

Tax relief for military personnel serving in combat zones

Your military clients serving in combat zones will receive relief with their personal income tax on par with what they receive from the federal government.

"Now that California's military servicemen and women are in harm's way, tax issues should be the least of their concerns," said State Controller and Franchise Tax Board Chair Steve Westly.

California tax law generally conforms to federal tax benefits for combat zones and qualified hazardous duty areas. These include:

- Extensions of the filing and payment of tax due dates for personal income

tax returns until at least 180 days after leaving the combat zone or qualified hazardous duty area without incurring penalties or interest.

- Suspension of delinquent tax collection of military personnel serving in the combat area for 180 days after leaving the combat zone or qualified hazardous duty area.
- For enlisted members and warrant officers, all compensation for active service earned in a combat zone or a qualified hazardous duty area is tax-free.

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Steer clear of abusive tax schemes

This article is the first in our series on abusive tax scheme transactions.

In recent years, individuals and business entities have increasingly taken advantage of abusive tax schemes.

The Internal Revenue Service defines abusive tax schemes as transactions promoted for the promise of tax benefits with no meaningful change in the taxpayer's control over or benefit from the taxpayer's income or assets.

These transactions typically have no economic purpose other than reducing taxes, and most involve the use of multiple layers of domestic and foreign pass-through entities including: partnerships, S corporations, limited liability companies, and trusts.

Another common abusive tax scheme uses offshore banks that issue debit/credit cards. The IRS is vigorously pursuing taxpayers investing in apparent abusive tax schemes. They are focusing on tax return preparers and the promoters of these investment schemes, and are pursuing penalties and criminal prosecution for these cases.

The IRS also has had limited compliance initiatives for certain abusive tax schemes that encouraged taxpayers to voluntarily come into compliance with the federal tax law and file amended returns before the IRS contacted them for an audit. As a result of these compliance initiatives the IRS was able to obtain the names of promoters and tax preparers involved in the marketing of abusive tax schemes, as well as the names

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Tax News

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TAX NEWS is a bimonthly publication of the Communications Services Bureau, California Franchise Tax Board. Its primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

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New process for Canadian retirement plans

We recently received an inquiry about the taxability of the earnings and distributions from a Canadian Registered Retirement Savings Plan (RRSP).

After reviewing the characteristics of a RRSP, we have revised our internal procedures and will now treat a RRSP like a savings account, not a functional equivalent of an Individual Retirement Arrangement. As a result, California resident taxpayers' **original contributions**, made while a Canadian resident, are treated as a capital investment in the RRSP. California residents are required to include the **earnings** from their RRSP in their California taxable income in the year earned. After taxpayers pay tax on these earnings, the earnings will also be treated as a capital investment in the RRSP.

When taxpayers receive distributions from their RRSP, the amount consisting of the contributions and the previously taxed earnings is treated as a nontaxable return of capital. Please note that the federal election to defer taxation on the RRSP earnings until a taxpayer begins receiving distributions, as discussed in Revenue Procedures 89-45 and 2002-23, is only available for federal income tax purposes and is unavailable for California income tax purposes.

Our revised treatment for a RRSP is now reflected in the online information resource used by our Tax Practitioner hotline. The number to call is (916) 845-7057.

Editor's note: The April 1, 2003 issue of Spidell's California Taxletter contains an article on this topic.

Abusive tax schemes

Continued from front page

of taxpayers investing in these schemes. Information received from the first initiative alone resulted in the disclosure of deductions totaling \$30 billion. For additional information on IRS activity on abusive tax schemes and numerous notices and announcements focusing on tax shelters, log onto their Website at www.irs.gov/businesses/corporations.

We are stepping up our audit activities on taxpayers investing in abusive tax schemes and working closely with the IRS to identify taxpayers, perform audits, and uncover abusive tax scheme transactions.

We've identified, for audit, tax returns reporting approximately \$4 billion in losses and we are also holding on to many tax returns pending the completion of the IRS' audits. Congress is considering legislation aimed at deterring or discouraging investment in abusive tax schemes.

Some of the proposed provisions include:

- Extending the period for issuing a federal deficiency notice for abusive tax scheme losses from three to six years, to allow the IRS more time to identify and address abusive tax schemes.
- Imposing penalties equal to 40 percent of the tax liability attributed to the abusive tax scheme for taxpayers investing in abusive tax schemes.
- Imposing penalties up to \$200,000 on taxpayers who do not disclose their investment in an abusive tax scheme on their return.
- Imposing penalties of up to 100 percent of the gross income earned in the marketing of the abusive tax scheme on the promoters.

The California legislature is also considering law changes to address abusive tax schemes, including considering the proposed federal legislation.

Tax relief for military personnel

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- This includes regular basic pay. Special pay, such as reenlistment bonuses, is also tax-free if the service member reenlists in a combat zone. For commissioned officers, the monthly tax exclusion is capped at the highest enlisted pay, plus any hostile or imminent danger pay received. For 2003, this amount is \$5,882.70 per month.

Military taxpayers filing on extension should alert us when they do file by writing in red on top of their tax return or payment: **COMBAT ZONE: OPERATION IRAQI FREEDOM** (or the name of the specific combat zone served in). Taxpayers also need to include the dates they entered and left the combat zone or qualified hazardous duty area.

Here are answers to some of the questions we're receiving from affected taxpayers:

Q: Do I have to file my return and pay my tax by the original due date?

No. Military personnel on duty outside the United States or in a designated combat zone or in a qualified hazardous duty area are allowed a filing extension of up to 180 days to file their California income tax returns and pay their tax, without interest or penalties as described below:

If you were in a designated combat zone or in a qualified hazardous duty area anytime during the tax year or filing period (January 1 to April 15), you are entitled to an extension of time to file and pay, without interest and penalties, of up to 180 days after leaving the combat zone or a qualified hazardous duty area. In addition, you are entitled to an additional extension of up to 106 days (number of days you were in a combat zone or QHDA during the filing period).

- If you served outside the United States, but not in a designated combat zone or QHDA, you are entitled to an extension of time to file and pay without interest and penalties, of up to 180 days after returning from overseas.
- For married persons filing a joint return, only one spouse needs to meet the requirement to qualify for the extension.

Q: Do I need to obtain a Power of Attorney from my spouse in order to file my return now?

No. California generally does not require a formal Power of Attorney in the same manner as the Internal Revenue Service. If your spouse is on active duty outside the United States, you may file a joint return now by attaching a statement to the return explaining the circumstances and signing the return on behalf of your spouse. When signing the return, be sure to indicate on the signature line that you are signing the return for your spouse, (Mary Smith for John Smith).

Filing returns for military personnel?

The following publications provide special information about filing and preparing California tax returns for military personnel. They are also available on our Website, www.ftb.ca.gov.

- FTB Pub. 1021 - *California Tax Information For Military Personnel - Extensions and Income Exclusions.*
- FTB Pub. 1031 - *Guidelines for Determining Residency Status.*
- FTB Pub. 1032 - *Tax Information for Military Personnel.*

Ask the Advocate



Debbie Newcomb
Taxpayer
Advocate

Q: My client has a hardship as a result of your collection actions. Do you have a process for handling cases such as this?

A: If any of your clients has a hardship as a result of our collection actions, there is a way to provide some relief. Our form FTB 911, *Request for Relief From Hardship*, enables you to obtain immediate relief for your clients when they experience hardship as a result of collection action taken by us.

The form is for tax practitioner use only. When you submit it, be sure to include a completed form FTB 3520, *Power of Attorney*, if you do not already have a current one on file with us.

We also provide, for tax practitioners only, a *Collections Fax Help Line*. Use it to get a fast resolution to personal income tax collection issues. The fax line number is (916) 845-0494 and is available 24 hours a day, seven days a week. In most cases, we respond within two business days.

Settlement program announces survey results

In August 2002, our Franchise Tax Board Settlement Program administered a survey to taxpayers and tax practitioners who had contact with the program between 2000 and 2002. From that survey we learned that our settlement program is doing a good job of listening to its customers and working with them to find solutions for their tax problems.

We also learned that at times the process takes too long, particularly the response times between the Chief Counsel approval and the Attorney General and Board approval steps.

Revenue and Taxation Code Section 19442, authorizes our FTB Settlement Bureau to settle civil tax matters in dispute that are subject of protests, appeals, or refund claims. It is responsible for the negotiation of settlements of civil matters in dispute consistent with a reasonable evaluation of the costs and risks associated with the litigation of these matters.

The settlement of litigation cases and audits in progress are statutorily excluded from our settlement program. The settlement program is also distinct from our *Offer in Compromise Program*, which assists taxpayers with undisputed tax liability matters.

In the survey we asked customers questions aimed at finding out how effective our settlement program is in meeting their needs. The responses from the survey were generally very positive and indicated that the program is effective. The survey also identified areas within the program that could be improved.

Further details about the survey are available on our Website. Go to the Tax Professionals Gateway at www.ftb.ca.gov and click on *Tax News Online*.

Here are some of the key survey results:

Overall impression of the settlement program

- 97 percent indicated that they were treated courteously.
- 92 percent indicated that the settlement process was clearly explained.
- 91 percent indicated that negotiations were conducted in a professional manner.
- 90 percent indicated that contacts were timely.
- 89 percent were satisfied or very satisfied with the settlement process.
- 88 percent indicated that they would use the settlement process again. (Four percent indicated that they would not use the process again; eight percent had no opinion).

- 83 percent indicated that nine months was an adequate time for settlements with occasional extensions when needed. (Of these, five percent wanted shorter periods).

Comparison with other dispute resolution processes

- 56 percent indicated that the settlement process was better than the appeals process.
- 41 percent indicated that the settlement process was the same as the appeals process.
- 3 percent indicated that the settlement process was worse than the appeals process.
- 61 percent indicated that the settlement process was better than the protest process.
- 38 percent indicated that the settlement process was the same as the protest process.
- 1 percent indicated that the settlement process was worse than the protest process.

Settling audits

The respondents split as to whether there should be an opportunity to settle audits: 42 percent said yes, 33 percent said no, and 25 percent had no opinion or left the answer blank.

Program's best features

The best features of the settlement program were:

- Opportunity to consider pros and cons and resolve accordingly.
- Opportunity to discuss issues with knowledgeable staff.
- Response time is often quicker than in other processes.
- High level of professionalism, knowledge and preparation exhibited by the settlement staff.

Suggestions for improvements

We received numerous comments regarding how the settlement program can be improved. Here are a few of them:

- Timely Responses.
- Offer conferences outside Sacramento.
- Lessen the time between Chief Counsel approval and the Attorney General and Board approval.
- Combine our settlement program with our offer in compromise program.
- Provide timelines for action.

More information

For more information about our Settlement Program refer to FTB Notice 2003-2, dated March 14, 2003, available on our Website.

(http://www.ftb.ca.gov/legal/notices/2003/2003_02.pdf)

You can e-file until Oct. 15

You can still e-file your clients' California tax returns during the six-month extension period following the April 15, 2003, deadline.

We will accept both refund and balance due returns through October 15, 2003. Please remember that any taxes owed must have been paid by April 15, 2003, to avoid any penalties and interest. (Note: The extended due date for the Internal Revenue Service is August 15, 2003.)

Take advantage of e-file's many benefits. If you are not an approved Electronic Return Originator and you want to e-file your clients' returns during the extension period, complete the fillable *California Application to Participate in the e-file Program* (form FTB 8633) online at www.ftb.ca.gov. You'll find it in the *Tax Professionals Gateway*, under *General Information*. Once you have completed the application, print, sign, and send it to us. You can also send the completed application via fax to our e-file Help Desk at (916) 845-0287, or mail it to the address shown on the application.

View Payments and Balance Due

Now you can view tax year summaries through our expanded e-service: *View Payments and Balance Due*. For accounts with a balance due as of the date you access this service, you can view their total tax liability, total payments, credits, voluntary contributions, penalties, fees, and interest.

View Payments and Balance Due is easy to find. Go to www.ftb.ca.gov and look for it under *Get Answers*. The link is entitled: *Check my payments or account balance*. This service is available 24 hours a day, seven days a week and operates in a secure and confidential electronic environment. To use this service you will need your



client's social security number and customer service number. In addition to the new tax year summary information, this service provides information on up to 25 estimated tax payments, estimate transfers, and extension payments waiting to be applied to a tax return and up to 60 of the most recent payments applied to a balance due.

Governor's budget contains mandatory e-file proposal

Governor Gray Davis has, in his 2003-2004 State Budget plan, proposed the implementation of mandatory e-file for tax practitioners who prepare more than 100 state tax returns annually. This measure will reduce tax return processing costs for the state. If you have questions or comments about mandatory e-file, contact us at e-file@ftb.ca.gov. You may also wish to contact your state legislator.

e-file workshops

Our e-file workshops, conducted with the Internal Revenue Service, continue to generate enthusiasm among tax professionals interested in participating in the e-file program. If you haven't participated before, now is a good time to get on board for the next filing season. The workshops are filled with essential information about the IRS and FTB e-file programs. Look for the schedule of upcoming workshops on our Website (www.ftb.ca.gov/professionals/eServices/efile/index.html).

We're still listening

We want to provide an e-file program that meets all your needs. To do so we need your input. We recently surveyed 1,200 tax professionals about our e-file program. Here what we found:

- Three out of every five respondents said they would likely use e-file to transmit tax returns year-round.
- Two-thirds of the respondents said they would likely take an online training class to learn about e-file.
- The business entity tax returns respondents are most interested in using e-file for include: forms FTB 565, *California Partnership*, FTB, 100, *Corporation Income*, and FTB 100S, *S Corporation*.
- More than one - half of the respondents thought it would be useful if we sent an their clients an e-mail message containing basic tax information, along with a reminder to file their tax return.
- Approximately one - half of the respondents prepared less than 100 personal income tax returns last year.
- Forty percent did not use e-file last year.

e-file on CD-ROM

Did you receive the e-file CD-ROM we sent you in December, 2002? It contained the *2002 e-file Handbook* (FTB Pub. 1345), *2002 e-file Handbook Supplement* (FTB Pub. 1345A), *e-file Quick References*, and other resource information. We replaced the paper versions of these publications with the CD-ROM and we want to know if you prefer the CD-ROM to the paper version. Tell us what you think by sending a message to e-file@ftb.ca.gov. Write CD-ROM in the subject line. If you did not receive a CD-ROM and would like one, send your request same email address.

State Reports on Median Income for 2001

The statistical report on page 7 compiled by our *Economic Research and Statistics Bureau* compares the median income of personal income taxpayers for each California county.

Median income is the point where one-half of the tax returns are above and one - half are below the midpoint. It represents the income reported by a typical California individual or couple.

California taxpayers reported a 10 percent decrease in adjusted gross income on their 2001 state income tax returns.

Californians filed nearly 14.2 million 2001 state income tax returns, reporting nearly \$891.1 billion of adjusted gross income. This marks a 10.3 percent decrease from the \$993.5 billion reported in 2000.

The statewide median income on all returns was \$31,666, an increase of 1.7 percent over the median income amount report for the year 2000.

For joint returns, the statewide median income was \$58,341, an increase of 0.6 percent over the 2000 income amount.

Over the past 30 years, the Bay Area counties of Marin, Santa Clara, San Mateo, and Contra Costa have consistently reported the highest median incomes. Marin County again had the highest median income for joint returns, reporting \$96,826, a decrease of 4.8 percent from 2000.

The largest percentage gain in median income for all counties was 9.1 percent reported in Alpine County. For joint returns the largest gain was in Sierra County with a 6.1 percent increase.

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Interest Rates

For the period of July 1, 2003, through December 31, 2003, the adjusted interest rate on underpayments and overpayments of California

personal income taxes will be **five (5) percent**. The interest on *corporation overpayments* will be **one (1) percent**.

Effective Date	Rate	Effective Date	Rate	Effective Date	Rate
1 Jan. 1992 to 30 June 1992	10%	1 Jan. 1996 to 30 June 1996	9%	1 Jan. 2000 to 30 June 2000	8%
1 July 1992 to 31 Dec. 1992	9%	1 July 1996 to 31 Dec. 1996	9%	1 July 2000 to 31 Dec. 2000	8%
1 Jan. 1993 to 30 June 1993	8%	1 Jan. 1997 to 30 June 1997	9%	1 Jan. 2001 to 30 June 2001	9%
1 July 1993 to 31 Dec. 1993	7%	1 July 1997 to 31 Dec. 1997	9%	1 July 2001 to 31 Dec. 2001	9%
1 Jan. 1994 to 30 June 1994	7%	1 Jan. 1998 to 30 June 1998	9%	1 Jan 2002 to 30 June 2002	7%
1 July 1994 to 31 Dec. 1994	7%	1 July 1998 to 31 Dec. 1998	9%	1 July 2002 to 31 Dec. 2002	6%
1 Jan. 1995 to 30 June 1995	8%	1 Jan. 1999 to 30 June 1999	8%	1 Jan. 2003 to 30 June 2003	6%
1 July 1995 to 31 Dec. 1995	9%	1 July 1999 to 31 Dec. 1999	7%	1 July 2003 to 31 Dec. 2003	5%

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COUNTY	Population July 1, 2001	All Returns-Taxable and Nontaxable				Joint Returns			Tax Assessed (Thousands)
		Number of Returns	AGI (Thousands)	Median		Number of Returns	Median		
				Income	Rank		Income	Rank	
Alameda	1,475,800	634,697	\$39,508,452	\$38,582	7	237,022	\$74,616	5	\$1,700,557
Alpine	1,200	296	12,492	31,999	19	151	51,470	26	355
Amador	35,850	14,226	616,447	31,931	20	7,351	51,346	27	17,983
Butte	206,800	75,889	2,840,131	24,847	46	33,203	44,582	42	80,268
Calaveras	41,500	16,631	744,289	31,780	21	8,771	50,406	30	22,092
Colusa	19,300	7,527	245,245	22,591	56	3,524	36,157	57	6,589
Contra Costa	977,000	419,867	29,672,517	43,012	4	181,601	79,989	4	1,328,640
Del Norte	27,650	7,711	276,576	25,887	40	3,729	44,164	43	6,525
El Dorado	163,900	60,134	3,667,164	38,978	5	32,176	67,175	7	137,390
Fresno	822,000	274,755	10,555,266	24,483	48	112,669	46,255	38	317,417
Glenn	26,850	9,640	318,490	23,085	55	4,718	37,187	56	7,502
Humboldt	127,800	48,012	1,752,510	24,892	45	19,800	46,004	40	48,876
Imperial	149,900	47,692	1,509,899	20,230	58	23,792	30,195	58	34,336
Inyo	18,200	7,952	318,250	27,870	34	3,632	49,691	31	9,113
Kern	681,900	213,751	8,561,726	26,906	38	96,802	48,174	35	237,571
Kings	132,700	35,354	1,241,542	24,795	47	16,241	42,622	47	28,199
Lake	60,200	20,697	760,104	25,741	41	9,504	43,084	46	19,850
Lassen	34,350	9,641	398,922	33,221	15	5,119	51,914	25	10,141
Los Angeles	9,748,850	3,682,470	185,260,578	26,909	37	1,287,740	48,801	33	7,396,751
Madera	130,000	39,646	1,398,387	23,876	53	19,065	41,450	49	35,611
Marin	248,900	119,307	13,070,415	45,889	1	46,118	96,826	1	755,186
Mariposa	17,000	6,288	225,918	26,236	39	3,082	43,372	45	5,587
Mendocino	87,500	34,733	1,337,346	25,340	43	14,762	44,777	41	40,871
Merced	216,400	71,758	2,499,690	24,159	51	32,619	41,450	48	58,434
Modoc	9,450	2,792	91,044	24,927	44	1,484	37,903	55	2,224
Mono	13,150	4,954	214,278	27,285	36	1,897	52,404	23	6,895
Monterey	408,000	147,849	7,394,217	28,994	29	60,449	52,109	24	279,611
Napa	128,100	50,265	3,218,651	35,069	11	21,906	61,850	14	144,057
Nevada	94,200	39,612	1,959,088	32,087	18	19,032	54,640	22	67,687
Orange	2,910,000	1,209,766	72,836,537	34,047	14	506,825	65,057	10	3,010,151
Placer	261,500	130,815	7,786,397	38,719	6	63,787	69,239	6	299,836
Plumas	21,000	7,909	321,460	29,717	28	4,044	47,761	36	8,892
Riverside	1,618,000	576,793	25,078,103	28,804	31	258,434	51,036	28	709,748
Sacramento	1,267,900	514,255	24,385,714	33,012	16	199,818	59,577	17	806,506
San Benito	55,200	21,155	1,113,187	34,694	12	10,024	64,783	11	37,334
San Bernardino	1,766,100	606,752	25,180,114	28,836	30	261,203	50,975	29	653,418
San Diego	2,890,800	1,173,247	64,110,170	31,267	23	475,932	57,925	18	2,551,643
San Francisco	789,600	397,070	29,622,985	37,315	9	103,405	60,635	15	1,637,335
San Joaquin	590,900	213,001	10,441,672	30,711	25	94,345	54,916	20	293,337
San Luis Obispo	252,000	101,058	4,815,226	30,886	26	44,815	55,978	19	166,232
San Mateo	714,500	323,173	33,225,802	44,897	3	128,128	84,367	3	1,950,141
Santa Barbara	405,700	159,792	8,848,558	30,080	27	65,908	54,681	21	366,234
Santa Clara	1,706,400	769,038	66,471,000	45,585	2	310,224	87,781	2	3,561,961
Santa Cruz	258,500	111,596	6,256,350	32,624	17	42,119	64,711	12	259,549
Shasta	168,600	65,338	2,668,890	27,314	35	31,936	46,052	39	78,010
Sierra	3,550	1,255	58,891	31,451	22	641	48,293	34	2,094
Siskiyou	44,650	16,835	571,723	24,068	52	8,422	38,365	52	14,544
Solano	403,100	163,714	8,179,670	37,507	8	70,850	66,443	8	250,846
Sonoma	488,400	204,036	11,129,296	35,322	10	83,293	65,338	9	428,242
Stanislaus	465,600	170,125	7,063,318	28,501	32	77,377	49,348	32	203,363
Sutter	81,000	30,345	1,151,689	26,158	40	14,833	43,930	44	31,796
Tehama	56,500	17,470	571,962	24,354	49	8,626	38,303	54	12,501
Trinity	13,050	4,473	140,930	23,400	54	2,225	38,364	53	3,104
Tulare	375,800	120,413	3,973,387	21,811	57	52,434	39,294	50	98,510
Tuolumne	55,800	21,336	909,347	28,466	33	10,367	47,741	37	28,262
Ventura	773,900	314,511	18,567,738	34,078	13	140,496	64,472	13	745,091
Yolo	174,500	68,440	3,351,668	30,825	24	28,394	59,956	16	118,095
Yuba	61,300	19,705	644,583	24,305	50	9,234	39,024	51	13,425
Resident Out-of-State	-	140,923	9,484,893	27,581	-	45,058	55,615	-	499,309
Nonresident	-	409,402	121,345,868	54,721	-	214,949	93,373	-	945,685
Unallocated	-	24,725	1,106,368	20,558	-	6,415	45,070	-	37,039
TOTAL									
58 Counties	34,758,000	13,637,562	\$759,146,001	-	-	5,416,120	-	-	\$31,146,518
All	-	14,212,612	\$891,083,130	\$31,666	-	5,682,542	\$58,341	-	\$32,628,551