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File Early, File Often!

Yes, you read it correctly! With the filing season upon us, unscrupulous individuals will file as many fraudulent refund tax returns as possible prior to legitimate taxpayers filing their returns. These fraudsters may modify their own tax return or use another individual's information (identity theft), fabricating wages, withholding, or other information in order to obtain a refund.

The Fraud and Discovery Section (FADS) implemented an effective prevention and detection program. FADS detected $78.5 million in attempted fraud during the 2012 calendar year, including $14.4 million in identity theft. Even with these results, fraudsters continue to test the system looking for weaknesses. We use multiple methods to limit fraudulent activities, such as:

- Verify all W-2 data by matching Employment Development Department data with tax returns.
- Utilize computer data enhanced modeling techniques for early detection.
- Compare historical tax return data for discrepancies.
- Contact businesses for employment verification.
- Manually review all questionable tax returns.
- Research informant referrals.
- Monitor questionable tax preparers.

Although we have fraud detection criteria in place, we suggest you use some of the following techniques to alleviate challenges associated with personal income tax fraud.

- Create the "perception of detection." Send a message to your clients that you actively look for fraud. Increase the perception that fraud will be detected, and it will substantially lessen the likelihood of its occurrence.

- Provide fraud awareness training to your staff; keep them informed about fraudulent activities.

- Know your client.
    - Have you done business with the individual before?
    - Does your client live or work near your office or have they traveled a significant distance?

- Scrutinize W-2s.
    - Is all pertinent information (social security number, federal/state employee identification numbers, state disability insurance, wage and withhold information, etc.) available?
    - Are multiple clients using W-2s with the same employer for wages and withholding? (Look for patterns.)

  - Are W-2 forms typical for that employer or have they been downloaded from the Internet?

- Confirm employment information.
  - Have you verified that the social security numbers are correct?
  - Is your client familiar with what their employer does and where the company is located?
  - Does your client know what they do for a living?
  - Are wages reasonable for the type of work performed and time on the job?

- Question dependent information.
  - Is your client familiar with their children's names, ages, or birthdates?
  - Does your client know the name, address, and phone number of their dependents care provider?

- Review business deductions.
  - If your client is claiming business income, do they have records to substantiate associated deductions?
  - Does it appear that business deductions are overstated and are they typical for the specific business?

Early detection is critical as inaccurate data may impact you, your client, and us. With this in mind, share questionable activities with FADS. It enables us to expedite the tax refund process and prevent the release of erroneous refunds.

If you have concerns, fax copies of questionable W-2s and your contact information to **916.843.6034**. Our goal is to confirm the validity of W-2s within 24-48 hours.

Additional precautions you may take before you transmit the tax return include:

- Contact the employer.
- Use MyFTB Account to:
  - Obtain California wage and withholding information.
  - Verify estimate payments before filing tax returns.
  - View FTB-issued 1099-Gs and 1099 INTs.
  - View recent payments applied to accounts.

To accomplish this, go to **ftb.ca.gov** and search for **MyFTB Account.**

State Wants to Return $14 Million in Undelivered Tax Refunds

We are holding more than $14 million in returned state income tax refunds.

This year, the US Postal Service returned nearly 48,000 tax refunds, ranging from $1 to $35,000. A taxpayer who moved and failed to update their address is the main reason refunds are returned.

To update your address, go to Access MyFTB Account feature on our website. We reissue returned tax refunds automatically once we receive a new address.

Taxpayers who expect a state tax refund or are unsure if they received their tax refund, can access our Check Your Refund Status. We offer this service in both English and Spanish.

We encourage taxpayers to use direct deposit when filing their tax returns. Direct deposit is a fast and secure method to receive your tax refund within days rather than waiting weeks for a paper tax refund. This year, more than 6 million California taxpayers received more than $6.2 billion directly into their bank accounts through direct deposit.

Information Directory Updated

When you need a phone number or a web, email, or location address, refer to our recently updated FTB 1240, *California Franchise Tax Board Information Directory.* This compact online listing contains a wealth of contact information.

Webinar: Tax Filing Tips for New Business Owners

Are you a new small business owner getting ready to file taxes for the first time? Or are you looking to start a new business in 2013? This free webinar covers important employer and tax compliance topics such as:

- Selecting a tax practitioner.

- Record-keeping and reporting tips.
- Differentiating between employees and contractors.
- Electronic filing systems.
- Important deadlines.
- Links to important resources and information.

Featured speakers:
Brenda Voet, Technical Assistant to the Advocate, Franchise Tax Board
Jimmy Wong, Employment Tax Consultant, Employment Development Department

Registration is required at no cost.

Date/Time: Thursday, January 10, 2013, 10 a.m. PDT
Duration: Approximately 60 minutes.
Hosted by: Office of State Controller, John Chiang

REGISTER NOW

FTB Audit Issues – First in a Series

Over the next few months, we will publish articles that focus on common audit issues for both individual and business entity taxpayers. This month, we focus on individual taxpayers.

Some of the most common tax audit issues currently affecting personal income taxpayers are:

1. Sale of property through Internal Revenue Code (IRC) 1031 exchanges.
2. Schedule D securities transactions.
3. Rental real estate losses.
4. Residency.
5. Head of Household (HOH).

Sale of Property Through an IRC 1031 Exchange
We continue to identify IRC Section 1031 tax issues (Like-Kind-Exchange) including erroneous boot calculations, improper property identifications, and "drop and swap transactions."

Schedule D Securities Transactions

Common audit issues involving Schedule D securities transactions include overstated stock basis, unreported option premium income, and regulated futures contracts.

Rental Real Estate Losses

Generally, losses from passive activities, including rental real estate, may be deducted only up to the amount of income from passive activities. Any excess loss is carried forward to the following year or years until the interest in the activity is disposed in a fully taxable transaction. In some cases, a taxpayer may classify rental activities as nonpassive for federal purposes. However, for California purposes rental activities are generally considered passive, with a few exceptions.

Residency

We continue to audit residency issues. The determination of a taxpayer's residency status is a facts and circumstances issue. In making this determination, we consider where the taxpayer has the closest connections and whether or not they receive substantial benefits and protection from California.

HOH Filing Status

We continue to see adjustments where the qualifying individual's income exceeds the gross income test of $3,700. We also see inconsistent reporting of HOH for Registered Domestic Partners (RDP). For tax years 2007 and later, RDPs must file their California income tax returns using either the Married/RDP filing jointly or Married/RDP filing separately filing status. An RDP may qualify to use the HOH filing only if the requirements are met to be considered not in a registered domestic partnership.

Accurately reporting the filing status for your HOH clients could prevent future correspondence or adjustments.

Power of Attorney Form Revised

We completely revised FTB 3520, Power of Attorney to improve the flow and provide you additional guidance for completing it. We also made changes in preparation for the implementation of Enterprise Data to Revenue (EDR). Here are the major changes to the form:

Joint Tax Returns

In keeping with federal requirements, joint filers must now complete and submit a separate FTB 3520, Power of Attorney Declaration (POA), for each spouse/registered domestic partner. Any joint designations filed by couples prior to this change will remain valid. In addition, we will continue to process a joint POA filed on an older version of FTB 3520.

Revised Taxpayer Information Sections

We revised the taxpayer information section to make it easier for you to identify your individual, business entity, or fiduciary relationship client.

Authorization for all Tax Years or Income Periods (Also known as Super Box)

Your clients can now authorize you to represent them for **all** matters with us regardless of income or tax year. This authority automatically expires four years from the date your client signs the POA or from the date they file a new POA that revokes this authorization.

Additional Checkboxes Added to Additional Privileges

We added checkboxes to help your client identify specific acts you may perform on their behalf.

Expanded Instructions

We expanded the instructions to provide you with additional guidance to complete the form.

State Controller's Unclaimed Property

California's Unclaimed Property Law requires corporations, businesses, associations, financial institutions, and insurance companies (referred to as "Holders") to annually **report** and deliver property to the State Controller's Office after there has been no activity on the account or contact with the owner for a period of time specified in the law. The most common types of unclaimed property are:

- Wages and commissions.
- Vendor payments.
- Bank accounts and safe deposit box contents.
- Stocks, mutual funds, bonds, and dividends.
- Uncashed cashier's checks and money orders.
- Certificates of deposit.
- Matured or terminated insurance policies.
- Estates.
- Mineral interests and royalty payments.
- Trust funds and escrow accounts.

Index Brackets for Doing Business in California

In our September 2012 Tax News, we released the 2012 state tax brackets for Personal Income Tax. Brackets are "indexed" each year by adjusting them to reflect changes in the California Consumer Price Index (CPI). For taxable years beginning on or after January 1, 2012, the conditions for determined "doing business" also have been "indexed" by California's CPI.

This year, the inflation factor increased 1.9 percent.

Also required to be indexed are the threshold requirements of California Revenue and Taxation Code (R&TC) Section 23101 which defines doing business in California. The new indexed amounts for tax years beginning on or after January 1, 2012, are:

Taxpayer's Threshold	Old Amount	Indexed Amount
Property	$50,000	$50,950
Payroll	$50,000	$50,950
Sales	$500,000	$509,500

R&TC Section 23101 as modified now provides that if a taxpayer satisfies **any** of the following conditions, they are doing business in California:

- The taxpayer actively engages in any transaction in California for the purpose of financial or pecuniary gain or profit.
- The taxpayer is organized or commercially domiciled in California.
- If the taxpayer's sales, as defined in subdivision (f) of R&TC Section 25120, including sales by the taxpayer's agents and independent contractors, exceeds the lesser of $509,500 or 25 percent of the taxpayer's total sales.
- The taxpayer's real and tangible personal property in California exceeds the lesser of $50,950 or 25 percent of the taxpayer's total real and tangible personal property.
- The amount paid in California by the taxpayer for compensation, as defined in subdivision (c) of R&TC Section 25120, exceeds the lesser of $50,950 or 25 percent of the total compensation paid by the taxpayer.

Furthermore, when we determine the amount of the taxpayer's sales, property, and payroll for doing business purposes, we include the taxpayer's pro rata share of sales, property, and payroll from partnerships, LLCs treated as partnerships, and S corporations.

Providing Specific Information about Your Client is Important

Whether you call our 800 number, our tax practitioner line, or use our new Live Chat service, we often ask if your inquiry is regarding a personal income tax or business entity matter. We ask in order to connect you with the appropriate staff.

California law and filing requirements differ depending whether you are an individual, partnership, limited partnership, limited liability company (LLC), corporation, or S corporation.

For example, we initially are asked, “What tax forms will a partnership need to file?” But as the conversation progresses, we find the question should have been, “What tax forms will an LLC that is doing business in California need to file?”

In general, an LLC, owed by two or more members, without an election to be taxed as a corporation, is treated as a partnership. For federal tax purposes the LLC files a Form 1065, U.S. Return of Partnership Income. For California, LLCs, doing business in California, generally need to file our Form 568, Limited Liability Company Return of Income. The LLC’s income would flow-through and be reported by its members as if the income were from a partnership. Under California law LLCs are subject to an annual tax of $800, are required to pay any nonconsenting nonresident member’s tax, and are potentially subject to a fee if the LLC’s total income (defined as gross income plus the cost of goods sold) and attributable to California is $250,000 or more. Our Form 568 and instructions help guide the LLC through the process of determining these liabilities.

Besides the forms you need to file, how to file, the kinds of documentation your clients need as support, other requirements or allowances differ depending whether a taxpayer is taxable under California’s personal income tax laws or under California’s corporation tax laws. Personal and corporation tax laws differ for depreciation, interest income, illegal activity, and some tax credits.

In order for us to serve you best, the more specific your information, the better we can assist you. If you have a general question, give Live Chat a try rather than calling in.

Live Chat handles nonaccount personal income tax and business entities question, and is so much better than waiting on hold. To get real-time answers to general questions about income tax rules and general collection questions, go to ftb.ca.gov then click on the Live Chat button.

For specific account resolution issues for your clients, call us at our Practitioner Hotline at (916) 845-7057.

Ask the Advocate

Taxpayers' Bill of Rights Annual Report to the Legislature

Each year the Taxpayers' Bill of Rights requires me to provide my findings to the California Legislature areas where FTB can improve its operations and services to taxpayers. 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
- Protests
- Customer service

For a complete copy of the 2012 Taxpayers' Bill of Rights Annual Report to the Legislature, go to ftb.ca.gov, and search for **2012 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

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 Release 1.0.1

We implemented EDR Release 1.0.1 on December 31, 2012. This release is the second of nine primary releases for the EDR Project.

This release expands our technology and processes for enhanced data capture and equipment introduced during Release 1.0, making our tax return and payment processes more efficient.

With EDR Release 1.0.1, we will:

- Scan all pages, schedules, and checks received with most paper-filed personal income tax returns, excluding 541s.
- Capture full images and about 40 percent more data from these tax returns and checks.
- Deposit checks electronically via Image Cash Letter (ICL).

We are capturing full images of the returns and checks, allowing us to eliminate paper and speed up processing.

Inside FTB

Taxpayers' Bill of Rights Hearing Update

On December 5, 2012, 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:

Amended Tax Returns and Mandatory e-payment – Once a taxpayer becomes subject to the mandatory electronic payment requirement, all payments of tax, penalties, and interest for any year must be made electronically. (R&TC Section 19011.5) However, if a taxpayer files an amended tax return and makes the payment electronically, we will likely refund the payment before the amended tax return is processed.

Withhold-at-Source Education and Outreach – Additional education and outreach on California's nonresident and backup withholding requirements is still necessary in the small business community.

Disaster Treatment Simplification and Improved Timing – California disasters (whether presidentially-declared, governor-declared or both) require follow-up legislation in California to secure disaster loss treatment on California tax returns.

Conformity – A recommendation was made to restore a process to achieve a date change and for us to take ownership of the issue.

Criminal Corner

Rancho Palos Verdes CFO Sentenced to 5 Years in Prison for Embezzling More Than $1 Million

The one-time chief financial officer of a popular southern California restaurant chain was sentenced to five years in prison for embezzling more than $1 million and failing to pay his personal state income tax.

James Edward Cram, 54, pleaded guilty in November 2011 to one count of grand theft and one count of filing a false state income tax return. According to court documents, Cram embezzled more than $1 million from 2006 to 2010. He also failed to file his state income tax returns for these same years. Cram owes the state over $200,000 in unpaid tax, interest, penalties, and the cost of the investigation. All income is taxable including income from illegal sources.

Cram is a former executive for a restaurant chain with more than 10 locations throughout southern California. The company employed Cram from 2006 to 2010 before they suspected he was embezzling funds.

Los Angeles Superior Court, Judge Thomas Sokolov, handed down the sentence in Department 4 of the Torrance Superior Courthouse. The judge ordered Cram, who has been in custody since October 2011, to serve the remainder of his sentence in the Los Angeles County Jail.

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

Big Business

Single Sales Factor Election to Taxpayers Meeting Special Apportionment

For taxable years beginning on or after January 1, 2011, and before January 1, 2013, apportioning taxpayers are allowed to elect to apportion their income using the single sales factor. Proposition 39 now requires the use of the Single Sales Factor method of apportioning income to be used for tax years beginning on or after January 1, 2013. We received many questions regarding these law changes and to clarify taxpayer's situations. The following is an example of one of questions we received:

Question:

For taxable years beginning on or after January 1, 2011, and before January 1, 2013 can a multistate taxpayer that is not otherwise precluded from making a timely single sales factor election under R&TC Section 25128, make a single sales factor election if they are required to follow special industry apportionment and allocation regulations per R&TC Section 25137?

Answer:

Yes. Multistate taxpayers who are not otherwise precluded from making a timely single sales factor election under R&TC Section 25128.5, (taxpayers that are precluded are those taxpayers that derive more than 50 percent of their gross business receipts from a qualified business activity – agricultural, extractive, savings and loan, and banking or financial business.), and who are required to follow special industry apportionment and allocation regulations under Section 25137, may make such an election for taxable years beginning on or after January 1, 2011 and before January 1, 2013. Specifically, Title 18, Regulation Section 25136-2(g)(3) provides that:

The sales factor provisions set forth in Regulation Sections 25137 through 25137-14 are hereby incorporated by reference, with the following modifications for taxable years beginning on and after January 1, 2011. . .

The regulation, thereafter, sets forth various portions of Regulation Sections 25137 through 25137-14 that are not incorporated into the market-based rules of Regulation Section 25136-2.

In other words, a multistate taxpayer who is required to follow special industry apportionment and allocation regulations under Regulation Section 25137 may make a single sales factor election for taxable years beginning on or after January 1, 2011, and before January 1, 2013. If the taxpayer makes such an election, the taxpayer must follow the sales factor provisions, with the exception of any rule excluded by the provisions of Regulation Section 25136(g)(3), and is not required to use the property and payroll factor rules.

Proposition 39 was approved by the voters in the November 2012 election. Proposition 39 amended the R&TC Section that allowed the annual election, by adding an end date for the availability of the annual single sales factor election and made the use of single sales factor apportionment mandatory for all but those taxpayers required to use equal-weighted three factor apportionment. The annual election could only be made for taxable years beginning on or after January 1, 2011, and before January 1, 2013. Proposition 39 also repealed the section allowing the annual election as of December 1, 2013.