Tax News

January 2012

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What's New and Other Important Information for 2011

Final Filing Date

Since Monday, April 16 is a legal holiday in Washington DC (Emancipation Day), California will accept returns and payments as timely if received on or before Tuesday, April 17.

Tax Decrease

The personal income tax rate decreased by 0.25 percent.

Dependent Exemptions Credit

The dependent exemption credit increased from $99 to $315 per dependent.

Child and Dependent Care Expenses Credit

The Child and Dependent Care Expense Credit is now nonrefundable.

Voluntary Contributions

Personal income taxpayers may contribute to the following three new funds:

- Municipal Shelter Spay-Neuter Fund.
- ALS/Lou Gehrig's Disease Research Fund.
- Child Victims of Human Trafficking Fund.

Estimated Use Tax Table

Personal income taxpayers may use the Estimated Use Tax Table in the 2011 California 540, 540A, and 540 2EZ Tax Booklets to report the use tax due on individual non-business items purchased for less than $1,000 each, instead of using the Use Tax Worksheet. This option is only available if taxpayers are permitted to report use tax on their income tax returns and taxpayers are not required to use the Use Tax Worksheet. Simply include the use tax liability that corresponds to the taxpayer's California Adjusted Gross Income and the taxpayer will not be assessed additional use tax on the individual non-business items purchased for less than $1,000 each.

Do not use the Estimated Use Tax Table to estimate and report the use tax due on purchases of items for use in business or on purchases of individual non-business items purchased for $1,000 or more each.

California Motion Picture and Television Production Credit

The credit, which is allocated and certified by the California Film Commission, is 20 percent of expenditures attributable to a qualified motion picture and 25 percent of production expenditures attributable to an independent film or a TV series that relocates to California.

The qualified taxpayer can:

- Offset the credit against income tax liability.
- Sell the credit to an unrelated party (independent films only).
- Assign the credit to an affiliated corporation.
- Apply the credit against qualified sales and use taxes.

Form FTB 3541, California Motion Picture and Television Production Credit.
Form FTB 3551, Sale of Credit Attributable to an Independent Film.

For more information go to ftb.ca.gov and search for **California Motion Picture and Television Production**.

2011 Corporation Tax Law Changes

California adopted and amended statutes that change how multistate corporations are taxed in California. The following areas of law have changed:

- **Market Assignment -** Requires a taxpayer to assign sales, other than sales of tangible personal property, based on market rather than costs of performance when a single-sales factor formula election has been made.
- **Finnigan Rule -** For taxable years beginning on or after January 1, 2011, the Finnigan Rule is adopted in assigning sales from tangible personal property. Finnigan refers to a method of calculating the sales factor numerator in a unitary group of corporations.
- **Gross Receipts -** The definition of gross receipts was amended.
    - "Gross receipts" means the gross amounts realized (the sum of money and the fair market value of other property or services received) on either of the following:
        - The sale or exchange of property.
        - The performance of services.
        - The use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss is recognized (or would be recognized if the

transaction were in the United States) under the Internal Revenue Code (IRC).

Amounts realized on the sale or exchange of property shall not be reduced by the cost of goods sold or the basis of property sold.

- **Doing Business** - A taxpayer is doing business if it actively engages in any transaction for the purpose of financial gain in California or if **any** of the following conditions is satisfied:
    - The taxpayer is organized or commercially domiciled in California.
    - The sales, as defined in Revenue and Taxation Code (R&TC) Section 25120(e) or (f), of the taxpayer in California, including sales by the taxpayer's agents and independent contractors, exceed the lesser of $500,000 or 25 percent of the taxpayer's total sales.
    - The real property and tangible personal property of the taxpayer in California exceed the lesser of $50,000 or 25 percent of the taxpayer's total real property and tangible personal property.
    - The amount paid in California by the taxpayer for compensation, as defined in R&TC Section 25120(c), exceeds the lesser of $50,000 or 25 percent of the total compensation paid by the taxpayer.
    - In determining the amount of the taxpayer's sales, property, and payroll for doing business purposes, include the taxpayer's pro rata share of amounts from partnerships and S corporations.

- **Single-Sales Factor Formula –** Any apportioning trade or business, other than an apportioning trade or business under R&TC Section 25128(b) such as certain taxpayers in agricultural, extractive, and financial areas, may make an irrevocable annual election on an original timely-filed return to apportion California business income using the single-sales factor formula. For more information, get Schedule R, Apportionment, and Allocation of Income.

For more information go to ftb.ca.gov and search for **2011 tax law changes**

New Schedule EO, Pass-Through Entity Ownership

The new schedule EO is developed for pass-through entities to report all pass-through entities in which the taxpayer holds ownership interests. In the past, we asked for that information in the form of a taxpayer statement. We also 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 to reduce processing time and errors.

Schedule EO (565) .
Schedule EO (568) .

Table 3, Partner's share of cost of goods sold, deductions, and rental income, added to Schedule K-1.

We added Table 3 to the Schedule K-1(565) for partnerships to report proportional cost of goods sold, ordinary deductions, real estate rental income, and other rental income, to all partnerships and limited liability companies taxable as partnerships. Table 3 also gathers information from the pass-through entity's own return as well as other Table 3s the entity receives. This facilitates the path of reporting to a limited liability company (LLC) subject to the LLC fee that will ultimately use the information to complete the LLC Income Worksheet.

Schedule IW, Limited Liability Income Worksheet

The Limited Liability Income Worksheet has been renamed as Schedule IW, Limited Liability Income Worksheet, and is now part of Form 568. It is no longer a separate attachment to Form 568. Making the Income Worksheet part of the Form 568 helps to make filing easier for taxpayers and faster processing for us.

Redesigned Tax Exempt Application Booklet

The Tax Exempt Application Booklet FTB 3500 has been redesigned to increase clarity in the language, flow of the booklet, and improve guidance.

Foreign Reduced Withholding

We began applying Federal Treasury Regulation 1.1446-6 procedures to reduce or eliminate withholding of California tax on effectively connected taxable income (ECTI) from California sources allocable to a foreign partner. The foreign partner must sign and send IRS Form 8804-C to the partnership. The foreign partner must sign and send Form 589 to the FTB along with a signed copy of IRS Form 8804-C. We will review the request within 21 business days. If the request is approved, the partnership should remit the reduced withholding amount to us along with Form 592-A.

Nonadmitted and Reinsurance Reform Act (NRRA)

Assembly Bill 315, effective July 21, 2011, conforms California law to the Nonadmitted and Reinsurance Reform Act (NRRA) that is part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This law was enacted by the federal government and authorizes the collection of tax on 100 percent of the premiums of California home state insured policies. If a person is determined to be a California home state insured, then all premiums related to all insurance policies obtained from a nonadmitted insurer are subject to tax, whether or not the insurance coverage is associated with California. The NRRA only allows one state to tax a home state insured, so proration of premiums among the states for taxation no longer occurs. For more information, get FTB Form 570.

Common Audit Issues and Recent Developments in the Like Kind Exchange Arena

As we begin 2012, one of our top audit issues continues to be like kind exchanges, also known as 1031 exchanges. Under IRC Section 1031 and conforming California laws, if certain conditions are met, taxpayers may defer gain from the sale of property, either in part or full. There are three general requirements:

- There must be an exchange, as opposed to a separate sale and reinvestment, by the same taxpayer.
- The relinquished property and replacement property must be "like kind."
- Both the property given up and the replacement property must be held for investment or for productive use in a trade or business. Property held for personal use or primarily for sale is generally not eligible for nonrecognition treatment.

If at any time during the exchange, the taxpayer or his agent has receipt or control of any portion of the sales proceeds, this will generally result in gain recognition. Along similar lines, if the taxpayer does not reinvest the full amount of proceeds into eligible replacement property, or obtains other property in the exchange (referred to as "boot"), this may also result in gain recognition. If the transaction is done in accordance with IRC Section 1031 regulations, a qualified intermediary will not be considered the taxpayer's agent.

The source of the original deferred gain on California property will remain with California, regardless of the location of the replacement property. When the replacement property is ultimately sold in a taxable transaction, the gain originally deferred on the California property will have its source in and be taxable by California.

Common Audit Issues

Common 1031 issues include:

- Sourcing of gains to California upon disposition of replacement property received in a California deferred exchange.
- Taxpayer receives other property (boot) in the exchange but does not report the boot on their return.
- Taxpayers do not meet identification or other technical requirements of IRC Section 1031.

- Relinquished and/or replacement property are not held for investment or for productive use in a trade or business (i.e. property is used for personal purposes or is held primarily for sale).
- The taxpayer who transfers relinquished property is a different taxpayer than the party who acquires replacement property.

We also continue to review certain "drop and swap" or "swap and drop" transactions. Not all of these transactions are ineligible due to varying facts and circumstances; however, where the form does not support the economic realities or substance of the transaction, we will recharacterize the taxpayer's transaction as appropriate.

Recent Developments

Recently, the Board of Equalization decided several notable, although noncitable, like kind exchange cases. The three cases are:

- Appeal of Frank and Mary Lou Aries, Appeal No. 464475 (swap and drop).
- Appeal of Gerald J. and Carol L. Marcil, Appeal No. 458832 (different taxpayer acquired replacement property, rehearing granted).
- Appeal of Howard Brief, Appeal No. 530872 (deemed contribution to a partnership).

The significance of these cases is that we are sustaining a taxable position where we have recharacterized the taxpayer's transaction to reflect the realities of the transaction.

Changes to Form 3506, Child and Dependent Care Expenses Credit

The 2011 Child and Dependent Care Expenses (CDC) Credit is no longer a refundable credit.

Senate Bill 86 made the CDC credit nonrefundable for tax years beginning on and after January 1, 2011, so the credit cannot reduce a taxpayer's liability below zero. See FTB Form 3506.

Qualifications for the CDC Credit

To assist your clients claiming the CDC credit and avoid processing delays, make sure all of the following eight qualifications are met:

1. Married taxpayers or registered domestic partners (RDP) must file a joint return to claim the credit. However, the credit may be claimed on a separate return if the:
   - Taxpayer lived apart from their spouse/RDP at all times during the last six months of 2011.
   - Qualifying person(s) lived in the taxpayer's home for more than half of 2011.
   - Taxpayer provided over half the cost of keeping up their home.

2. Care must be provided in California for one or more qualifying persons.
   - Any of the following can be a taxpayer's qualifying person :
     - A child under the age of 13 who meets the requirements to be the taxpayer's dependent as a Qualifying Child.
       - A child who turned 13 during the taxable year only qualifies for the credit for expenses incurred up to, but not including, the child's 13th birthday.
     - The taxpayer's spouse/RDP that was physically or mentally incapable of self-care.
     - The taxpayer's dependent, regardless of age, which was physically or mentally incapable of self-care.
     - Any person who was physically or mentally incapable of self-care and would have been the taxpayer's dependent except that:
       - They received gross income of $3,700 or more.
       - They filed a joint return.
       - The taxpayer or taxpayer's spouse/RDP with whom a joint return is filed could be claimed as a dependent on someone else's 2011 return.

3. The qualifying care expenses must be paid by the taxpayer so that the taxpayer (and spouse/RPD) could work (full-time or part-time), attend school full-time, or seek employment.
   - Qualifying care expenses include:
     - Expenses related to sending a child to a pre-kindergarten educational program such as nursery school or preschool.
     - Expenses related to sending a child to a before or after school program while the taxpayer is at work.
     - Day camp, even if it specialized in a particular activity, such as soccer.
   - Qualifying care expenses do **not** include:
     - Amounts paid for education (school tuition at the kindergarten level and above)
     - Expenses paid by, or reimbursed through, a subsidy program
     - Child support payments
     - Overnight camp expenses

4. The taxpayer (and spouse/RDP) must have earned income, be a full-time student, or be disabled during the year
   - Earned income includes wages, salary, tips, active duty pay, or net earnings from self-employment income.
   - Earned income does **not** include pensions, social security payments, worker's compensation, interest, dividends, capital gains, unemployment compensation, or public assistance.
   - If the taxpayer's spouse/RDP was a full time student or disabled, see page 4 of the instructions for Form 3506, Part III, line 5.

5. The taxpayer and the qualifying person(s) must live in the same home for more than half the year.
   - If the qualifying person lived with more than one person during the year, see the "Tie-Breaker Rules" table on page 1 of Form 3506 instructions.
   - When parents file separate returns, only one parent can claim the CDC credit, even if both parents paid for child care. See the rules on pages 1 and 2 of the Form 3506 instructions for rules for divorced, RDP terminated, separated, or never-married parents.

6. The care provider cannot be the taxpayer's spouse/RDP, parent of the qualifying child, or a person for whom the taxpayer can claim a dependent exemption.
   - If the taxpayer's child provided the care, the child must have been age 19 or older by the end of 2011.

7. All required information about the care provider(s) and the qualifying person(s) must be provided on Form 3506. Incomplete information may cause delay or disallowance.
   - The physical address (street address, city, state, and zip code) where the care was provided must be entered. Post office box addresses are not acceptable.

8. The taxpayer's federal adjusted income must be $100,000 or less.

Some More Ways to Help Prevent Reduction or Disallowance of the CDC Credit

We routinely audit CDC credit claims to verify the information provided on Form 3506 and the taxpayer's entitlement to the CDC credit. During this audit, the taxpayer may be asked to produce evidence to prove entitlement to the credit. We may also contact the care provider to verify the information provided. The following tips can help prevent a reduction or disallowance of the taxpayer's CDC credit:

- We recommend that taxpayers maintain accurate records which include identity records for the care provider (e.g. copies of driver's license and social security card), identity records for the qualifying persons (e.g. copies of birth certificate and social security card), and proof of payment for the care expenses (e.g. copies of canceled checks/money orders). Taxpayers should retain their records for at least seven years.

- Ensure that the contact information provided for the care provider on Form 3506 is accurate and up-to-date.

Online Business Registration Coming Soon

The Board of Equalization (BOE) will offer a new service called eReg that will allow businesses to register for a permit or license online for the tax and fee programs administered by the BOE.

The new eReg system will be implemented in early 2012. eReg will provide you an easy, quick, and accurate method of registering your business. No more filling out paper applications! The new system will also create efficiencies and generate cost savings for California.

eReg will guide you through the process whether or not you know what type of registration you require. Answers to questions regarding your business activity will determine the appropriate registration type(s) required.

As implementation approaches, details regarding the new system will be available on BOE's website, boe.ca.gov.

CTEC Update on Continuing Education Requirements

California Senate Bill 944 takes effect January 1, 2012, which revises the hourly breakdown of continuing education requirements for tax preparers registered with the California Tax Education Council (CTEC).

Starting this year, CTEC-registered tax preparers (CRTPs) must complete a minimum of 15 hours federal and five hours state of continuing education each year. Prior to the legislative change, CRTPs were required to complete 12 hours federal, four hours state, two hours ethics, plus two hours federal and/or state of continuing education each year.

The goal of the legislative change was to conform CTEC federal continuing education requirements to the new Internal Revenue Service requirements.

Starting January 1, 2012, the IRS is requiring nonexempt tax preparers to complete 15 hours of federal continuing education each year (three hours of federal tax law updates, ten hours of other federal tax law, plus two hours ethics). Nonexempt tax preparers, including CRTPs, must also pass an IRS competency exam and background check by 2013.

Attorneys, certified public accountants, and enrolled agents are exempt from the new IRS continuing education and exam requirements.

Online Services

MyFTB Account - Individuals

We've made some changes to MyFTB Account to benefit you and your clients. New features include:

- Displays zero balance tax year information
- Advises if taxpayer has a mandatory e-pay requirement
- Advises if we have a returned mail indicator on the taxpayer's account (taxpayers only, not available for tax professionals.)

Also it's been brought to our attention there is some confusion with the manner estimated tax payments are displayed. Estimated tax payments made on joint accounts are generally reflected in full for each taxpayer.

Example:
A 2010 tax return is filed by Taxpayer A and Taxpayer B using the Married/RDP Filing Jointly status. A $1,000 credit from the 2010 return is carried forward to the 2011 tax year. The June 2011 estimated tax payment of $2,000 was not submitted as a joint payment; it only had Taxpayer A's social security number. The September estimated tax payment of $3,000 was submitted using both taxpayers' social security numbers. MyFTB Account reflects:

Taxpayer A

Type	**Amount**	**Date**	**Tax Year**
Estimate Payment	$3,000	09/15/11	2011
Estimate Payment	$2,000	06/15/11	2011
Transfer from 2010	$1,000	04/15/11	2011

Taxpayer B

Type	**Amount**	**Date**	**Tax Year**
Estimate Payment	$3,000	09/15/11	2011
Transfer from 2010	$1,000	04/15/11	2011

In this example, the transfer from 2010 of $1,000 and the joint estimate payment of $3,000 are reflected on each taxpayer's MyFTB Account. Both taxpayers are legally entitled to these credits, and if the taxpayers file separately in 2011, they must decide how to divide these credits. Although both the $1,000 transfer and $3,000 estimate payment are reflected on each taxpayer's account, the total joint credit amount available for use by either party is $4,000 and use of any of this $4,000 credit by either taxpayer will deplete the credit available to the other taxpayer. For example, if Taxpayer A and Taxpayer B file separate 2011 tax returns, and Taxpayer B reports estimate payments/credits of $4,000, the joint credits have been exhausted by Taxpayer B and the only credits available to Taxpayer A would be the $2,000 paid in June.

The estimated payment made only to Taxpayer A's account is only available to Taxpayer A. If Taxpayer A and Taxpayer B file a joint return, total estimated tax and other payments available are $6,000. (Joint Transfer of $1,000 + Joint Estimated Payment of $3,000 + Separate Estimated Payment of $2,000.)

Use caution to correctly report the amount of estimated tax and other payments available when filing your clients' returns since joint payments are reflected on each taxpayer's account. Also make sure to include each taxpayer's account information when submitting joint payments.

MyFTB Account – Business Entities

You and your clients can use MyFTB Account to view estimated tax payments online. Estimated payment information is available for corporations (including exempt organizations), Limited Liability Companies (LLCs), and partnerships. To view your client's account you must complete a onetime registration. For more information, go to MyFTB Account for Businesses.

Web Pay - Individuals

Web Pay is FTB's online system for making electronic payments. On January 3, 2012, we are rolling out a set of major improvements that will make Web Pay much easier to use. See the article, Major Improvements to Our Web Pay, for more details.

Web Pay – Business Entities

Web Pay is now available for corporations, partnerships, and LLCs. After a one-time registration process, businesses can make online payments, 24 hours a day, 7 days a week. Businesses can pay today or schedule a payment up to one year in advance. We do not charge for this service. Go to Web Pay for Businesses

If your clients use Web Pay, do not mail the paper payment vouchers. Currently, businesses cannot make real estate, resident/nonresident, or backup withholding payments through Web Pay. Use Web Pay for Individuals when making a payment for group nonresident/composite returns.

Not Registered Yet?

In order to access your client's MyFTB Account you first need to complete a one-time registration, to create your Tax Professional account. Once you have created your account, you login and with your client's permission, use information from a previous year's tax return to view their MyFTB Account. You no longer need to retrieve and use your client's Customer Service Number.

More than 230,000 customers, including 23,000 tax professionals, have registered to use this service.

Based on feedback from customers experiencing problems during registration, here are some things to remember about registration:

Username, Password, Security Questions, and Answers

- Select your own username and password – **make sure you remember them**.
- Select three security questions and answers – **make sure you remember them**.
- **We recommend that you write them down and keep them in a secure place**.

Confirmation Email

- We send you an email after registering. You have to click on the link in the email within 72 hours of registering. If you do not do this your account is not activated.
- Some email providers can take several hours to deliver new emails to your inbox.
- If you do not see the confirmation email in your inbox, check your spam folder.

Assistance Choosing a Role

- You must choose a role when you register. You can add additional roles after you have initially created an account. You will be able to add additional roles after you have created your account. You can register for just one role or all three roles. You can register as:
    - An individual - To view your personal tax account information.
    - Business entity – If you work for a corporation, partnership, or LLC and plan to make payments on behalf of the business.
    - Tax professional - To view your clients' tax account information.

Assistance Adding a Role

- Login to your account.
- Select "Add another role."
- Follow the prompts.

For additional information, see [How do I add another role?]()

Preparer Tax Identification Number (PTIN) (Tax Professional Identification Number)

- Verify the PTIN, EFIN, CPA or CTEC number you enter during registration is correct. We found that the practitioners who experienced difficulty during registration entered the wrong professional identification number.
- The Board of Accountancy only provides us with licensing information for CPAs who were issued their license in California. If you are a CPA in another state you will not be able to use your CPA number when registering. You will need to use a different number such as your PTIN or EFIN.

Hardware and Browsers we support

- Handheld devices
  - We currently do not support mobile operating systems for the registration process. Mobile phones, iPads and other tablets accessing the internet using iOS, Android, or Windows Phone 7 are not supported either.
- Older browser versions
  - Make sure your browsers and operating systems are current. See our Browsers We Support page for further information.
  - If your browser is not compatible with our system, you will need to upgrade your current version or download a different browser.

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e-filing

We Now Allow Year-Round and Previous Year Individual e-filing

We allow year-round individual e-filing. We no longer shut down our individual e-file program after October 15. We also support e-filing of certain previous year returns through individual e-file. Check with your e-file Software Provider to see if they support these individual e-file features.

Business Entities

For taxable years on or after January 1, 2011, we offer e-filing for exempt homeowners associations and exempt political organizations filing Form 100, California Corporation Franchise or Income Tax Return. Check with your software providers to see if they support business e-filing.

Beginning mid-July 2012, we will offer e-filing for exempt organizations filing Form 199, California Exempt Organization Annual Information Return.

Permission to Access MyFTB Account

You shared many positive stories of how helpful the information provided by us in MyFTB Account is to taxpayers and tax professionals, especially being able to view the estimated payment information when preparing returns.

As filing season approaches, we want to remind tax professionals that although you may possess the tax return information needed to access your clients' MyFTB Accounts, you should also have their permission. Permission is between you and your client. Our permission is not required.

How tax professionals choose to gain permission is a personal choice. Some potential ways to obtain permission might include:

- Using Form FTB 3520, Power of Attorney.
- Using IRS Form 2848, Power of Attorney
- Using Form FTB 743, Online Account View Access Authorization.
- Having clients sign and date a Client or Engagement letter that includes permission language.

Remember that because this is an agreement between you and your clients, you should retain the permission agreement in your files. Only the Power of Attorney Form FTB 3520 must be submitted to us. Do not mail Form FTB 743 to us, as it was created merely to assist you in obtaining and confirming a client's permission.

For a copy of the Form FTB 743, Online Account View Access Authorization, go to ftb.ca.gov and search for **FTB 743**. If you choose to use this form, keep in mind that the authorization remains in effect until your client revokes it in writing. So, you may want to get former clients to give you written revocation for your files when an FTB 743 was previously used.

Major Improvements to Our Web Pay

Web Pay is our online system for making electronic payments. On January 3, 2012, we are rolling out a set of major improvements that will make Web Pay much easier to use.

The first significant change is that both individual and business taxpayers can access Web Pay directly once they've logged in to MyFTB Account. No additional authentication will be required. Once the taxpayer has logged in to their account, they can take advantage of three new features:

Save information for future payments – Taxpayers will be able to save information they use to make a Web Pay. They will be able to save bank account information for two accounts that they can use for future payments. Individual taxpayers can save spouse/RDP information, too. Also, since the taxpayer is already in MyFTB Account they no longer have to input their mailing address. (Individual taxpayers can update their address information in MyFTB Account.)

View scheduled payments – Taxpayers can view all Web Pay requests made on or after January 3. The payments will be displayed in three groups – pending, processed, and canceled.

- Pending means we have not sent the request to the taxpayer's bank. These payments can be canceled if the taxpayer needs to make changes or reschedule the payment.
- Processed means we have sent the request to the taxpayer's bank. We also provide links back to MyFTB Account to verify the payment has been applied. If the bank rejects the payment request, we will display the reason.
- Canceled shows payments the taxpayer has canceled. This provides confirmation that the payment request was not sent to the taxpayer's bank.

Cancel pending payments – Taxpayers will be able to cancel payments that we show as "pending" in our system. They can usually cancel a payment up until noon on the scheduled payment date. To ensure the payment's cancelation, it's advised the cancelation take place no later than two business days before the scheduled payment date. If the taxpayer needs to change the account they're using, the amount of the payment, or the date the payment will be made, they will need to cancel the payment and complete a new payment request.

Individual taxpayers still have the option to access Web Pay without registering for MyFTB Account. They can log in with their social security number and last name, as they do now, but they will not be able to use any of the new features. If they need to cancel a payment, they will need to contact our e-Programs Customer Service Unit at 916.845.0353, TTY/TDD 800.822.6268, at least two business days before the scheduled payment date. We encourage all taxpayers to register with MyFTB Account so they can take advantage of the new features in Web Pay and manage their payments.

Alert Taxpayers to Errors in Reporting Income Exclusions for Disability Payments

We received many amended returns that incorrectly exclude what is properly taxable income reported on the Form 1099-R.

We are concerned about the volume of amended returns that we are receiving that reduces taxable income based upon exclusion under IRC Section 104. The IRC provides for the exclusion of income received due to personal injuries or sicknesses. Included in this exclusion are amounts for personal injuries or sickness resulting from active service in the armed forces.

Tax exempt income from the Department of Veterans Affairs (VA) is generally not reported on a Form 1099-R, box 1-gross distributions ,and therefore does not need to be calculated and excluded on the taxpayer's income tax return.

On many of the amended returns we are receiving, the taxpayer or tax representative is using the taxpayer's VA service-connected disability rating to reduce taxable income. A taxpayer's VA disability rating is the measure of the extent of a taxpayer's disability and is stated as a percentage. This percentage equals a specific dollar amount. It is not a factor to be multiplied against income to determine excludable income.

Another problem we are seeing with the amended returns and documentation provided is that the VA service-connected disability rating is not retroactive nor has the rating changed. Therefore the 1099-R issued for military retirement pay has already been reduced by any VA disability payments.

As a way for the taxpayer or tax representative to verify the accuracy of the amount reported on the 1099-R when a change has occurred they can use the Retiree Account Statements provided by Defense Finance and Account Service (DFAS) form DFAS-CL 7220/148 for the corresponding period and look under the "pay item description" section for the VA waiver amount which should correspond to your VA disability rating amount.

If you believe the current year 1099-R incorrectly reports income that should be excluded, please seek a corrected 1099-R.

In the case where the taxpayer's disability rating has been retroactively changed and corrected forms are not available, please include all supporting documentation with your filing. This documentation needs to include but is not limited to the VA's decision for service-connected compensation which specifically identifies the rating decision along with the effective dates and form DFAS-CL 7220/148 for the incorrect months before and after the change occurred.

For more information see Internal Revenue Service Publication 525, Taxable and Nontaxable Income.

Taxpayers' Bill of Rights Hearing Summary

On December 1, 2011, the Franchise Tax Board held its annual Taxpayers' Bill of Rights Hearing along with a regularly scheduled board meeting. Practitioners and taxpayers were invited to submit issues in writing and could also request time to address the board during the meeting to present their issue. Here are a few of the items presented to the board.

Conformity – This continues to be an issue for California taxpayers. This year, the board heard recommendations for California to consider an expansion of areas of automatic conformity to defined subchapters or parts of the IRC.

Litigation – A taxpayer and several members of his bankrupt company testified that if the services of city, county and state governmental agencies in California were denied until such time as an entity is in full compliance with the tax laws, we would see its ability to collect revenues due the state increase significantly.

Mandatory E-Pay Waiver – A suggestion was made to allow for waiver of the mandatory e-pay requirement where a taxpayer is disabled and cannot meet this requirement.

IRS Ruling on Mello Roos – A request was made for us to obtain a written ruling from the IRS that sets forth when a Mello-Roos property tax assessment is deductible and when it is not.

Practitioner Hotline Upgrade – Practitioners urged us to implement the Virtual Hold Technology (VHT) service on the practitioner hotline due to long wait times experienced by practitioners.

These are just a few of the issues we heard this year. The Taxpayers' Rights Advocate's goal is to review and address each one of these issues as well as all of the issues received in writing, and respond by February 1, 2012. Our responses will be posted on our website.

Earned Income Tax Credit Can Put Money in Your Client's Pocket

Your client could be eligible to get more money back from the IRS - as much as $5,751. If your clients earned less than $49,078 from wages, self-employment, or farming last year, they may qualify for the Earned Income Tax Credit (EITC).

EITC is a financial boost for working people in a recovering economy. Your clients may be among the millions who will qualify for the first time because their financial, marital, or parental status changed in 2011.

Eligibility is based on several factors, including the amount of earned and other types of income, or combined income if married, whether you have qualifying children and how many workers without children may also qualify.

Four of five eligible people claim and get their EITC. Use IRS's online EITC Assistant to see if your client qualifies. If so, file and claim the credit to get it.

Free help is available at volunteer income tax assistance sites. Locate a volunteer site by calling your community's 211 or 311 number for local services or call the IRS at 800.906.9887.

Tax News Flashes

We flashed the following article on December 15:

Upcoming Live: Free California Source Income Withholding Webinar

We will host a free California source income withholding webinar in December 2011.

The topic is: Nonresident Independent Contractor Withholding.

We designed this webinar for those who must withhold on California source income payments to resident and nonresident independent contractors. We will look at:

- The basics of nonresident withholding.
- Backup withholding.
- A three-phase summary of withholding and what to do:
  - Before payment (Forms 587, 588, 589, 590).
  - At the time of payment.
  - After payment (Forms 592, 592-V, 592-B).
- Updates on our new electronic Form 589.
- The consequences of noncompliance.
- Withholding resources and contact information you can use any time.

Date/Time: Tuesday, December 20, 10 a.m. PST.
Duration: Approximately 35 minutes.

Register here Registration takes only a few minutes. Space is limited.

Ask the Advocate

Taxpayers' Bill of Rights Annual Report Available

Each year the Taxpayers' Bill of Rights requires me to provide my findings of areas where FTB can improve its operations and services to taxpayers to the California Legislature. I do this in my Taxpayers' Bill of Rights Annual Report to the Legislature.

Areas of improvement are primarily identified during my interactions with the tax professional community and from submissions into our Systemic Issues Management System (SIMS). My constant interaction with the tax professional community during my frequent presentations, the annual Taxpayers' Bill of Rights Hearing, and Advisory Board meetings, allow me to hear firsthand what issues, concerns, and challenges taxpayers face and the impact of tax legislation. Furthermore, when I combine the information gained from my tax professional interactions with submissions into our SIMS, I am able to stay apprised of the effects that law changes, FTB's policies, processes, and procedures have on taxpayers.

In this year's report, I discuss issues, areas of concern, and challenges that both the taxpayers and FTB face regarding the following issues:

- Auditor Retention
- Collections
- Conformity
- Late State/Federal Legislation
- Tax Liens
- Investigations Transparency
- Penalties
- Education and Outreach

A complete copy of the 2011 Taxpayers' Bill of Rights Annual Report to the Legislature is available at ftb.ca.gov. Search for **2011 Annual Report**.

If you would like to report a systemic issue, go to ftb.ca.gov and search for **systemic**. Systemic issues:

- Affect multiple taxpayers.
- Relate to FTB systems, policies, and/or procedures.
- Involve protecting taxpayer rights.
- Reduce or prevent taxpayer burdens.

Steve Sims, EA
Taxpayers' Rights Advocate

Follow me on Twitter at twitter.com/FTBAdvocate.

Event Calendar

Education and Outreach			
Speaking Engagements and Small Business Fairs			
January 2012			
Date	**Event Association**	**Subject Matter**	**Location**
3	California Society of CPAs	CA Tax Updates	Woodland Hills
3	San Fernando Valley Discussion Group	CA Tax Updates	Van Nuys
5	IRS Seminar	CA Tax Updates	Escondido
6	IRS Seminar	CA Tax Updates	San Bernardino
7	IRS Seminar	CA Tax Updates	Santa Barbara
10	IRS Seminar	CA Tax Updates	Torrance
11	IRS Seminar	CA Tax Updates	Irvine
12	IRS Seminar	CA Tax Updates	Los Angeles
13	IRS Seminar	CA Tax Updates	Burbank
14	Philippine Institute of CPAs Seminar	CA Tax Updates	San Francisco
24	CA Society of Enrolled Agents	CA Tax Updates	Fairfield
24	CA Society of Accountants and Tax Preparers	CA Tax Updates	Oakland
25	Society of CA Accountants	CA Tax Updates	Arcadia
25	Society of CA Accountants	CA Tax Updates	San Rafael

February 2012			
Date	**Event Association**	**Subject Matter**	**Location**
15	Cal CPA	CA Tax Update	West LA
28	UC San Francisco	Nonresident/Foreign Scholars	San Francisco
March 2012			
Date	**Event Association**	**Subject Matter**	**Location**
9	International Education Center	Nonresident/Foreign Scholar	Riverside

Enterprise. Data. Revenue!

Announcing External EDR Webpage

We are introducing our new EDR project webpage. Through this webpage, taxpayers will be able to see how they will benefit from the EDR project, get an overview of the revenue projection, and watch a brief video about the project.

Criminal Corner

Fake CPA, Partner Sentenced for Bogus Investment Scheme

A Glendale tax preparation business owner and his colleague were each sentenced to five years in state prison and ordered to pay $1.3 million restitution after pleading guilty to their roles in a bogus investment scheme.

Donald R. Ford, of Glendale, and Gregory A. Edwards, of Culver City, were sentenced on November 30, on multiple felony charges including financial elder abuse, grand theft, false statements in the offer or sale of a security, and filing of a false state income tax return related to a bogus securities investment scheme.

Ford persuaded senior citizen clients, whose trust he had gained from his tax preparation business, to invest in a phony investment scheme. Ford, who posed as a certified public accountant, and Edwards scammed investors by promising them high rates of return on investments. Instead, Ford and Edwards used the money on personal expenses and to fund a lavish lifestyle, which included luxury cars and expensive vacations.

Ford earned more than $1.3 million in income from the unlawful scheme and Edwards earned more than $961,000 for his role in the scam. Ford failed to report this income on his 2005, 2006, and 2007 state income tax returns and Edwards failed to report his income on his 2005, 2006, and 2007 state income tax return. All income is taxable including income from illegal sources.

The pair is scheduled to surrender January 30, to begin their prison sentences.

Los Angeles County Superior Court Judge Robert J. Perry handed down the sentence November 30, in Department 104 of the Clara Shortridge Folz Criminal Justice Center. California Department of Justice (DOJ) Deputy Attorney General, Edward Skelly prosecuted this case. This is a joint investigation between DOJ and us.

CPAs are licensed by the state. The public can check on the status of a CPA with the California Board of Accountancy at www.cba.ca.gov or by calling 916.263.3680. We and the IRS have issued a brochure, FTB Publication 982, How to Select an Income Tax Return Preparer where taxpayers can learn more about choosing a tax professional.

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

Inside FTB

Interagency Intercept Collection (IIC) Program Expanding

We implemented a pilot program to expand the IIC program to offset income tax refunds for C corporations, S corporations, general partnerships, limited partnerships, limited liability limited partnerships, limited liability companies treated as partnerships, limited liability companies treated as corporations, and exempt organizations with unrelated business income beginning January 2, 2012.

We administer the IIC program on behalf of the State Controller's Office for individual tax refunds, lottery winnings, and unclaimed property payments to apply to state and local debts. More than 300 agencies participate in the program including Board of Equalization and the Employment Development Department.

Nineteen city, county, and state agencies will participate in the year-long pilot. The pilot will then be evaluated for full implementation in the future.

Government Code Sections 12419.2, 12419.3, 12419.5 and 12419.7 authorizes the IIC program.

The following notices will be sent to entities notifying them of the intercept:

- Pre Intercept Notice – Participating agencies send this notice at least 30 days prior to referring debts to the IIC program.
- FTB Form 5947D, Zero Balance Refund Return Information Notice with FTB Form 5949, Return Information Notice Explanation.
- FTB Form 4141B, Agency Offset Notice.

Refer entities that received a notice regarding intercept funds to:

- Interagency Intercept Desk at 916.845.5344.

- FTB/Intercept Desk
  PO Box 2966 MS A-460
  Rancho Cordova, CA 95741-2966

Big Business

Contractors Can Now Operate as LLCs

Beginning on January 1, 2012, the Contractor State License Board is authorized to issue a contractor's license to a limited liability company (LLC). This will allow LLCs to render services that may be lawfully rendered only pursuant to a license, certificate, or registration.

Generally, LLCs are not allowed to be used for certain businesses subject to professional licensing requirements. However, as is now the case for contractors, amendments to the law allow specific businesses with licensing requirements to form and operate as an LLC. This change to the Business and Professions Code and the

Corporations Code for contractors was enacted on September 30, 2010, in Senate Bill (SB) 392. For more information and other requirements for contractors, see SB 392.

It is important for contractors to know what their filing requirement will be should they decide to operate as an LLC.

For California income tax purposes, an LLC with more than one member will be classified as a partnership and an LLC with a single individual member will be classified as a sole proprietorship/disregarded entity, unless the LLC chooses to be classified as a corporation for income tax purposes. California treats the LLC, and its owners, in the same manner the LLC is treated for federal tax purposes.

LLCs classified as partnerships or disregarded entities and organize in California, register in California, or conduct business in California must file California Form 568, Limited Liability Company Return of Income. The return must be filed by the 15th day of the fourth month after the close of the LLC's taxable year. They are also required to pay an annual tax of $800, and may be subject to an LLC fee based on total income from all sources derived from or attributable to the State of California. The annual tax is due by the 15th day of the fourth month of the taxable year, and is paid using FTB 3522, Limited Liability Company Tax Voucher. The estimated LLC fee is due by the 15th day of the sixth month.

In addition, an LLC filing Form 568, which has members who are not residents of California, must file FTB 3832, Limited Liability Company Nonresident Members' Consent with Form 568. FTB 3832 is signed by the nonresident individuals and foreign entity members to show their consent to California's jurisdiction to tax their distributive share of income attributable to California sources. The LLC must pay the tax for every nonresident member that did not sign a FTB 3832 and are subject to a withholding requirement on distributions of income made to nonresident members.

LLCs classified as a corporation and organize in California, register in California, conduct business in California, or receive California source income, must file California Form 100. The California Form 100 must be filed by the 15th day of the third month after the close of the LLC's taxable year. The LLC will be taxed at the corporate tax rate of 8.84 percent and will be subject to a minimum tax of $800.