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## **Take a Quick Survey to Help Us Help You!**

We invite you to participate in a quick, three-minute online survey related to the [Tax Professionals](#) section of our website. We intend to use the information we gather to update this section to better meet your needs as you serve your clients. The [survey](#) will be available online from October 18, 2012, through November 15, 2012. Completing the survey today improves your website for tomorrow.

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## **Keeping Good Records of Your Credits**

California has many credits that California taxpayers and businesses may benefit from. Tax laws regarding tax credits are always changing, but there are tax credits qualified taxpayers can use to reduce their tax liability. Since tax credits directly reduce a qualified taxpayer's tax liability, they can save your clients more than a tax deduction. For example, for taxable years beginning on or after January 1, 2012, and before January 1, 2017, California has a new Donated Fresh Fruits or Vegetables Credit, as an alternative to claiming a deduction. Qualified taxpayers who make a qualified donation of fresh fruits or fresh vegetables to a California food bank and received the required certificate acknowledging the donation will be able to claim a credit equal to 10 percent of the costs, as specified. Any unused credit may be carried over and used in the following seven years.

Tax credits are usually enacted as incentives to do something, like encourage business investments and promote the creation of new jobs. For example, California's New Jobs Credit which allows small business owners, who had 20 or fewer employees on the last day of the previous taxable year, to claim a credit for each additional full-time employee hired. California allocated \$400 million for this tax credit. As of October 6, 2012, the cumulative total amount of New Jobs Credit generated on personal income tax and business entity tax returns filed and processed is \$133,963,239. This credit is allocated on a first-come, first-served basis up to \$3,000 for each additional full-time qualified employee.

Now is the time to make decisions to take advantage of tax credits. When it comes to tax credits one thing they all have in common is the need to retain the proper documentation/records for the tax credits you want to claim.

Good tax planning would include looking ahead at what credits your client may qualify for and determine what records you should keep that will support the tax credit they plan to claim in the upcoming year.

## **Keeping good records helps you**

Having a good recordkeeping system which you keep up-to-date will help you:

- Keep track of qualified expenses.
- Save time and accountancy costs.
- Pay the correct amount of tax.
- Receive the correct amount of benefits or credits.
- Avoid paying any extra tax or penalties.

## **The records you need to keep**

The sort of records you need to keep depends upon the type of tax credit you plan to claim.

## **How to keep your records**

The law does not say how you must keep your records. You must keep some original paper documents which show that tax has been deducted. You can keep all original documents; however, records can be kept electronically (on a computer or any storage device, such as disk, CD, memory stick, or microfilm) as long as the method you use:

- Captures all the information on the document (front and back).
- Allows the information to be presented to us in a readable format, if we need to see it.

## **How long to keep your records**

As a general rule, you should keep your records for as long as you have credit available to be used plus a minimum of four years (in addition to the year a credit amount is claimed).

## **California's 15-Day Rule - What is it and How Does it Work?**

### **Short Tax Year**

California law (R&TC Sections 17936, 17946, 17948.2 and 23114) contains provisions that operate to provide relief to business entities (limited partnerships, limited liability partnerships, limited liability companies, and corporations) from the general requirement to pay the annual/minimum tax.

A business entity is not subject to the \$800 annual/minimum tax if the entity:

- Did not conduct business in the state during the tax year.
- The tax year was 15 days or less.

The short tax year of 15 days or less rule is explained in FTB Publication 1060, Guide for Corporations Starting Business in California. And when it comes to corporations, if the rule qualifies for the short-year 15-day rule, this period of time will also be disregarded for purposes of determining the corporation's first year minimum tax waiver (see October 2012 and August 2011 Tax News for more information).

### **Entity Conversions**

Under California law, a business entity may be able to convert its legal form into another business entity type by filing the necessary paperwork with the Secretary of State (SOS), such as when a limited partnership converts into a limited liability company.

An entity that converts into another entity is effectively the same entity that existed before the conversion, except for tax purposes.

The converting entity ends its tax year on the date of conversion, while the converted entity does not begin its tax year until the next day.

The 15-day rule does not normally apply to entities involved in a conversion because they are usually continuously doing business during the both periods involved, so both the converting and converted entity will each have a filing requirement.

### **Fractional Month**

Unlike the short tax year discussed above, when it comes to determined due dates for payment and filing, every day counts, and a fractional month counts as a full month. California's laws due dates are normally determined based on the 15<sup>th</sup> day of a specified month. For example, individuals and corporations generally have a requirement to make estimated tax payments on the 15<sup>th</sup> day of the 4<sup>th</sup>, 6<sup>th</sup>, and 9<sup>th</sup> month of the tax year and the 15<sup>th</sup> day 1<sup>st</sup> month following the end of the tax year. Tax

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returns are generally due on either the 15<sup>th</sup> day of the 3<sup>rd</sup> or 4<sup>th</sup> month after the close of a tax year depending on the type of tax return filed. Limited liability companies are required to pay their \$800 annual tax on or before the 15<sup>th</sup> day of the 4<sup>th</sup> month of its tax year. Taxpayers who fail to timely file or make payments by the required dates are generally subject to penalties and interest.

We have been receiving inquiries from taxpayers who have received a bill for penalties and or interest, wanting to use a 15-day rule to disregard a month within a longer tax year. When it comes to counting months for a tax year (that is more than 15 days), there is no 15-day rule in the law. Any fraction of month counts as a full month whether it is at the beginning of a tax year, like the start of a new business, or at the end of a tax year.

For newly-formed LLCs, the \$800 annual tax payment is due and payable by the 15<sup>th</sup> day of the 4<sup>th</sup> month after the LLC registers with the California SOS or the date it begins doing business, if business began before it registers with the California SOS. Any portion of a month is considered a full month for calculating the annual tax payment due date.

Example: LLC1, a newly-formed LLC, organizes as an LLC and registers with the California SOS on June 18, 2012. LLC1 begins doing business in California on August 14, 2012. Since LLC1 registered on June 18, 2012, the annual LLC tax is due by September 15, 2012 (by the 15<sup>th</sup> day of the 4<sup>th</sup> month). LLC1's annual tax payment for taxable year 2013 is due by April 15, 2013. If LLC1's fiscal year (June 1, 2013 – May 31, 2014) the annual tax payment for taxable year 2013, is due by September 15, 2013. The annual tax payment is due with Form FTB 3522, LLC Tax Voucher.

Based on your input that our instructions are unclear when it comes to counting a short formation month as the first month we will add language and an example to the 2012 Form 568, Limited Liability Return of Income.

## **Ask the Advocate**



### **CSEA Annual Meeting**

On September 21 2012, we held our annual liaison meeting with the California Society of Enrolled Agents (CSEA). This year, like every year, they had some really great questions for FTB staff. I've decided to share a few of questions I thought our Tax News readers would find most interesting in my Ask the Advocate column this month.

#### **Question 1:**

Please provide any progress towards FTB's ability to accept amended and prior year returns through e-file.

#### **Response 1:**

**Amended returns:** Software providers have indicated they will not support e-file for CA amended returns (FTB 540X) until the IRS begins allowing federal amended returns (IRS 1040X) to be e-filed. Therefore 540X returns will be implemented at the same time the IRS implements e-file of 1040X returns. At this time the IRS has not set a definitive date, but currently is planning to implement the 1040X in January 2015, at the earliest.

**Prior year returns:** FTB currently supports e-filing of two prior tax years in addition to the current tax year. Tax preparers should check with their software provider to see if they support e-filing of prior years.

#### **Question 2:**

Our members reported that taxpayers, who have filed tax returns and failed to claim real estate withholding on Form 593-B, even in situations where FTB has been able to confirm receipt of these funds as credits on the taxpayer account, are not refunding these amounts unless an amended return with Form 593 B is filed with FTB requesting the amount. Is this correct information? Shouldn't the withholding be included on a Return Information Notice (RIN) and refunded in the normal processing of the original return?

**Response 2:**

FTB eliminated Form 593-B beginning with tax year 2008. Real estate withholding is reported on FTB Form 593, Real Estate Withholding Tax Statement, when escrow is completed.

To claim the withholding credit, the taxpayer should:

- Report the sale or transfer as required on their appropriate tax return.
- Enter the withholding amount from Form 593, on the appropriate line designated for real estate withholding on the tax return. Attach a copy of Form 593 to the lower front of the tax return, Side 1.

If the real estate sale or transfer is reported on an original return but the taxpayer fails to claim the withholding credit on that return, the subsequent request is a refund claim under Revenue and Taxation Code (R&TC) Section 19322. We request the taxpayer file an amended return to properly report the credit to ensure accurate processing and to preserve the taxpayer's administrative appeal rights if the claim is denied. We understand the concerns with time and costs associated with filing an amended return. Our system generates a RIN when an error on the return results in an adjustment during processing. The taxpayer will not receive a RIN when real estate withholding is omitted because our current systems are not able to associate unclaimed withholding with the tax return during processing. We are working to improve our systems and current practices and expect to have the ability to notify taxpayers of any unclaimed withholding credits at the end of 2013 or early 2014. These are estimated dates, pending available resources.

**Question 3:**

CSEA was pleased to see FTB 2012 Legislative Proposal C, which seeks to reenact expired R&TC Section 21004, authorizing the FTB Taxpayer Advocate to waive penalties and other additions to taxes for FTB errors. If this provision is reenacted effective January 2013, could you explain the correct procedure for a taxpayer to apply for this relief with the Taxpayer Advocate's office?

**Response 3:**

On September 17, 2012, the Governor signed AB 2686. Accordingly, the procedures for requesting equity relief will be similar to the existing process for requesting an abatement of interest. Specifically, taxpayers will make requests for equity relief in writing.

The request for equity relief will include:

- Taxpayer's name.
- Social security or entity identification number.
- Taxpayer's address.
- Tax year and type of relief requested.
- An explanation of why relief should be granted.
- Signature, title, if applicable, and date.

We are presently creating a form, similar to FTB 3701, that may be used to make requests or equity relief.

Mail request to:

EXECUTIVE AND ADVOCATE SERVICES  
FRANCHISE TAX BOARD MS A381  
PO BOX 157  
RANCHO CORDOVA CA 95741-0157

Fax request to: 916.845.6614

**Question 4:**

Members have reported that an FTB procedure allows for corporate revivors of suspended corporations before full payment is received. This includes processing delinquent franchise tax returns, concluding with installment payment arrangements. Please clarify your revivor practice, including timing for revivor with/without all delinquent returns and full payment.

**Response 4:**

Generally, suspended corporations or LLC's (entity) are required to file all missing returns and pay all amounts due as a condition of being revived to good standing. (R&TC Sections 23305 and 23305.1)

However, if collection of the full amount cannot be secured because of the suspension, collection staff has the discretion to consider reviving the entity to good standing without full payment to allow the entity to receive funds or other assets used to pay any amounts due in full. (R&TC Section 23305b) A specific future source or method of collection must be identified and secured and the entity must provide any documentation to support the decision to revive the entity that is requested. Under this procedure, an entity may be revived without full payment, however all missing returns must be filed. If there is a financial hardship, an installment agreement may be approved with this procedure.

Estimated revivor turnaround time once a complete request is received:

Revivor request by mail	Up to 6 weeks
Revivor request by telephone	Up to 2 weeks
Revivor request at the field office	Up to 2 weeks
Rush "walk-through" revivor*	Same day
Discretionary revivor (R&TC Section 23305b)	Up to 10 days

\*Rush walk-through revivor is available in the Sacramento, Oakland, San Francisco, Santa Ana, Los Angeles, and San Diego field offices. A fee of \$56 applies for corporations. There is no fee for LLC's at this time. All requirements must be received in the field office by 2 p.m., 1 p.m. for Los Angeles. To expedite processing, please call 888. 635.0494 to obtain up-to-date revivor requirements prior to your visit to our field office.

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

Follow me on Twitter at [twitter.com/FTBAdvocate](https://twitter.com/FTBAdvocate).

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## 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.



## **Enterprise. Data. Revenue!**

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### **EDR in the News**

#### **Successful Implementation of EDR Release 1.0**

On September 30, we successfully implemented [EDR Release 1.0](#). Release 1.0 uses new technology and equipment that makes our return and payment processes more efficient. For instance, our four new scanners are faster and allow us to scan more types of returns and attachments.

We implemented Image Cash Letter (ICL). ICL allows us to electronically deposit checks into our bank accounts instantly by transmitting electronic images of the checks to our bank. Our new deposit process allows us to make many electronic deposits throughout the day versus one deposit per day.

On December 31, 2012, we will kick-off EDR Release 1.0.1. This release expands the types and volumes of returns and payments that we are scanning.

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### **Inside FTB**

#### **New Tax News Live Video – Avoid an Estimate Penalty**

We partnered with California Society of Enrolled Agents Education Foundation to produce our latest new video. Our newest video, [Avoid an Estimate Penalty](#), gives tips to tax professionals for when their clients should pay estimated tax payments. For other products, go to our [products page](#) at [ftb.ca.gov](http://ftb.ca.gov).

## **Criminal Corner**

### **Los Angeles Tax Professionals Arrested for Illegal Tax Schemes Costing State \$7.6 Million**

A Cerritos CPA and Los Angeles attorney were arrested on felony charges of conspiracy and tax evasion.

((\*\*\*\*\*)), 53, and ((\*\*\*\*\*)), 51, each own one-third of Kruse Mennillo, LLP. According to our special agents, ((\*\*\*\*\*)) and ((\*\*\*\*\*)) allegedly promoted an abusive tax avoidance transaction (ATAT) to more than 100 clients during the years 2002-2005. The fraudulent activity cost the state more than \$7.6 million in tax liability.

They each face three felony counts of aiding in the preparation of false state income tax returns and one felony count of conspiracy. Each tax count carries a maximum sentence of three years in state prison.

They instructed their clients to utilize an ATAT involving the creation of Nevada corporations and Roth IRA or Employee Stock Option Plans (ESOP) as the sole shareholders. The ATAT was formed with a series of related transactions with no valid business purpose other than tax evasion.

((\*\*\*\*\*)) and ((\*\*\*\*\*)) were recently arrested and both pleaded not guilty at their arraignments.

Los Angeles County Deputy District Attorney (Major Fraud Division), Lana Kim is prosecuting the case.

Legislation enacted in 2003 and 2011 provided us with more enforcement tools to crack down on abusive tax shelters, such as increasing the time period to conduct audits, greater registration requirements, and increased penalties for both investing in and promoting illegal tax shelters.

Our audit program identified and referred this case to the department's criminal investigation program. We continue to attack the use of abusive tax shelters, which costs California hundreds of millions in lost revenue.

NOTE: ((\*\*)) = Indicates confidential and/or proprietary information that has been deleted.

## **Big Business**

### **Short Period Return Due Date**

What is a short period return and when is it due? Let's start with defining a short period tax year as. It is any period of less than 12 months. The circumstances that would generally result in a "short period" return to be filed with California are:

- When a federal return for a period of less than 12 months is required.
- When there is an accounting period change. In such case, the return shall be made for the short period beginning on the day after the close of the former taxable year and ending at the close of the day before the day designated as the first day of the new taxable year.
- A business entity exists for only part of what would otherwise be its taxable year.
- When an S corporation election is terminated during its year. The corporation must file two short-period returns. Each short-period return is deemed a separate tax year, and both will generally be subject to the minimum franchise tax.

Although California does have a paperless extension that allows the tax return to be filed later, for most business entities, except limited liability companies, tax is generally due on either the 15<sup>th</sup> day of the 3<sup>rd</sup> or 4<sup>th</sup> month after the close of a tax year depending on the type of tax return being filed. Therefore, the tax for short period corporate return generally will be due on the 15th day of the 3rd month after the close of the short-period tax year, unless provided otherwise in the law.

For more information, see FTB Publication 1060, Guide for Corporations Starting Business in California at [ftb.ca.gov](http://ftb.ca.gov).