

## Changes made to real estate withholding requirements

Governor Schwarzenegger signed Assembly Bill 1338 into law on September 15, 2004. It amends Revenue and Taxation Code Sections 18662 and 18668, making changes to real estate withholding requirements and exemptions effective for all transactions closing on or after January 1, 2005. The following is a summary of the changes.

AB 1338:

- Eliminates the waiver process for nonindividuals and replaces it with an expanded self-certification process similar to the process used by individuals. Although nonindividuals will not be able to request reduced withholding on small gains, they will be able to self-certify that they are exempt from withholding if they will have a loss on the sale, are doing an IRC Section 1031 exchange, or the property is being involuntarily converted and the seller intends to replace it to meet the requirements of IRC Section 1033.
- Clarifies that no withholding is required when the transferee acquires the property: at a sale pursuant to a power of sale under a mortgage or deed of trust, at a sale pursuant to a decree of foreclosure, or by a deed in lieu of foreclosure.
- No longer provides for an exemption for irrevocable trusts that have a California resident trustee.
- No longer provides for an exemption for estates when the decedent was a California resident.

In order to get the word out about this law change we will be conducting escrow and agent presentations, updating the various real estate withholding forms and FTB Publication 1016, *Real Estate Withholding Guidelines* (available by mid-December or early January), and updating our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) (Website keywords: *real estate withholding*).

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## FTB provides e-filers with electronic signature options

You may have heard that we are adding electronic signature options for e-filed returns to mirror those provided by the Internal Revenue Service. Like the IRS, you and your clients have the option of signing through the use of taxpayer, practitioner, and Electronic Return Originator (ERO) PINs. You will continue to have the option of using the *California e-file Return Authorization Form* (form FTB 8453).

In early January, all EROs will receive our e-file CD-ROM. All of our e-signature information will be included. But, in case you can't wait until then, here is a comparison chart of the different options and a list of frequently asked questions.

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# Tax News

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

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## Real estate or nonresident withholding credits:

### Be sure to correctly claim them on your clients' California income tax returns

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If your clients are individuals and sold California real property that was not their principal residence, withholding was probably performed as part of the transaction and they should have received Form 593-B, *Real Estate Withholding Tax Statement*, to document how much real estate withholding credit they have. To claim this credit on your clients' California income tax return, enter the credit on the Real estate withholding or Nonresident withholding line. Do not claim it on any other line or the credit will be delayed or denied during processing.

#### Nonresidents

If your clients are nonresidents, they may have a nonresident withholding credit. If so, they should have received form FTB 592-B, *Nonresident Withholding Tax Statement*, or form FTB 594, *Notice to Withhold Tax at Source*, to document their nonresident withholding credit. To claim this credit on the clients' California income tax return, enter the credit on the *Nonresident Withholding* or *Real Estate Withholding* line. Do not claim it on any other line or the credit will be delayed or denied during processing.

#### Pass-through entities

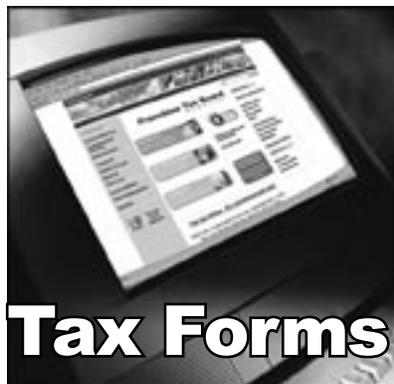
If any of your affected clients are pass-through entities they may need to flow the credit through to their partners, members, shareholders, or beneficiaries. See FTB Publication 1017, *Nonresident Withholding Partnership Guidelines*, for information on how to flow the credit through.

#### Contact us

If you have withholding questions that are not specific to your client's account, call our Withhold at Source Hotline at (916) 845-7315. If you have withholding questions specific to your client's account, please call our toll-free number (888) 792-4900. For callers outside the United States, call (916) 845-4900.

We comply with the American with Disabilities Act. Persons with hearing or speech impairments please call TTY/TDD (800) 822-6268.

You can also email us at [wscs.gen@ftb.ca.gov](mailto:wscs.gen@ftb.ca.gov) (nonconfidential email).



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# Tax Forms

# Ask the Advocate



**Debbie Newcomb**  
Taxpayer Advocate

Dear readers:

We have all heard those radio ads urging Californians to incorporate in Nevada to avoid paying California taxes. During our tax gap symposiums in July, many of you felt that some of these advertised tax avoidance strategies were questionable. Some tax practitioners suggested we launch our own advertising campaign to counteract their claims.

We are using our Website, [www.ftb.ca.gov](http://www.ftb.ca.gov), to provide information that can help the public recognize questionable tax avoidance strategies. You can help by sharing these facts about California taxation with your clients:

As you know, California residents are taxed on *all* income, including income from sources *outside* California. Tell your clients that if they incorporate outside of California, yet remain California residents, any dividends or salary they receive from the corporation will be taxable to California, regardless of where the corporation is incorporated or does business.

In addition, non-California residents who receive income from a California source, such as salary for work performed in California for a corporation, regardless of where that corporation is incorporated or does business, may be required to pay California tax.

Any corporation, regardless of where it is incorporated, that is *doing business* in California, is subject to California franchise tax. *Doing business* is defined as actively engaging in any transaction for profit. A single transaction can be sufficient to be *doing business*. In the case of limited partnerships, limited liability partnerships, and limited liability companies, California assesses an \$800 annual tax for doing business in this state. Limited liability companies are also assessed an additional fee, which is based on worldwide gross receipts.

For more information on corporation filing requirements, see the following publications:

- FTB Publication 1060, *Guide for Corporations Starting Business in California*.

- FTB Publication 1063, *California Corporation Tax Law – A Guide for Corporations*.
- FTB Publication 1050, *Application and Interpretation of Public Law 86-272*.

Thankfully, most of you, when asked by your clients about those radio ads, have been successful in explaining why incorporating out-of-state may not shield them from paying California tax. We believe that by working with you to educate the public about the advantages of lawful, voluntary compliance, we can dry up the market for illegal tax avoidance schemes and reduce California's tax gap. Keep reading *Tax News*, as we will continue to provide you with information you can use to educate your clients. When you share this information with your clients be sure to also explain to them the seriousness of the tax gap and why we need to close it. You can find comprehensive information about the tax gap on our Website.

If you have clients (businesses or individuals) who have mistakenly failed to meet their filing obligations, now is the best time for them to come into compliance by participating in either California's Income Tax Amnesty Program or our ongoing Voluntary Disclosure Program.

### **Tax Amnesty Program**

California's 2005 tax amnesty program offers a window of opportunity for business entities and individuals to pay their past-due income or franchise taxes and interest, and they will not have to pay most penalties and fees or fear prosecution. If they choose to take advantage of this limited time program, they can correct tax records and save money. We will waive most existing penalties and fees applicable to taxable years beginning before January 1, 2003. Log onto our Website for the most current and comprehensive information about this historic opportunity.

### **Voluntary Disclosure Program**

The Voluntary Disclosure Program allows qualified entities, shareholders, or beneficiaries that may have an unfulfilled franchise or income tax obligation to come into compliance voluntarily. If your clients are admitted into the Voluntary Disclosure Program we will waive certain penalties associated with the return filings.

See FTB Pub. 1071, *Guidelines for Voluntary Disclosure Agreements*, for more details. Or go to our Website and type *Voluntary Disclosure Program* into the search engine.

Not sure which program to use? Here is a comparison chart to help you determine which program is best for your clients' situation:

## Tax Amnesty Program or Voluntary Disclosure Program?

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	<b>Tax Amnesty Program</b>	<b>Voluntary Disclosure Program (VDP)</b>
<b>What is the application period?</b>	February 1, 2005 –March 31, 2005	Ongoing.
<b>What are the eligible tax years?</b>	2002 and earlier tax years	Six year look-back.
<b>Who is an eligible entity/individual?</b>	All individuals, corporations, fiduciaries, estates, and trusts, and other entities (LLCs, partnerships, etc.)	C corps, S corps, S corp. shareholders, certain trusts, certain trust beneficiaries, LLCs and their owner-members.
<b>What are the qualifications?</b>	<ul style="list-style-type: none"> <li>➢ Failed to file income tax returns.</li> <li>➢ Underreported tax liability on a previously filed income tax return.</li> <li>➢ Failed to pay any taxes previously assessed.</li> </ul>	<ul style="list-style-type: none"> <li>➢ Cannot be qualified, registered, or organized in California.</li> <li>➢ Neither the applicant nor any predecessors to the applicant may have previously filed California returns.</li> <li>➢ Neither the applicant nor any predecessors to the applicant may have been contacted by us regarding a tax obligation.</li> <li>➢ Cannot have staffed and maintained a permanent facility in California.</li> <li>➢ Must establish reasonable belief that there was no filing obligation.</li> <li>➢ Eligible S corp. shareholders, trust beneficiaries and LLC owner-members. cannot be California residents on the date they sign their VDP agreement.</li> </ul>
<b>Who is disqualified from the program?</b>	Under investigation as of February 1, 2005, or eligible for our Voluntary Compliance Initiative or Offshore Voluntary Compliance Initiative (but only disqualified in this latter case with respect to tax shelter items).	Admitted applicants will have their VDP agreements voided if they misrepresent a material fact, fail to file and pay timely, or the tax stated on a return is understated by 10 percent.
<b>What is the approval process?</b>	Automatic (unless disqualified).	We evaluate applications. Our executive officer and chief counsel recommend and submit VDP agreements to the three-member Franchise Tax Board for approval. The Board typically renders a decision approximately 60 days later.
<b>What taxes are eligible?</b>	Income, franchise, sales, and use taxes.	Income and franchise.
<b>What required payments must be made?</b>	Tax, interest, and certain penalties and fees.	Tax, interest, certain penalties and fees.
<b>What is relieved?</b>	Certain penalties and fees.	Certain penalties.
<b>Is relief discretionary or mandatory?</b>	Mandatory.	Discretionary.

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# Tax Amnesty Program or Voluntary Disclosure Program?

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	<b>Tax Amnesty Program</b>	<b>Voluntary Disclosure Program (VDP)</b>
<b>Imposition of 50 percent interest-based amnesty penalty</b>	Applies to amnesty eligible candidates with a balance due that do not apply by March 31, 2005. (other than grandfathered installment agreements), and to deficiency and self-assessed amounts that become final for amnesty eligible tax years after March 31, 2005.  This penalty cannot be waived.	Applies to VDP applications approved after March 31, 2005, for amnesty eligible tax years (if account has not been fully paid by that date).  This penalty cannot be waived.
<b>Identity of applicant</b>	Must be disclosed on the amnesty application.	Remains anonymous until accepted in VDP.
<b>Time to file required returns</b>	No later than May 31, 2005. (must have applied for amnesty by March 31, 2005)	After the Board approves applications, staff has discretion to allow admitted applicants up to 120 days to file returns and make payment.
<b>Appeal process</b>	None.	None.

## Try our new 1099 Internet filing option

Reporting information returns is now greatly improved with our new 1099 Internet filing option. The program is safe, private, and easy to use. Access this secure Website to view the edit results for your file (results are posted within one week of filing).

Send text or zip files using the same file format as that for magnetic media filing (see the IRS Publication 1220, *Specifications for Filing Forms 1998, 1099, 5498, and W-2G, Electronically or Magnetically*). And, you also get an immediate confirmation when we receive your file.

To join, go to our Website, [www.ftb.ca.gov](http://www.ftb.ca.gov), and type

keywords: *1099 Internet filing*, into our search engine. Download form FTB 4092A, *Internet Filing Application – Information Returns* and mail or fax it to the address provided.

### Form FTB 8305

We no longer print and distribute form FTB 8305 *Reporting Requirements for Forms 1098, 1099, 5498, and W-2G* to information return transmitters. The form will continue to be available on our Website. Programming changes affecting calendar year 2004 information return reporting are published in IRS Publication 1220.

## For faster results, call practitioner hotline; don't send letters with client's return

The best way to receive specific answers to your clients' questions regarding their tax return or other issues requiring timely action is to contact our Franchise Tax Board Tax Practitioner Hotline at (916) 845-7057.

Don't attach a letter to your client's tax return. Often these letters are not answered until they have traveled through our entire return processing system and are ultimately rerouted to our Taxpayer Service Center for reply.

This can take many weeks and sometimes the letters are inadvertently filed without a reply. The only exception is

if the letter provides an explanation for some information contained in the return. In most cases, our customer service representatives can answer your questions immediately when you call our hotline. And, for those situations when you need to furnish us with additional information, you can send it to us via fax.

If you can't call our hotline, send us your question via fax. Our Tax Practitioner Hotline is open from 8 a.m. to 5 p.m., Monday through Friday. Send us a fax 24 hours a day, seven days a week, at (916) 845-6377.

# Electronic signature options

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The following chart shows the taxpayers' and EROs' responsibilities when using each of the signature options.

	<b>Practitioner PIN</b>	<b>Self-Select PIN</b>	<b>Form FTB 8453</b>
<b>Taxpayers must:</b>	<ul style="list-style-type: none"> <li>Review and sign form FTB 8879.</li> </ul>	<ul style="list-style-type: none"> <li>Enter their PIN on your computer.</li> <li>Provide their shared secret (prior-year California AGI).</li> </ul>	<ul style="list-style-type: none"> <li>Review, sign, and retain form FTB 8453.</li> </ul>
<b>ERO must:</b>	<ul style="list-style-type: none"> <li>Review, sign, and retain form FTB 8879.</li> <li>Enter your client's PIN as shown on form FTB 8879.</li> <li>Enter your ERO PIN.</li> </ul>	<ul style="list-style-type: none"> <li>Allow the taxpayers access to your computer.</li> <li>Enter your ERO PIN.</li> </ul>	<ul style="list-style-type: none"> <li>Review, sign, and retain form FTB 8453.</li> </ul>
<b>Notes</b>	<ul style="list-style-type: none"> <li>Shared secret (prior year California AGI) is generally not required.</li> </ul>	<ul style="list-style-type: none"> <li>No paper forms required.</li> </ul>	<ul style="list-style-type: none"> <li>No shared secret or form FTB 8879 required.</li> </ul>

## Electronic signature options -- frequently asked questions

### 1. Why is FTB adding electronic signature options?

The new electronic signature options make our signature processes more consistent with those of the IRS. This means streamlined processes for you and less confusion for your clients.

### 2. What is the *California e-file Signature Authorization (form FTB 8879)*?

This form allows you to enter your clients' PIN without the need for your client to be present. Your clients sign this form after reviewing their return and you can then enter their PIN as the signature for the tax return. This form can also be used when the shared secret is not known or is unavailable. This form is very similar to form IRS 8879.

### 3. Do I need to use form FTB 8879 for every return I e-file?

No. Use form FTB 8879 when your clients (or their spouses) are unavailable to personally enter the PIN or when the shared secret is not known or is unavailable.

### 4. When do my client's sign form FTB 8879?

Form FTB 8879 must be signed after the return is prepared, but before it is e-filed. Your clients must have the opportunity to review

their return and sign form FTB 8879 before you send the return to us.

### 5. Can taxpayers give me their PIN verbally?

No. Taxpayers must either personally enter their PIN or complete form FTB 8879 to authorize you to enter their PIN for them.

### 6. Can my clients fax me the signed form FTB 8879?

Yes.

### 7. Am I required to give my clients a copy of form FTB 8879?

No. You are required to keep a copy of form FTB 8879 for four years. However, you must provide a copy to your clients upon request.

### 8. Do I have to store a paper copy of form FTB 8879?

No. You can also scan and store the signed form FTB 8879 electronically.

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# Electronic signature options

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## 9. Is the shared secret required when using form FTB 8879?

No. As with the IRS, the shared secret is only required when the taxpayer enters his or her own self-select PIN. (Exception: If, on a joint return, one taxpayer chooses to enter his or her own PIN and the other authorizes you to enter a PIN for him or her, the first taxpayer must also enter the shared secret.)

## 10. What shared secret will taxpayers need to enter?

The California adjusted gross income from their previous year tax return.

## 11. Why is the shared secret the prior year California adjusted gross income when the Customer Service Number (CSN) uses the prior year balance due or refund?

We are mirroring the IRS process to minimize confusion and maximize consistency. We are also changing the CSN online application to use the prior year California AGI.

## 12. If the taxpayer uses the self-select PIN option, am I also required to use a PIN?

Yes. The ERO PIN process must be used for professionally prepared returns if the taxpayer elects to use any electronic signature option.

## 13. Will I get more rejects if my clients use the e-signature options?

Possibly. When the taxpayer uses the self-select PIN option, we will validate the shared secret (California's prior year AGI). If the secret does not match our records, then the return will be rejected.

## 14. How are the California options different from the IRS options?

There are three main differences you need to be aware of:

1. If you use the practitioner PIN method, you must retain the California form FTB 8879
2. If you use the self-select PIN method, your clients must provide their prior year California AGI.
3. If you don't use one of the electronic methods, you must retain (not mail) the California form 8453.

## Mandatory e-file – Update

We have some good news about mandatory e-file. Due to recent legislation, the penalty provision effective date has changed to *on or after January 1, 2005*. The law specifies a penalty of \$50 per return for willful neglect to e-file acceptable California individual income tax returns.

We are sending letters, calling, and visiting those practitioners who we have identified as meeting the mandatory requirements to e-file, but who did not participate, to ensure they comply with the law. If you were subject to the mandate and were unable to participate, it is not too late to get on board.

### e-File Program Enrollment Process

#### Step 1: Enroll in the Internal Revenue Service e-file Program.

You need an IRS Electronic Filing Identification Number (EFIN) to enroll in our e-file Program. To get an EFIN, visit the IRS Website at [www.irs.gov](http://www.irs.gov), and search for: **EFIN**.

#### Step 2: Enroll in our e-file Program.

Complete and submit our new online *California e-file Program Participant Enrollment Form* (form FTB 8633). Go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for: **e-file enrollment**.

If you would prefer to fax or mail your enrollment form, you can download the paper version available from our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov). Use the fax number or address shown on the enrollment form.

#### Step 3: We process your enrollment form.

After we receive your enrollment form, we will conduct a review of your account to ensure that all your business entities are valid and licensed, all personal and business tax returns are filed timely, and all liabilities are current.

#### Step 4: We send you an acceptance letter.

When you have passed our review, we will issue your acceptance letter. In addition, we will provide you with a CD-ROM of e-file resources to guide you through the e-file process.

#### Step 5: e-file enrollment is complete.

When you receive your acceptance, you can begin e-filing returns.

For additional information regarding mandatory e-file requirements, visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and search for: **Mandatory e-file**.



# FTB e-file: Filing season review

During this past filing season we saw a tremendous increase in the number of e-filed returns, particularly in tax practitioner e-filing. Mandatory e-file was the main

driver for the 86 percent increase in the number of e-file returns we received and a 106 percent increase in the number of e-file returns we received from tax practitioners.

<i>Electronic Returns Received</i>	<i>2004</i>	<i>2003</i>	<i>+Increase/-Decrease</i>
<b>e-file</b>			
Taxpayers (through third party)	907,425	814,679	+10%
Taxpayers (Direct)	109,076	38,083	+286%
Practitioners	5,942,515	2,885,868	+106%
<b>TeleFile</b>	74,344	121,431	-39%
<b>Total e-file/TeleFile</b>	<b>6,959,016</b>	<b>3,738,630</b>	<b>+86%</b>

## Reduce paper consumption and minimize waste

Reducing paper consumption is one of the most effective ways to minimize waste. When taxpayers send us unnecessary attachments, particularly federal income tax returns, our cost to process their return increases. In 2002 alone, 1.8 million taxpayers unnecessarily attached their federal return to their California income tax return. Many attached a Form 1040 return to their Form 540 2EZ!

Processing tax returns containing unnecessary federal tax returns is a costly procedure, and so is processing those returns that lack the required federal tax return attached. We received 600,000 such returns in 2002 and in many instances we had to contact taxpayers and request that they send us their federal income tax return.

Both problems are significant because of their extremely high volumes. Most of you already instruct your clients on what to send us when they file. Please also explain to them how important it is to follow your instructions when they file, and to attach only what we require from them. As a general

reminder, here are some guidelines for when to attach federal returns to California personal income tax returns (for filing purposes):

<b>When filing:</b>	<b>Attach Federal Return?</b>
540 2 EZ	No
540 with Schedules And B only	No
540 NR (Short)	No
540A	No
540 with any other schedules other than A and B	Yes
540 NR (Long)	Yes

If special circumstances exist and you're not sure of what documentation your client needs to provide us, please check the filing instructions on the tax form. You can find all our forms and related instructions on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov). For a fail-proof way to ensure your clients are filing their returns properly, use e-file.

## Tips for completing business entity payment vouchers

Incomplete or inaccurate payment vouchers slow down processing of your business entity clients' estimate and extension payments. They can also increase the risk of your clients' payments being applied to the wrong accounts, erroneous or delayed refunds, and erroneous billings.

Here are some general guidelines for producing complete and accurate payment vouchers:

- Include the complete business entity name on the voucher as shown on the Secretary of State's (SOS) records.
- Obtain a corporation or file number from SOS before payment is due.
- Include the correct corporation or file number and federal employee identification number (FEIN) on the voucher.
- Include the month, day, and year of the period to which the payment should be applied at the top of the voucher if filing on a fiscal year basis.
- There are several vouchers to choose from. Be sure to use the correct one:
  - FTB 100ES, *Corporation Estimated Tax*.
  - FTB 3522, *Limited Liability Company Tax Voucher*.
  - FTB 3538, *Payment Voucher for Automatic Extension for Limited Partnerships, LLPs, and REMICs*.
  - FTB 3539, *Payment Voucher for Automatic Extension for Corporations and Exempt Organizations*.
  - FTB 3537, *Payment Voucher for Automatic Extension for LLCs*.

## State conforms to Military Family Tax Relief Act of 2003

### *Changes made to the exclusion of gains on sale of principal residences and increases to the amount of exclusion of military death gratuity payments*

California now conforms to the federal Military Family Tax Relief Act of 2003, which makes many changes to the taxation of military personnel. A couple of notable provisions include changes made to the exclusion of gains on the sale of a principal residence, and increases to the amount of exclusion of military death gratuity payments.

Regarding the rules for principal residences, California taxpayers have until November 10, 2004, (the same date for filing federal claims for refund) to file amended returns to take advantage of the new provisions for older years barred by the statute of limitations. An extended period is available for members serving in a combat zone or a contingency operation.

#### **Exclusion on gain from sale of a principal residence by a member of the uniformed services or the foreign service**

New law now provides that an individual may elect to suspend for a maximum of 10 years the five-year test period for ownership and use during certain absences due to service in the uniformed services (e.g., the Army, Navy, Air Force, Marine Corps, Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, and the Public Health Service). This provision is effective for sales

or exchanges made after May 6, 1997. Taxpayers who want to make claims for refunds for older years that are otherwise closed by the statute of limitations (generally tax years 1997 through 2000) have until November 10, 2004, to make the federal election, which is binding for state purposes. This new provision also applies to members of the U.S. Foreign Service. When amending for state purposes, write "Military Family Tax Relief Act" in red on the top of the amended return. An extended period is available for members serving in a combat zone or a contingency operation.

#### **Exclusion from gross income of certain death gratuity payments**

Qualified military benefits include certain death gratuities with the level of the death gratuity exclusion increased from \$3,000 to \$12,000. The provision is effective for deaths occurring after September 10, 2001. Since the death gratuity income exclusion is increased retroactively, taxpayers who included part of the death gratuity as income for deaths occurring in 2001, 2002, or 2003, should file an amended return claiming a refund because of the change in law that excludes from income the full amount of death gratuity benefit. Write "Military Family Tax Relief Act" in red on the top of the amended return.

## Check out our new forms update Webpage

We often update our tax forms after we initially release them. It is now easier than ever to review the most recent updates, online, using our *Forms and Publication Webpage*. Go to our Website, [www.ftb.ca.gov](http://www.ftb.ca.gov), and click on *Forms and Publications*.

We have added pull-down menus that allow you to view the list of forms and publications that have been

revised since the initial paper version was released to the public. To view the revisions, first select the form using the pull-down menu. Then click the View Updates button. You will get a description of the change(s), and information about where the revision is located on the form.

Editor's note: Most of our revised forms are not reprinted in a paper format.

## Time to order 2004 California Package X

We are now accepting orders for the 2004 California Package X. We will offer the printed version in bound and loose-leaf formats for \$18 plus sales tax.

If you subscribe to the print version of *Tax News*, you'll receive a personalized order form on the back of this issue. Use it to order your Package X and to renew your *Tax News* subscription. When completing the form be sure you:

- Use only the personalized 2004 order form provided on the back page of this issue. Do not use an order form from a previous year's issue. Using an outdated order form will delay your order, even if you cross out the year and write in 2004.
- Make any necessary corrections to your name and mailing address printed on the form.
- Provide your current telephone number.
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### Interest rates

For the period of January 1, 2005, through June 30, 2005, the adjusted interest rate on underpayments and overpayments of California personal income taxes will be **four percent**.

The interest on corporation overpayments for the same period will be **one percent**.

# Substitute, scannable forms need our approval

If you are planning to use tax preparation software next year, be sure that the substitute and scannable California income tax forms generated from your software meet our Substitute Forms Program requirements.

All companies that manufacture and sell tax preparation software that generate substitute and scannable California income tax forms must file an agreement with us stating their intent to comply with our requirements for the 2004 tax year. By signing form FTB 1096, Agreement to Comply with FTB Publication 1098, the company agrees to follow the rules for developing substitute and scannable forms.

Each year, tax software companies that produce substitute and scannable forms are required to submit their forms to us for approval before they are offered to their customers. If you are unsure whether the forms you plan to use this upcoming filing season have our approval, ask your software provider to show you

the FTB issued approval letter for each form you plan to use, before you use it. Do not accept a general statement from your provider that all company forms have been approved. Instead, give your software provider a list of the forms you plan to use and ask them to provide a copy of the FTB approval letter for each form.

Note: Companies that either sell or provide photocopies of official FTB income tax forms do not need to submit them for approval.

Filing tax returns on unapproved forms can lead to processing delays and in those cases where we cannot process the tax returns we will have to contact your clients directly in an effort to process their tax returns.

By press time, the following software companies filed forms FTB 1096 with us.

5227 Tax System Inc.	626-578-1978	My 1040ez.com, Inc.	435-669-1122
2 <sup>nd</sup> Story Software, Inc.	319-373-3600	Nelco	800-968-1099
Accountant Stationers and Printers	213-749-9241	On-line Taxes, Inc.	816-232-0095
Accountware	513-841-4700	Ortax Software Solutions	425-641-4357
Alpine Data Inc.	800-525-1040	Petz Enterprises Inc.	800-345-4337
American Financial and Tax	714-669-1172	Probate Software	970-336-5973
ATX II, LLC	800-944-8883	Pricewaterhouse Coopers	214-756-1627
Basic Computer Services	801-813-4000	Rhodes Computer Services	706-868-0985
Block Financial Corporation	800-457-9525	RIA	800-327-8829
BNA Software	301-424-6350	SMS/First American Title	800-767-7832
Brass Tax Presentations	858-487-2331	Southern California Permanente	
CCH Incorporated	800-739-9998	Medical Group	626-405-3024
CFS Tax Software, Inc.	800-343-1157	Spidell Publishing, Inc.	714-776-7850
Creative Solutions	800-968-0600	STF Services Corporation	800-541-7197
C&S Technologies Inc.	408-935-8468	Tax Biz	408-243-1472
Data Technology Group	315-493-1120	Tax\$imple	866-729-7798
Deloitte & Touche Tax		Tax Technologies, Inc.	866-239-4884
Technologies, LLC	847-236-8000	TaxWare Systems, Inc.	800-877-1065
Drake Software	828-524-8020	Thomson Business and	
Ernest & Young LLP	212-773-1162	Professional Publishing	951-656-3732
File Your Taxes.Com	805-644-9398	TriTech Software	
H&R Block	816-714-2504	Development Corp.	800-380-6407
HowardSoft	858-454-0121	Trust Tax Service	
ImageOne	818-718-7044	of America	508-753-9311
Intuit, Inc.	858-525-7108	Universal Tax Systems, Inc.	706-624-4245
Jackson Hewitt Tax Service	941-378-7127	Vertex, Inc.	941-342-3600
Lamson Tech	215-463-0196	William H Downs, CPA	818-981-4313
Legal Aid Society		Wilson LLP	404-419-3006
of Orange County	714-571-5203	WNC & Associates, Inc.	714-662-5565

# Summary of legislation signed into law in 2004

Several legislative measures affecting the Franchise Tax Board were signed into law in 2004. We have summarized them below. If you want to learn more about a legislative measure you read about here, go to the *Law and Legislation Webpage* located on our Website, at [www.ftb.ca.gov](http://www.ftb.ca.gov). You can also find comprehensive information about all legislative measures on the *Official California Legislation Information Website*, [www.leginfo.ca.gov](http://www.leginfo.ca.gov).

## Amnesty (& Budget Trailer items)

SB 1100 (Senate Budget Committee) Chapt. 226

This budget trailer act:

- Extends the years during which the *Natural Heritage Preservation Tax Credit* may be awarded and claimed.
- Suspends the *Teacher Retention Tax Credit* for the 2004 and 2005 taxable years.
- Creates a tax amnesty program for certain taxpayers that
  - 1) Failed to file income tax returns.
  - 2) Underreported income on a previously filed income tax return.
  - 3) Failed to pay any taxes previously assessed.
- Allows us to charge fees for specific services requested by an individual or entity.

## Child support collections

AB 2358 (Steinberg) Chapt. 806

This act transfers the authority and responsibility for the collection of past-due child support from us to the Department of Child Support Services.

## Conformity

AB 1073 (Dutton) Chapt. 261

This act conforms California law to the new federal law by increasing the amount of the death gratuity excludable from gross income from \$3,000 to the entire amount of the death gratuity, currently \$12,000.

SB 615 (Cedillo) Chapt. 388

This act makes California law compatible with the federal *Servicemembers Civil Relief Act* (SCRA) (PL 108-189) that was enacted on December 19, 2003. This act provides expressly that:

- The military compensation of a servicemember not domiciled in this state may not be used to increase the tax liability imposed on other income earned by that servicemember or that servicemember's spouse.
- The running of the statute of limitations is suspended for the period of a servicemember's military service.

- The rate of interest is limited to a maximum of six percent per year on any underpayment incurred before the servicemember enters military service.
- A servicemember not domiciled in this state does not become a resident of this state by reason of being present in this state solely in compliance with military orders.
- Military compensation of a servicemember not domiciled in this state is not income for services performed or from sources within this state.

Native American servicemembers whose legal residence or domicile is a federal Indian reservation are treated as living on the federal Indian reservation and the compensation for military service is deemed to be income derived wholly from federal Indian reservation sources.

SB 1713 (Machado) Chapt. 552

This act conforms California law to the changes made by the federal *Military Family Tax Relief Act of 2003*.

The act contains the following provisions:

- Exclusion of gain on sale of a principal residence by a member of the uniformed services or the foreign service.
- Exclusion from gross income of certain death gratuity payments.
- Exclusion for amounts received under *Department of Defense Homeowners Assistance Program*.
- Expansion of combat zone filing rules to contingency operations.
- Modification of membership requirements for exemption from tax for certain veterans' organizations.
- Clarification of treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States.
- Treatment of service academy appointments as scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts.
- Suspension of tax-exempt status of terrorist organizations.
- Above-the-line deduction for overnight travel expenses of National Guard and Reserve members.
- Extension of certain tax relief provisions to astronauts.

## Court-ordered debt

SB 246 (Escutia) Chapt. 380

This act gives California superior courts the authority to refer restitution orders to us for collection and requires us to seek resources to accept additional debt collection referrals.

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## e-File

AB 2480 (Campbell) Chapt. 267

This act repeals a penalty provision for tax practitioners that are required to e-file individual income tax returns, and adds an identical penalty provision to be operative at a later date.

## Franchise Tax Board sponsored legislation

AB 1260 (Matthews) Chapt. 163

This act makes it a crime to fraudulently obtain a state refund in any manner, not just by paper warrant.

By expanding the form of fraudulently obtained refunds that may be prosecuted as a violation of the Revenue and Taxation Code, this act effectively expands existing provisions to allow the department to recover investigative costs for fraudulent direct deposit refunds as well as other forms of fraudulent refunds.

AB 1740 (Assembly Revenue and Taxation Committee)  
Chapt. 13

This act does the following:

- Clarifies the method of calculating the taxable income of nonresidents and part-year residents to eliminate concerns that were identified during the implementation of AB 1115 (Stats. 2001, Chapt. 920).
- Corrects a drafting error made when the California Child and Dependent Care Credit was enacted in 2000, as well as a cross-reference error created from a law change made in 2002. These corrections specify the definition of adjusted gross income used when calculating the amount of the credit for all residents, nonresidents, and part-year residents.
- Allows a nonresident taxpayer a prorated alimony deduction.
- Presumes that the late-filing penalty does not apply when, under certain circumstances, the corresponding federal late-filing penalty is determined not to apply.

AB 3071 (Assembly Revenue and Taxation Committee.)  
Chapt. 353

This act:

- Removes an erroneous statutory reference to the statute of limitations for relief from joint and several liability.
- Eliminates inconsistent payment due dates between two sections of California tax law.

AB 3073 (Assembly Revenue and Taxation Committee)  
Chapt. 354

This act:

- Conforms California law to the federal claim of right provisions.

- Extends the voluntary disclosure program to limited liability companies and their owners.

SB 1172 (Ackerman) Chapt. 62

This act provides expressly that California is conformed to federal statutes that limit or preempt California's ability to tax the California source income of specified nonresidents. This act will prevent lengthy and expensive litigation to validate the preeminence of federal law.

## Limited liability companies

AB 1859 (Nakano) Chapt. 416

This act allows domestic limited liability companies to cancel their existence in California without obtaining a tax clearance certificate.

## Miscellaneous

AB 1416 (Bermudez) Chapt. 412

This act extends the repeal date from January 1, 2005, to January 1, 2009, for the provision of the Revenue and Taxation Code that essentially expands the client/attorney privilege for communications regarding tax advice to communications between a client and a non-attorney tax practitioner.

AB 1510 (Kehoe) Chapt. 772

This act allows taxpayers special tax treatment, called *disaster loss treatment*, for losses sustained as a result of the Middle levy break, the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake.

AB 1704 (Assembly Judiciary Committee) Chapt. 339

This act makes a non-substantive technical clarification to recently enacted law that allows an obligor under financial hardship that meets certain conditions to file for a claim of exemption for an amount that is less than or equal to the amount levied by us. In addition, this act makes non-substantive technical changes regarding the use of the term *transfer* when referring to delinquent child support debts referred to us.

AB 2585 (Parra) Chapt. 885

This act requires us to determine the increase in state income tax revenues attributable to locating the *Joint Strike Fighter* program in Kings County.

AB 2722 (Laird) Chapt. 715

This act allows the Wildlife Conservation Board to use bond

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funds to reimburse the General Fund for lost revenue resulting from the award of the *Natural Heritage Preservation Tax Credit*.

SB 1097 (Senate Budget Committee) Chapt. 225

This act does the following:

- Allows local governments to certify employees for purposes of the *Enterprise Zone Hiring Credit*.
- Authorizes the Department of Housing and Community Development to issue emergency regulations to carry out the intent of this bill.

SB 1193 (Soto) Chapt. 547

This act creates a \$10,000 death benefit, which is excluded from tax, for the surviving spouse or beneficiary of certain military personnel killed in the performance of duty.

SB 1458 (Johnson) Chapt. 591

This act:

- Adds to the *Political Reform Act of 1974* a one-year deadline for completing reports of our audits conducted on a random basis.
- Modifies the statute of limitations for initiating a civil action with reference to our audit report completion deadline date.

SB 1689 (Poochigian) Chapt. 402

This act excludes from gross income any payments, including related interest, made because of persecution during the Ottoman Turkish Empire received by an eligible individual or by the individual's heir or estate.

The act defines *eligible individual* as a person who was persecuted on the basis of race or religion by the regime that was in control of the Ottoman Turkish Empire from 1915 through 1923.

## Real estate withholding

AB 1338 (Chavez) Chapt. 528

This act:

- Revises the withholding provisions affecting certain corporations to match that of individuals.
- Provides alternatives for how the real estate escrow person submits withheld funds to the department.
- Clarifies that persons transferring real property in foreclosure or in lieu of foreclosure would not be subject to withholding.

- Authorizes the department to prescribe forms and instructions for the efficient administration of the withholding law, including de minimus thresholds.

## Reports

AB 79 (Dutra) Chapt. 409

This act allows a public agency the option of preparing or submitting any written report not specified under this bill to the Legislature or Governor, unless required under specific circumstances. Those circumstances are as follows:

- The report is required in whole or in part by a court, federal law, or regulation.
- The annual *Budget Act* requires the report.
- The Legislature expressly states that a written report will be prepared and submitted.
- The report is necessary to prepare or to implement the *Budget Act* as determined by the Department of Finance.
- The report is required under the Business and Professions Code.

## S corporations

AB 2328 (Wyland) Chapt. 782

This act provides limited tax relief for corporations required in 2002 to be *S* corporations for state purposes. In addition, this bill would conform to the current federal accrual method of accounting rules.

## Tax preparers

SB 1543 (Figueroa) Chapt. 921

This act:

- Authorizes us to enforce the laws regulating tax preparers.
- Prevents an accountant or tax preparer from disclosing confidential client information unless the client consents in writing.

## Tax forms

SB 1534 (Johnson) Chapt. 844

This act requires us to make available to certain taxpayers the option of using Form 540 2EZ to file their income tax return. To qualify for this filing option, the taxpayer's income would have to be under the following income thresholds:

- A taxpayer filing as single or as a head of household with *total income* for the taxable year of \$100,000 or less.
- Taxpayers filing a joint return or a taxpayer filing as a

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qualified widow(er) with *total income* for the taxable year of \$200,000 or less.

For purposes of this bill, *total income* would mean taxable wages, dividends, interest, and pension income.

## Tax shelters

AB 263 (Oropeza) Chapt. 868

This act amends the tax statute that allows a deduction for dividends received by a parent corporation from an insurance company subsidiary because the statute was previously found

to be unconstitutional. The act also stops corporations subject to tax under the Corporation Tax Law from overcapitalizing insurance subsidiaries that are subject to the insurance gross premiums tax instead of the corporate income tax.

## Voluntary contributions

AB 658 (Nakano) Chapt. 562

This act establishes the *California Prostate Cancer Research Fund* for taxpayer contribution designation on the personal income tax return.

## Do your part...

### Here's how to properly assemble scannable tax returns

Follow these steps when assembling your clients' *scannable* Forms 540 and 540A tax returns. You will help us work more efficiently and speed up our processing of the tax returns.

1. If your clients have Forms W-2, use our new Schedule W, California W-2 Attachment, to help us keep track of them. The Schedule W works with our scannable Forms 540 and 540A. To use it, attach paper copies of the Form(s) W-2s, W-2Gs, 1099, 592-B, 594, and 597 to the Schedule W instead of attaching them to the face of the tax return.
2. Leave the first page of the return loose. Do not attach anything to it.
3. Place any payments inside the envelope. Do not attach payments to the return.
4. Staple together the rest of the return; page 2, followed by Schedule W, then all other schedules and attachments in the usual order.

...File smart