

California increases crackdown on abusive tax schemes

We offer guidance for taxpayers looking to reconsider their participation in schemes

This article is the second in our series on abusive tax schemes. You can find the entire series on Tax News Online, <http://www.ftb.ca.gov/education/taxnews/Index.html>.

The California Legislature has proposed two bills aimed at discouraging investment in abusive tax schemes and providing the state with more tools to combat the behavior.

Senate Bill 614 mirrors federal proposed legislation by creating broader reporting and disclosure requirements and new, costlier penalties that increase the risks associated with playing audit roulette.

Assembly Bill 1601 proposes to increase existing tax shelter penalties. Both bills extend the amount of time California has to issue deficiency notices for tax shelters from four years to eight years.

Some of the proposed penalties in SB 614 will apply to tax years beginning in 1999. The extension of time to issue a deficiency notice will also apply to tax years beginning in 1999.

These tools are necessary to crack down on abusive tax schemes now, not just to deter future investments in these schemes.

We have received some inquiries regarding options available to

taxpayers who are reconsidering their use of tax avoidance schemes to understate their tax liabilities.

Your clients can amend their state income tax return at any time to restate their proper tax liability. Payment of their self-assessed tax and appropriate interest is due when they file their amended return.

The accuracy related penalty is applicable to many abusive tax schemes, however your client may avoid this penalty by filing a *qualified amended return* (for that taxable year) as provided in Treasury Regulation Section 1.6664-2(c).

Timing is critical. Inform your clients that in order to avoid our accuracy related penalty we must receive the qualified amended return before we or the Internal Revenue Service contacts them about the return; otherwise they are ineligible to file a qualified amended return and remain subject to penalties.

If any of your clients are interested in filing a qualified amended return, please use the address below.

To ensure proper handling, write *QAR TS* on the top right margin of the first page.

ATTN: 343:M, MS D-757
Franchise Tax Board
PO Box 942867
Sacramento CA 94267-0001

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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 fee for copies of returns

Effective July 1, our fee for providing copies of personal income tax and business entity (bank, corporation, partnership, and limited liability company) income tax returns will be **\$20** per return.

The new fee is based on the actual cost of providing the service to taxpayers. We will no longer furnish free copies of tax returns for taxpayers during or after an audit; however, we will continue to waive fees under the following conditions:

- When taxpayers state they are the victim of a designated California or federal disaster.
- When taxpayers request copies from our field office that assisted them in completing their returns.

Requestors must pay the fee when they submit their requests. Checks or money orders must be payable to the *Franchise Tax Board* for the total amount due. To request copies, have your clients complete and mail to us form FTB 3516, *Request for Copy of Personal Income Tax*

or *Fiduciary Return*. The form is available online at <http://www.ftb.ca.gov/forms/misc/3516.pdf>.

They can also request copies by sending us a letter specifying the tax year and type of return.

If requesting a personal income tax return, write to:

RID Unit MS C-2
Franchise Tax Board
PO Box 1468
Sacramento, CA 95812-1468

If requesting a business entity return, write to:

RID Unit **Corp** MS C-2
Franchise Tax Board
PO Box 1468
Sacramento, CA 95812-1468

Personal income tax returns are kept for three and one-half years from the original due date. Business entity returns are generally kept for five years from the original due date.

FTB mails head of household questionnaires

The 2002 head of household audit season begins in August with the first mailing of audit questionnaires. These important facts about our *Head of Household Program* can help you better serve your affected clients.

E-filers have an advantage

In general, taxpayers who completed a *Head of Household Questionnaire*, form FTB 4803e, at the time they e-filed their tax return will not receive a head of household questionnaire. An exception would be if the form was incomplete or contained conflicting information.

Need help? We're on the Internet

Our *Head of Household Webpage* provides information on the rules for

qualifying for the head of household filing status, our audit process, and answers to frequently asked questions. There is also a self-test to help taxpayers determine if they qualify for the filing status.

To get there, go to the Franchise Tax Board home page at www.ftb.ca.gov, select *Individuals* find the *Return Filing Assistance* section and click on *Head of Household Information*.

Taxpayers or tax preparers who don't have access to the Internet can call our *Head of Household Automated Assistance Line* at (800) 555-4005.

This automated line has tips on how to complete the audit questionnaire, who may

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New penalty waiver program exceeds expectations

The *Penalty and Interest Waiver Program* has struck a chord with many taxpayers to the tune of \$21.4 million in payments of delinquent taxes.

The program is the result of the enactment of Revenue and Taxation Code Section 19444 in September 2002.

The law gave us a new cost effective tool for resolving delinquent tax collection accounts the state previously considered uneconomical to pursue. The law allows us to offer certain individual taxpayers whose accounts were considered to be *high risk* a full waiver of interest, penalties, and fees, in exchange for full and immediate payment of any unpaid tax.

In addition to the \$21.4 million already paid, we have received an additional \$4 million in promises to pay from

taxpayers. Approximately 80 percent of the money collected has come from taxpayers who have no California assets and who reside outside of California - and in many cases outside the United States.

The legislation governing the program was designed to maintain tight control of the eligibility criteria. In order to participate, taxpayers must first receive an eligibility notice from us.

While the law allowed the sending of notices through June 30, 2003, there is the possibility that legislation may extend the deadline.

If you have clients who you think meet the criteria but did not receive an eligibility notice, please contact our Penalty and Interest Waiver Group at (800) 522-4144.

Head of household

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qualify a taxpayer for the head of household filing status and has answers to frequently asked questions.

The assistance line provides answers in both English and Spanish.

FTB Publication 1540, *California Head of Household Filing Status*, summarizes

the general rules for qualifying for the head of household filing status, has self-tests, frequently asked questions and definitions of commonly used terms.

It can be ordered through our *Head of Household Automated Assistance Line*. A Spanish version, FTB Publication 1540SPAN, *California Información Sobre el Estado Civil Cabeza de Familia*, is also available.

Ask the Advocate



Debbie Newcomb
Taxpayer
Advocate

Dear Readers:

We are vigorously pursuing abusive tax schemes and similar illegal activities that cost our economy billions of dollars.

On July 15, we, along with the UC Davis Center for State and Local Taxation, the California State Library, and the California Research Bureau will sponsor a special symposium aimed at educating California officials about abusive tax schemes.

The Abusive Tax Schemes Symposium will be held at the Sacramento Convention Center. National and state experts will discuss what the Franchise Tax Board, the Internal Revenue Service, and other states, are doing about abusive tax schemes.

They will discuss the collaborative efforts underway to eliminate abusive tax schemes and participants will hear the real world perspective from representatives from the private sector. For more information about the symposium contact Alice Paige at (916) 845-5249.

Tax Practitioner Services

Tax Practitioner Hotline

Telephone (916) 845-7057
Fax (916) 845-6377

Personal Income Tax Collection

Fax (916) 845-0494

Business Entities Collection

Fax (916) 845-0145

FTB e-file Help Desk

Telephone (916) 845-0353

State once again considers mandatory e-file

In his 2003-2004 State Budget, Governor Gray Davis is once again proposing the implementation of mandatory e-file for tax practitioners who prepare more than 100 individual state income tax returns annually. This measure will reduce tax return processing costs for the state.

Following is a list of questions and answers that may be helpful to you regarding the mandatory e-file proposal. This information is also available online on our Website, www.ftb.ca.gov/professionals/index.html, under *What's New*.

Can the proposal be found in legislation?

The proposal was originally introduced as a part of the Governor's 2002/2003 annual budget and reintroduced as part of the Governor's 2003/2004 annual budget. It is currently included in Senate Bill X7. You can view the bill at the following link:

www.leginfo.ca.gov/pub/bill/sen/sb_0001-0050/sbx1_7_bill_20030428_amended_asm.pdf.

Why is the Governor making e-file mandatory?

The Governor believes that by making e-file mandatory for returns prepared by tax preparers who use software to prepare tax returns, we can significantly reduce the cost of processing tax returns. During the first year of implementation, we anticipate between 2.5 million and 4 million additional e-file returns.

Who must e-file tax returns under this proposal?

Tax preparers who prepare more than 100 tax returns and use tax preparation software will be required to participate in mandatory e-file.

What types of returns must be e-filed under the mandatory proposal?

At this time, all current year individual income tax returns that can be e-filed are included in the mandatory proposal. The proposal does not include prior year, fiduciary, or amended returns.

If I reside or have an office outside California, am I still subject to the mandate?

Yes. If you meet the mandatory e-file requirement, the returns you prepare are required to be e-filed, even if you reside or have your office outside the state.

What if I have multiple offices and each files less than 100 returns?

For the purposes of this proposal, an *income tax preparer* is defined as a person who prepares, in exchange for compensation, or who employs another person to prepare, in exchange for compensation, any return for the tax imposed. This means even if a person in your employ or one of your offices files less than 100 returns, if the total of all tax returns prepared from multiple offices equals more than 100 and tax preparation software is used, all acceptable returns you prepare are required to be e-filed under this proposal.

When will mandatory e-file take effect?

If enacted, the proposal will take effect on January 1, 2004.

How do you plan to enforce mandatory e-file?

The proposal allows us to assess a penalty against preparers for each return that is not e-filed, unless a reasonable cause exists.

How much is the penalty?

The penalty is \$50 per return filed on paper that should have been e-filed.

What if my client (the taxpayer) does not want their return e-filed?

This year's suggested language contains *reasonable cause* to allow opt-outs as long as the opt-outs are not due to willful neglect. Recent changes include *taxpayer request* as a reasonable cause for opting-out.

What if my software doesn't support a form, filing status, etc., that is required to be e-filed?

If your software doesn't support a form or filing status, you may want to encourage your software provider to offer the form or filing status you need to complete your tax returns. Or, you may want to acquire software that supports the forms or filing statuses you need.

I'm new to e-file. Where do I learn more about your e-file Program?

You can find information on our Website at www.ftb.ca.gov/professionals/eServices/efile/index.html or by calling our e-file Help Desk at (916) 845-0353. You can also check with your professional organization to network with others who are participating in our e-file Program.

Where can I get software to e-file?

We provide a listing of approved e-file software developers on our Website at www.ftb.ca.gov/professionals/eServices/efile/prosoftware.html. You can also contact our e-file Help Desk at (916) 845-0353.

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e-file open until October 15

There is still time to e-file your clients' returns. As you know, California grants an automatic six-month extension to file. So, if you are new to e-file, this is a great time to try out the program.

We will accept both refund and balance due returns through October 15, 2003. Please remember that any taxes your clients owe must have been paid by April 15, 2003, or we may assess penalties and interest. (*Note: The extended due date for the IRS is August 15, 2003.*)

If you would like to join the California e-file Program, you must also be approved for the Internal Revenue Service e-file Program. Details on joining the e-file program are available on our Website at www.ftb.ca.gov/professionals/eservices.

Netfile -- Your connection to free, direct e-file!

On April 13, 2003 we deployed our new NetFile Program. NetFile provides taxpayers and tax practitioners a free, direct-to-us method to e-file.

More than six million taxpayers are eligible to use the NetFile Program.

Here are a few of the benefits of NetFile:

- Free.
- Quick refunds— within five to seven business days.
- Available 24 hours a day.
- Direct to us.
- Electronic payment options.
- Confirmation that we received the return.
- Easy-to-use interview process.

Look for NetFile on our Website at www.ftb.ca.gov.

2EZ Direct Program retired

In May, we removed the *2EZ Direct Program* from our Website. More than 20,000 taxpayers used this free, direct e-file program during the filing season.

The NetFile Program is available for taxpayers and tax practitioners interested in free, direct e-file.

Mandatory e-file

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What are you going to do with all the money you'll save from us e-filing? Can you compensate us?

The savings generated by mandatory e-file would help reduce the state's overall budget deficit. The proposed legislation does not provide for any direct incentives to tax practitioners.

Where can I find more information about the proposal?

As more information is available, we

will post it to our Website under our *Mandatory e-file* link. You can check back frequently for the latest news at www.ftb.ca.gov/professionals/index.html under our *What's New* section.

Who should I contact about this proposal?

We want to hear from you about mandatory e-file. You can email your questions, comments, concerns, and ideas to e-file@ftb.ca.gov. Please be aware that we have only been charged with the implementation of the proposal once it is enacted.

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 percent**.

The interest on *corporation overpayments* will be **one percent**.

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