Please see the legal definitions for Parent/Stepparent (Father or Mother) and Temporary Absence in FTB Publication 1540, California Head of Household Filing Status, for exceptions to this rule.
- The qualifying person was related to the taxpayer and met the requirements to be a qualifying child or qualifying relative.
- The taxpayer was entitled to a Dependent Exemption Credit for his or her qualifying person. However, the taxpayer does not have to be entitled to a Dependent Exemption Credit for his or her qualifying child if the taxpayer was unmarried and not a RDP, and the taxpayer's qualifying child was also unmarried and not a RDP.
- The taxpayer was not a nonresident alien at any time during the year.

There are several resources available to assist you in determining if your client qualifies for head of household:

- The 2011 personal income tax instruction booklets for Forms 540/540A and 540 2EZ contain the general rules for using the head of household filing status.
- For detailed information, refer to FTB Publication 1540.
- FTB Publication 1540SPAN is the Spanish version of the 1540.
- You can also access the same comprehensive information online on our HOH Webpage.
- The HOH self-test.

- Under our Practitioner's Corner Webpage, you can find more information about the topics covered in our HOH seminar. See FTB 1585, Head of Household Workshop Supplement and our PowerPoint presentation in the June 2008 issue of Tax News.

By reviewing these sources and using the self-test to determine eligibility, most taxpayers can avoid a denial of their head of household filing status, and an assessment of additional tax plus interest.

For your clients who file electronically, we highly recommend having them file Form 4803e with their electronic return. By filing Form 4803e, (an electronic version of the HOH Audit Letter) with their electronic return, most electronic filers can avoid later receiving a paper copy of the HOH Audit Letter in the mail asking them to provide information about their qualifications for head of household filing status. They may, however, still receive a follow-up audit letter if they provide incomplete or conflicting information on the Form 4803e.

New Taxpayer Liabilities - Court-Ordered Restitution and Investigation Collection

Recently, we added Court-ordered Restitution (COR) and Court-ordered Investigations (COI) costs awarded to us in criminal proceedings to our internal accounting systems. We collect these taxpayer liabilities the same as other tax year balances due, but now it will appear as a taxpayer liability penalty in our systems and in the correspondence to the taxpayer. This will make it easier to understand the breakdown of these taxpayer liabilities.

Our Criminal Investigation Bureau assesses or abates these taxpayer liabilities.

New Withholding Tool

You asked for it at our Advisory Board Meeting and we listened by creating a Small Business Withholding Tool – Three stages to help you determine when you need to withhold California source income.

New Video for Our Tax News Live Series

We just posted another video to our products page. This new video gives you more information about our systemic issue management system.

Real Property Taxes

In response to our education and outreach effort on the deductibility of real property taxes, we continue to receive many comments and questions about what is deductible and how to find it on a property tax bill. The biggest question perhaps is whether taxes have to be ad valorem to be deductible. To clarify our position on this, we issued Legal Division Guidance 2011-12-01. We explain that the Internal Revenue Service's (IRS) well established official position, to which California law conforms, is that the only real property taxes deductible as an itemized deduction are those that are assessed on the basis of the value of the property, i.e., ad valorem. Our Legal Division Guidance also discusses that there are limited exceptions where a portion of other amounts on a real property tax bill may be deductible.

Since most taxpayers have assumed that the total bill amount paid is deductible, we have updated our website, Understanding the Real Estate Tax Deduction, with sample property bills from every county to help taxpayers find amounts on their bills that are based on the property value. Included on our website are instructions on how to review the tax bill. One thing we ask taxpayers not to do is use Federal Form 1098 'Mortgage Interest Statement' to determine the amount of real estate taxes that are deductible. The amount reported on Form 1098 reflects the total taxes paid, not the deductible portion.

Our position on the real estate tax deduction is not based on a law change and is the same as the official IRS position, which means taxpayers should deduct the same amount for real property tax on their federal returns.

New Legislation - Credit for Fresh Fruits or Fresh Vegetables Donations

Beginning January 1, 2012, qualified taxpayers may receive a tax credit for donations to California food banks. Thanks to Assembly Bill 152, donating fresh fruits or fresh vegetables may entitle the donor to a credit equal to 10 percent of the donation's costs. According to the author's office, the purpose of this bill is to increase access to fresh produce for families that are "food insecure."

A "qualified taxpayer" would be defined as the person responsible for planting the crop, managing the crop, and harvesting the crop from the land. The cost of donated fresh fruits or fresh vegetables would be the cost of those products that would otherwise be included in inventory costs. Generally, inventory costs would include both the direct costs and the allocated indirect costs required to produce the fresh fruits or fresh vegetables. Because inventory costs are a cost of doing business, the credit would be available only to a business that is also a qualified taxpayer.

The recipient of a donation of fresh fruits or fresh vegetables would be required to provide to the donor certification of the type and quantity of the products donated, the name of the donor or donors, the name and address of the donee nonprofit organization, and, as provided by the donor, the estimated value of the donated products and the location where the donated product was grown. The donor would be required to provide the certification to us upon request.

This credit is nonrefundable; however, it may be carried forward for six years. For more information on this new law, see our AB 152 complete analysis.

Tax News Flashes

We flashed the following article on January 5:
Our Entire Website Now Uses Secure Socket Layer (SSL) Encryption

Effective Monday, December 19, 2011, our entire website was secured using SSL encryption. We automatically redirect all visitors from "http" to "https." We plan to update all http references in our web content and products to https over the next few months.

- The change will encrypt any sensitive data submitted by customers when using email forms and the survey. Customers should not include their confidential information.

- Customers will no longer receive a message stating they are leaving a secure website when going from an interactive service or application (CalFile, My FTB Account, or Check Refund) to static content (ftb.ca.gov homepage).
- Customers will see the lock image in the browser acknowledging they are on a secure site.
- If you experience any technical problems, email the Webmaster.

Ask the Advocate

How Your Clients may Avoid Wages and Salary Garnishments

This year we are contacting more than 900,000 people who did not file a 2010 state income tax return.

Last year, we collected more than $574 million through these efforts. Unfortunately, for some taxpayers a portion of this was collected through wage and salary garnishments because we were not contacted.

The events leading up to the garnishments often follow this scenario. We received information from an employer that they paid wages to the taxpayer. Under California Revenue and Taxation Code (R&TC) section 18501, when an individual's income exceeds specific amounts, they must file a return even if they have no tax due or are due a refund.

When our records indicate that returns have not been filed, we contact taxpayers by mailing a Demand for Tax Return notice to the last address of record in accordance with R&TC 18416. This notice explains that within 30 days the taxpayer should either file a return, support why a return did not need to be filed, or provide a copy of the return if it was already filed.

If we do not receive a timely response, we then issue a Notice of Proposed Assessment for taxes, penalties, and interest on estimated net income as allowed under R&TC 19087. We estimate net income using 400 million income records we receive each year from third parties such as the IRS, banks, employers, state departments, and other sources.

At this point, the taxpayer has 60 days from the date of the Notice of Proposed Assessment to file a written protest with us per R&TC 19041. However, when a protest is not timely made, the amount of the proposed assessment becomes final and the tax, penalties, and interest become due and payable under R&TC Section 19042.

Now, collection action begins. We will send a Statement of Tax Due, and potentially an Income Tax Due notice, and a Final Notice. If we are not contacted during this time, we begin to use other methods of collections.

If the taxpayer is an employee who earns wages or salaries, we will likely contact their employer to establish an Earnings Withholding Orders for Taxes (EWOTs), provided by R&TC Section 19264, if we are unable to resolve the tax debt another way. EWOTs affect both employees and employers by directing the taxpayer's employer to withhold a certain amount of wages or salary each pay period, and forward it to us to pay the liability.

Unfortunately, it is not until their wages are being garnished that you get a panic call from your client. And, while we may adjust a EWOTs payment amount if your client has a financial hardship, at this time we will not release a valid EWOT to set up an installment agreement -- unless there are exceptional circumstances.

If you have clients who receive collection notices and can't pay, encourage them to pay what they can and then contact us 7:30 a.m. to 6 p.m., weekdays, except state holidays at:

Individuals:
- 800.689.4776
- 916.845.4470 (outside U.S.)

Business entities:
- 888.635.0494

When your client can't pay, our first choice is to find a way to work with them to resolve the collection issues sooner than later. This benefits all involved parties. The taxpayer avoids penalties and interest, the employer avoids extra work, and the state saves money otherwise spent on collection activities.

Your clients may be able to prevent collection actions if they:

- Pay their tax liability in full.
- Enter into an installment agreement.
- File all required tax returns or provide proof that they have no filing requirement.
- Make an Offer in Compromise that we accept.
- Establish that a financial hardship prevents them from paying their liability.

Steve Sims, EA
Taxpayers' Rights Advocate
Follow me on Twitter at twitter.com/FTBAdvocate.

Event Calendar

A New Look for Our Calendar

As part of our education and outreach to the tax professional community, we participate in many different presentations and fairs. We now provide a Calendar of Events to show the events we are attending as well as other events happening with us such as interested party and board meetings. Consolidating our events to one calendar on our website was a suggestion at our annual Advisory Board Meeting, and we believe provides better customer service.

EDR Enterprise. Data. Revenue!

EDR in the News

The EDR Project allows us to use technology to leverage existing data to more effectively administer our tax systems. This includes more efficient operations throughout FTB, better customer service, a higher level of transparency than we can provide currently, and additional revenue.

EDR Update:

We are implementing two initiatives next month to help us bring in additional revenue for the state. The initiatives are:

Financial Institution Record Match (FIRM)

FIRM will increase our leverage in collecting taxes from delinquent taxpayers. We will generate additional levies that enable us to obtain delinquent taxpayers' banking information by matching their records against financial institutions that do business in California. An overview of the program, along with additional information that includes a FIRM General Information Booklet, is available on our FIRM webpage.

Interactive Voice Response (IVR) Installment Agreements (IA)

IVR IA will provide us with an enhanced IVR application that supports payment installment agreements for taxpayers. Taxpayers can set up installment agreements by making a free phone call to an easy-to-use self-service application. The application will help increase the number of installment payment plans while freeing call center staff to assist more taxpayers with complex issues.

Criminal Corner

Father and Son Arrested for Fraud and State Tax Evasion Charges

After an 18-month investigation between the Santa Barbara Police Department, the Santa Barbara County District Attorney's Office and us, the owner of Montecito Motors, Inc. of Santa Barbara and his father were arrested on 58 felony criminal charges including state tax evasion, grand theft, embezzlement, and financial elder abuse, according to the Santa Barbara Police Department and us.

Chester Adam Taylor, AKA Adam Taylor, 41, and Chester Lee Taylor, AKA Chet Taylor, 71, are accused of filing false personal income tax returns and failing to file corporate tax returns for 2004-2010, plus numerous other crimes.

According to the arrest warrant, the Taylors stole more than $1 million from 26 separate victims. They concealed car sales and defrauded people who had consigned their cars for sale with Montecito Motors, Inc. Months, and sometimes years, would go by and the car owners would be told by Chet or Adam Taylor that the car had not sold when in reality the car had sold months (or years) earlier. The Taylors illegally obtained duplicate titles, forged signatures, and lied to car owners about selling their cars to conceal the sales and avoid paying the owners the money owed after the sale of their vehicles. They are also charged with theft from a private investor of more than $290,000 for receiving a line of credit that was supposed to be secured by the titles of cars they owned, but was not. Many of the titles were either duplicate titles from cars they already sold, or titles of cars that were on consignment that they did not own.

According to investigators, it is alleged that the Taylors used Montecito Motors, Inc. funds to pay their personal expenses such as home rental fees, mortgage payments, personal credit card payments, and personal cash withdrawals. The Taylors also neglected to report the income on their state income tax returns. All income is taxable including income from illegal sources.

Chet Taylor is charged with filing false personal income tax returns for 2005 through 2010 and failing to report more than $400,000 from Montecito Motors, Inc.

Adam Taylor is charged with filing false tax returns and failing to file personal returns 2004 through 2010, and not reporting more than $500,000 from Montecito Motors. He is also charged with failing to file corporate tax returns from 2005 through 2009 and not reporting more than $24.7 million in gross sales. This information was cited from a Santa Barbara police department news release.

Inside FTB

Judicial Court Amnesty Program

We will be working with the Judicial Council of California, Administrative Office of the Courts (AOC) on their amnesty program. The Administrative Office of the Courts will administer the statewide program over a six month term, from January 1 to June 30, 2012. The program will provide relief to individuals who have found themselves in violation of a court-ordered obligation because they are financially unable to pay infraction bail or fines.

The program will not adversely impact our current Court-Ordered Debt (COD) collection or Interagency Intercept Collection (IIC) programs. If you have a client affected by this program, we can refer you to the court where the violation incurred, or you can go to the AOC which has provided a list of frequently asked questions for the amnesty program.

The courts and counties are responsible for identifying the cases, notifying us, and withdrawing amnesty accounts. Less than 1 percent of our court-ordered debt cases may qualify for amnesty relief.

Big Business

Federal Health Care Tax Credit for Small Businesses

We encourage small businesses to review IRS guidelines to determine eligibility for the small business health care tax credit. The tax credit is part of the 2010 Affordable Care Act.

The small business health care tax credit helps small businesses and small tax-exempt organizations afford the cost of covering their employees. According to the Internal Revenue Service (IRS), small employers that pay at least one-half of the premium for employee health insurance coverage may be eligible for the small business health care tax credit. Small tax-exempt organizations also may qualify.

The credit is worth up to 35 percent of a small business's premium costs (25 percent for tax-exempt employers). In 2014, this rate increases to 50 percent (35 percent for tax-exempt employers).

To qualify, an employer must have fewer than the equivalent of 25 full-time workers (for example, an employer with fewer than 50 half-time workers may be eligible). A qualifying employer also must pay average annual wages below $50,000.

The credit phases out gradually for firms with average wages between $25,000 and $50,000 and for firms with the equivalent of between 10 and 25 full-time workers.

To determine if they qualify, businesses may use this three step fact sheet from the IRS. Eligible small employers will use IRS Form 8941, Credit for Small Employer Health Insurance Premiums, to calculate the credit.

More information is available from the IRS.