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Tax Credits Abuse – Be on Alert!

We recently noticed taxpayers filing returns (original or amended) claiming carryover credits they never earned to reduce current tax liabilities. Claims for credits have long been repealed, but eligible taxpayers who have carryover balances are still allowed to claim the carryover amounts from prior years.

> **Example:** You prepared a return for your client that showed total tax of $5,000. Later, someone else approaches your client offering to help them reduce the total tax to $3,500 for a fee of $300. They advise your client to report $1,500 carryover credits (e.g., political contribution credit carryover or solar energy credit carryover). To your client, this appears to be a great deal. However, upon further investigation, you determine your client was never entitled to those credits.

Be aware of this trend and advise your clients they may only claim credits they earned. We disallow any improper credits and may impose any applicable penalties.

For a complete list of current and valid California tax credits, go to ftb.ca.gov and search for **individual tax credits.**

Exempt Organization e-file Now Available

Currently, Exempt Political Organizations and Homeowners' Associations who file the Form 100 California Corporation Franchise or Income Tax Return for taxable years beginning on or after January 1, 2011, can e-file their returns.

Beginning July 2, 2012, exempt organizations who file the Form 199 California Exempt Organization Annual Information Return for taxable years beginning on or after January 1, 2011, will be able to e-file their returns.

Business e-file allows business taxpayers to e-file returns for the following form types:

- Form 100, Corporation Franchise or Income Tax Return (**New** — Now includes exempt political organizations and homeowners' associations)
- Form 100S, S Corporation Franchise or Income Tax Return
- Form 100W, Corporation Franchise or Income Tax Return — Water's-Edge Filers
- Form 100X, Amended Corporation Franchise or Income Tax Return
- Form 199, Exempt Organization Annual Information Return (**New**)
- Form 565, Partnership Return of Income

- Form 568, Limited Liability Company Return of Income

Contact your software provider to find out if they support e-file for exempt organizations and file the Form 199 or Form 100. Stay tuned to our website and **Tax News** for more information about our business e-file program.

Time to Purge Our Files

It is the time of year to purge individual taxpayer information. According to our document and data retention policy for individual taxpayers, we started purging individual taxpayer data in June.

We recognize the public's concern about privacy and the increasing amount of information we collect and use. To address these concerns, we adopted the Information Privacy Principles for Individuals. These principles, based on the California Information Practices Act, demonstrate our commitment to protect and use individual taxpayer's information responsibly. Specifically, the data retention principle states that we retain information only as long as necessary to address our business needs for that information for it.

The guidelines state we retain tax year information for seven years from the due date of the return, seven years from the date the return was filed, or, in the case of an open audit issue, four years from the resolution date, whichever is later.

Our data retention policy informs taxpayers that we delete their old data for their protection and security.

New Contracts for Private Collection Agencies

As we covered in our November 2011 issue, we contract with private collection agencies to collect delinquent California personal income tax debts that are not economical for our collectors to pursue. In addition to other legal provisions governing this collection program, we are allowed to contract with at least one private collection agency—or more. On May 1, 2012, we awarded contracts to Continental Services Group, Inc, dba ConServe, and Premiere Credit of North America, LLC. These agencies collect tax debts from individuals inside California. For more information, go to ftb.ca.gov and search Private Debt Collection.

Head of Household Audit Questionnaires Coming in July

The 2011 Head of Household (HOH) season is just around the corner. Beginning in mid-July we will begin mailing the HOH audit questionnaires. This year we expect to mail approximately 120,000 HOH Audit letters for the 2011 tax year. If you have clients who receive an audit letter, advise them to respond by the letter's due date to avoid the Failure to Furnish Information Penalty.

HOH audit staff will review the completed questionnaires to determine if taxpayers qualify for the HOH filing status. If the audit letter questionnaire is incomplete, or provides conflicting information, we will contact the taxpayer to resolve the issue. Once we confirm the HOH filing status, we will mail an acceptance letter to the taxpayer. Acceptance letters only apply to the specific tax year examined and will not qualify the taxpayer for any other tax year.

Taxpayers who fail to respond to the questionnaire or whose responses indicate they do not qualify for HOH, can expect a Notice of Proposed Assessment that disallows their HOH filing status.

Taxpayers who receive a 2011 HOH audit questionnaire can complete it in any of the following ways:

- Go to ftb.ca.gov and search for **hoh web response** to find the HOH Audit Letter Web Response page. They will need their social security number and the FTB ID listed at the top of the letter. Using this method of responding will expedite questionnaire processing. Encourage your clients to use this method.
- Fax the completed questionnaire, and any supporting information to **866.223.8195**.
- Mail the completed questionnaire in the enclosed pre-addressed envelope.

You and your clients can go to our HOH webpage get more information about the HOH filing status, and access the HOH Web Response Application.

IRS Nationwide Tax Forums

Tax Forums registration is now open! Join tax professionals from across the country for three days of the latest tax law information, hands-on workshops, networking opportunities, and exhibits of the newest products and services to improve your business.

In 2012, the IRS Nationwide Tax Forums will visit the following cities:

Orlando, FL – June 19 - 21
Atlanta, GA – July 10 - 12
San Diego, CA – July 17 - 19
Las Vegas, NV – July 31 - August 2
Chicago, IL – August 21 - 23
New York, NY – August 28 - 30

Take advantage of this great opportunity to receive up to 18 CPE credits, network with your peers, learn from subject matter experts from the IRS and from our national association partners, or receive assistance on your most difficult case on site.

$211 Preregistration
$201 Members of Partner Associations
$340 Onsite or Late Registration

For more information or to register, please visit the Nationwide Tax Forum website.

Tax NewsFlashes

We flashed this article on June 19:
Return Information Notices (RIN) - Why They're Issued, and How to Prevent Them!

Join us for a webinar on June 26.

Register Now

Space is limited.

Do you know the most common reasons why we issue a RIN? Would you like to learn how to prevent the issuance of a RIN?

Join us for a free webinar and get the information you need.

The webinar is developed for individuals, businesses, and government entities.

Title: Return Information Notices (RIN) - Why They're Issued, and How to Prevent Them!

Date: Tuesday, June 26, 2012

Time:10 AM - 11 AM PDT

After registering you will receive a confirmation email containing information about joining the webinar.

System Requirements

PC-based attendees
Required: Windows® 7, Vista, XP or 2003 Server
Macintosh®-based attendees
Required: Mac OS® X 10.5 or newer

Ask the Advocate

Corporate Penalty for Failure to File Returns

In this month's Inside FTB column, we address our ongoing efforts to bring business entities current with their California filing requirements. Under California law, corporations in good standing with the California Secretary of State are allowed an automatic extension to file without the need to file a written request if its return is filed within the extension period. For corporations the automatic extension is seven-months. However, if a nonqualified, suspended, or forfeited corporation doing business in California does not file a tax return within 60 days after we send them a legal demand (i.e. FTB 4684 or FTB 4685, Demand for Tax Return) to file their corporate return, we will impose a $2,000 penalty per tax year (Revenue and Taxation Code (R&TC) Section 19135), in addition to other penalties, including the penalty for failure to file after notice and demand imposed pursuant to R&TC Section 19133.

With the amendments to R&TC Section 23101 that add specific conditions (threshold tests) for "doing business" in California for taxable years beginning on or after January 1, 2011, more out-of-state (foreign) corporations will have a California filing requirement.

As a result of this law change, a corporation is doing business in California if it actively engages in any transaction for the purpose of financial or pecuniary gain or profit in California or if **any** of the following conditions are satisfied:

- The nonqualified corporation is commercially domiciled in California.
- Sales of the nonqualified corporation in California, including sales by the corporation's agents, independent contractors, combined with any pro rata or distributive share of sales from pass-through entities exceed $500,000. California sales of $500,000 or less will also cause the nonqualified corporation to be considered to be doing business if they exceed 25 percent of the nonqualified corporation's total sales.
- The nonqualified corporation has real and tangible personal property, combined with any pro rata or distributive share from pass-through entities, in California over $50,000. California property of $50,000 or less will constitute "doing business" or if it exceeds 25 percent of the corporation's total real and tangible personal property.
- The nonqualified corporation paid California compensation, combined with any pro rata or distributive share of compensation from pass-through entities, over $50,000 (or over 25 percent of the total compensation).

When you consider whether or not a business entity has California sales for purposes of the above threshold test be sure to apply the new sales factor rules, including the Market-Based Rules for Sales Other Than Sales of Tangible Personal Property (Regulation 25135-2) for assigning sales **as if** the business entity made had made an election to use the new single sales factor apportionment method.

Steve Sims, EA
Taxpayers' Rights Advocate

Follow me on Twitter at twitter.com/FTBAdvocate.

Event Calendar

As part of our education and outreach to our tax professional community, we participate in many different presentations and fairs. We now provide a combined-calendar to show the events we are attending as well as other events happening with us such as interested party and board meetings.

EDR Enterprise. Data. Revenue!

EDR in the News

EDR's First Year is a Success!

We successfully completed the first year of the 66-month EDR Project and are on target to exceed our projected revenue of $65 million. We accomplished this through early initiatives designed to increase efficiencies and effectiveness in our compliance programs.

We attribute our success during this first year to many key elements which are present in most successful projects:

- Extensive Planning
- Clear Scope
- Realistic Budget
- Effective Schedule Management
- Strong Focus on Organizational Change Management

We believe the EDR Project will give us the opportunity to provide better service, reduce taxpayer burden, and make significant progress toward reducing the Tax Gap. Overall, the project goals align with our organizational goals.

We strategically planned the project for a few years prior to kick off. We understand that a critical component to a successful large project includes identifying and resolving well-defined business problems. We began this effort with a business problem analysis study before the feasibility study report to ensure we had measurable, clearly-defined business objectives that would help close the tax gap, and address our system limitations.

We often hear about other large IT projects that fail. Many fail because they assumed too much risk, did not have well-defined business problems that everyone understood, and/or did not use a contract model that effectively aligned the goals of the State and Solution Provider.

We believe the EDR Project will continue to succeed because:

- The EDR Project modernizes our systems and processes. It does not include a full system replacement.
- The EDR Project uses a phasing strategy for the roll-out of all new solution components. The phasing strategy is designed to slowly implement the components in steps, with each step building on the previous steps.
- The EDR Project uses a benefits based payment model. This means that payments to the contractor are based on the benefits that the State receives. If the State does not receive benefits, the contractor does not receive payments.

We implemented an Organizational Change Management Program to obtain critical stakeholder buy-in to support the success of the EDR Project.

Criminal Corner

Father and Son Team Sentenced for Fraud and State Tax Evasion

In February, we ran an article regarding the arrest of Chet Taylor, 71, and his son Adam Taylor, 41, a father-and-son team who ran Montecito Motors, a high-end used-car dealership that abruptly closed in 2010 amid suspicions of criminal activity. According to the Santa Barbara Independent, they pleaded no contest to 46 total felony charges of conspiracy, grand theft, and tax evasion, part of a plea deal that will mean lengthy prison terms for both.

They were also charged with forging signatures, filing false tax returns, and misleading creditors. Chet will be sentenced next month to 13 years in state prison. Adam will be sentenced to 11 years. Sarah Taylor Swing, Chet’s daughter, and his wife, Jennifer Taylor, pleaded guilty to one count each of misdemeanor tax evasion and were ordered to pay restitution and fines.

The District Attorney's Office estimates the Taylors stole $1.2 million from 27 of their customers over a period of six or so years. At a hearing scheduled for June 21, a judge will tally what each victim is owed. Adam, the official owner of Montecito Motors, was ordered by Judge Clifford Anderson to pay the state $2.28 million in unpaid business sales tax and $2.9 million in business income tax which dated as far back as 1998.

However, it is unlikely that the state or Taylors' customers will be paid anytime soon. During a two-year investigation with us, California Board of Equalization, and the District Attorney, determined no assets were available to seize.

Inside FTB

Thousands of Businesses Contacted to File Tax Returns

We are contacting more than 100,000 California business entities that have not filed their 2010 state income tax returns.

Businesss we contacted will have 30 days to file a tax return or show why there is no filing requirement. Businesses that do not file tax returns or demonstrate they are not required to file will receive a tax assessment based on income and other information reported to us.

We annually review more than 5 million income records received from the IRS, the Employment Development Department, the State Board of Equalization, financial institutions, and city business tax information. We match this information against state records to identify noncompliance. Through last year's efforts, we collected approximately $21 million from businesses that failed to file tax returns.

More information on these notices is available, go to ftb.ca.gov and search for the Bills and Notices page and select Respond to request or demand for tax return.

Businesses can request more time to respond, retrieve information to assist them in filing a tax return, request tax forms, learn about payment options, sign up to receive an email reminder to file, and much more. Information is also available by calling 866.204.7902.

Big Business

Suspended/Forfeited Business Entities Revivors

Did you know suspended/forfeited business entities continue to accrue tax, along with penalties and interest until the business entity is formally cancelled?

Until the business entity formally terminates their legal existence, the entity continues to exist. Likewise, their filing and annual tax requirements continue to exist. Not filing timely tax returns or paying the annual tax usually leads to the business entity getting suspended or forfeited by us. Once we suspend or forfeit the business entity, the business entity no longer has any rights or privileges and the Secretary of State (SOS) cannot accept termination documents until the entity is revived to good standing.

When a business entity forms in California or qualifies to do business with the SOS, the entity continues to have an obligation to file and pay taxes. Left unresolved, a suspended or forfeited business entity can accumulate a substantial amount of tax, penalties, fees, and interest which need to be paid before the entity can be formally terminate or resume doing business in California.

The cost depends on the business entity's actual facts and business type. The following is an example of the amounts:

Example: In this example, all business entities were assumed to only owe the minimum tax. Each entity was suspended for failure to file and pay their annual/minimum tax for the tax year 2009, and was owned by two shareholders/members, with no payments made, including estimate payments. This chart also assumes that each entity did not receive a notice and demand penalty pursuant to Revenue and Taxation Code (R&TC) Section 19133, non-qualified, suspended, or forfeited penalty pursuant to R&TC section 19135, or had a filing enforcement fee imposed. Other penalties may apply. To be revived the entity will need to file and pay all taxes, penalties and interest currently due by August 1, 2012, and file a Form 3557, Application for Certificate of Revivor. This chart does not include all filing fees or costs for expedited services by us or SOS.

Year	**Corporation**		**S Corporation**		**Limited Liability Company (LLC)**	
2009	Tax:	$800	Tax:	$800	Tax:	$800
	Delinquent Penalty:	200	Delinquent Penalty:	200		
					Underpayment/monthly:	200
					Member Penalty:	100

	Estimate Penalty:	35	Estimate Penalty:	35		
	Interest to 8/1/12:	94	Interest to 8/1/12:	94	Interest to 8/1/12:	115
	Subtotal:	**$1,129**	**Subtotal:**	**$1,129**	**Subtotal:**	**$1,215**
2010	Tax:	$800	Tax:	$800	Tax:	$800
	Delinquent Penalty:	200	Delinquent Penalty:	200		
					Underpayment/monthly:	152
	Estimate Penalty:	29	Estimate Penalty:	29		
			Shareholder Penalty:	$432	Member Penalty:	$432
	Interest to 8/1/12:	51	Interest to 8/1/12:	51	Interest to 8/1/12:	71
	Subtotal:	**$1,080**	**Subtotal:**	**$1,512**	**Subtotal:**	**$1,454**
2011*	Tax:	$800	Tax:	$800	Tax:	$800
	Delinquent Penalty:	200	Delinquent Penalty:	200		
					Underpayment/monthly:	$104
	Estimate Penalty:	25	Estimate Penalty:	25		
			Shareholder Penalty:	180	Member Penalty:	144
	Interest to 8/1/12:	15	Interest to 8/1/12:	15	Interest to 8/1/12:	36
	Subtotal:	**$1,040**	**Subtotal:**	**$1,220**	**Subtotal:**	**$1,084**
Totals		**$3,249**		**$3,861**		**$3,743**

We assess a failure to comply late filing penalty for each shareholder or member of the S-Corporation or LLC (in addition to the other applicable penalties) required to be filed with the return. This penalty is applicable to S corporations beginning with returns required to be filed after January 1, 2011. Also as of January 1, 2011, the penalty increased to $18 per shareholder or member, for each month or fraction of the month the return is late or incomplete, up to a maximum of 12 months. Prior to January 1, 2011, the penalty was $10 per month per member for each month the return was late or incomplete, up to a maximum of five months.

Although we can waive both types of late filing penalties for reasonable cause, to get the business entity revived the penalties need to be paid. If the business entity can show they meet the reasonable cause exception, they need to file a written request to get the penalties waived.

* A business entity must be revived on or before the original due date of the return to avoid late filing penalties. A suspended or forfeited business entity loses its powers, rights, and privileges has no an extension of time to file its return.

The Revivor Process

The revivor process starts with a phone call to our Revivor Unit at 888.635.0494 to determine what your client needs to do to bring their corporation or LLC into compliance (aka “good standing”).

Mail-In Revivor

After you contact us, we send you or your client:

- Written revivor requirements.
- Application for Certificate of Revivor.
- Information on contract voidability.

It takes approximately six weeks to process the revivor request once we receive the entity’s information.

After a one-time registration process, you can use Web Pay for Businesses to make corporation, partnership, and LLC payments online. Businesses can make payments 24 hours a day, 7 days a week.