

FTB Refund Fraud Unit Saves Millions

During the first 10 months of 1996, the Franchise Tax Board detected close to \$3.8 million in income tax refund fraud.

If fraud detection continues at the current pace, the 1996 figure will be more than twice the approximately \$2.4 million in fraudulent refunds detected during the previous year.

Most attempts to obtain fraudulent income tax refunds take the form of bogus tax returns or W-2 forms. FTB often identifies fictitious returns through social security numbers that are made up or appropriated. Bogus W-2s often show excessive withholding amounts. And in an era when most W-2s are computer-

generated, false W-2s often are typewritten, sometimes with misspellings of well-known corporate names and with strike-overs. Some lack pertinent information such as FICA figures or show excessive amounts withheld.

FTB's primary objective in impeding fraud is to find false refund claims and prevent them from being paid, without interrupting the normal tax processing operations. In some instances, when income tax refund fraud is detected after a refund has been issued, the matter is transferred to FTB's investigation staff.

CONTINUED ON PAGE 15

Filing by Phone



Individuals who qualify to file Form 540EZ may be able to TeleFile this year. See article on page 2.

Inside ...

- 2 ... TeleFile's second year: What's new?
- 2 ... FTB to collect unpaid student loans
- 2 ... Correction
- 3 ... Three counties are firestorm disaster areas
- 3 ... Was tax return destroyed in firestorm?
- 4 ... Information Directory published in Tax News
- 4 ... Partnerships: Make the K-1 connection
- 4 ... Doing business: Limited partnership, yes/limited partners, no
- 5 ... Corporations: New laws mean new procedures
- 5 ... FTB calendar
- 6 ... Remind electronic filers to pay balance due
- 6 ... Electronic filers: Hang on to declarations
- 6 ... Electronic filers have low error rate
- 7 ... When to take enterprise zone, LARZ and LAMBRA incentives
- 7 ... Program areas converted
- 8 ... Electronic funds transfer a must for installment payments
- 8 ... Withholding amounts to be verified on-line
- 8 ... What are PIT wages?
- 9 ... SBE opinions
- 9 ... Wanted: 1995 tax returns
- 10 ... No business license tax offsets for financial corporations
- 10 ... FTB approval needed for scannable and substitute forms
- 11 ... Follow special rules for computer-generated returns
- 11 ... Hotline: Same number, new name
- 12 ... Index lists 1996 Tax News articles
- 12 ... 1996 Tax News index
- 13 ... Is your Tax News subscription expiring?

CONTINUED ON PAGE 3

Tax News

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TAX NEWS is a bimonthly publication of the Technology and Resources Branch, California Franchise Tax Board. Its primary objective is to provide information to income tax preparers about state income tax laws, regulations, policies and procedures.

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TeleFile's Second Year: What's New?

For its second year of operation, the Franchise Tax Board's TeleFile program has streamlined its procedures and expanded its potential audience.

If some of your clients called in their tax information last year, tell them that this year they will:

- Not be required to send FTB their form W-2s, as they were last year. Instead, they must keep the forms along with their completed TeleFile worksheets.
- Hear a simplified message that means the call will be completed as quickly as possible.
- Use a simplified TeleFile booklet.
- Be able to use the system even if they owe taxes. Last year, the Telefile program was available only to

individuals who qualified for refunds or owed no additional tax.

Your clients may participate in the TeleFile program only if they receive a file-by-phone booklet from FTB, qualify to file a Form 540EZ, "California Resident Income Tax Return for Single and Joint Filers With No Dependents," and meet certain other conditions. For more information, see "TeleFile: Just a Phone Call Away" in the November 1996 Tax News. This year, FTB mailed its TeleFile booklet to approximately 1.6 million California taxpayers; last year, only 100,000 taxpayers were invited to participate.

The toll-free TeleFile line is now available 24 hours a day, every day, until October 15, 1997. □

FTB to Collect Unpaid Student Loans

The Franchise Tax Board this month began the first step in a new venture with the California Student Aid Commission to collect unpaid student loans.

As authorized by AB 255 - Speier (Ch. 96-1001), the Student Aid Commission may refer all or part of its delinquent student loan accounts to FTB for collection. First, however, the accounts must be assigned to a private collection agency for at least nine months.

The target date for FTB's first student loan billings is July 1997. During the program's first year, fiscal 1997-98, the commission expects to refer 150,000 cases to FTB. First year collections are estimated at \$20 million. Currently, FTB and the Student Aid Commission are working to integrate system data and define system requirements.

FTB will use the same collection procedures for the delinquent student loans that it does for personal income tax liabilities. They include billings, telephone contacts and, when necessary, bank levies and wage garnishments.

Student loan collection is the latest in a series of non-tax debt collection responsibilities that recently enacted laws have given FTB. The agency also collects delinquent child support payments, vehicle registration fees, court-ordered debt and Department of Industrial Relations debt. □

Correction

In an article in the November 1996 Tax News on Senate Bill 1077, which establishes a tax education council to oversee tax preparer educational requirements, the number of continuing education hours was misstated. The incorrect sentence should have read: The council will issue a "certificate of completion" to tax preparers who demonstrate that they were previously registered with the Tax Preparer Program or who have completed at least 60 hours of specified instruction within the previous 18 months. □

Three Counties Are Firestorm Disaster Areas

Los Angeles, Orange and San Diego counties have been designated disaster areas as a result of the firestorms that began there on October 21, 1996. Because of the designation, victims of the firestorms may claim their disaster losses on either their 1995 or 1996 tax returns.

To deduct a disaster loss in the prior tax year, taxpayers should submit a Form 540X, "Amended Individual Income Tax Return," or Form 100X, "Amended Corporation Franchise or Income Tax Return."

Whether they claim the loss in 1995 or 1996, taxpayers should:

- Attach the federal Form 4684, "Casualties and Thefts," and any other necessary schedules, using California amounts on the federal form.
- Use Form 4684, Section B to figure the disaster loss for property that is trade or business, income-producing or rent or royalty property.
- Determine whether losses need to be reported on Schedule D-1, "Sales of Business Property;" Form FTB 3805V, "Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations -- Individuals, Estates and Trusts" or Form FTB 3805Q, "Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations -- Corporations."
- Attach to the 1996 tax return or amended 1995 tax return a statement that includes the disaster date and the city and county in which it occurred.
- Print "Firestorms '96" at the top of Side 1 of the tax return. This will speed up the refund process.

Amended 1995 personal income tax returns claiming a disaster loss must be filed by April 15, 1997. Amended corporate returns must be filed by the 15th day of the third month after the close of the income year in which the disaster occurred.

For some disasters, the California Legislature allows taxpayers to carry over

100 percent of any excess disaster loss to future taxable years. At press time, legislation that would allow this treatment for the October firestorms had not been introduced.

For more information, see FTB Publication 1026M, "California Disaster Relief Tax Provisions/Fire Damaged Locations -- California, 1996." It is available without charge. Contact FTB's Tax Practitioner Support Unit by calling (916) 858-0571 or faxing (916) 845-6377. Or write Tax Forms Request, Franchise Tax Board, P.O. Box 307, Rancho Cordova, CA 95741-0307.

Also, if you have Internet access, you may view, download and print the publication. It is available at FTB's <http://www.ftb.ca.gov> address. □

Was Tax Return Destroyed in Firestorm?

Were some of your clients' tax returns lost or destroyed during the October firestorms?

To replace lost or damaged California tax returns, write to RID Unit, Franchise Tax Board, P.O. Box 942840, Sacramento, CA 94249-0060. Or complete form FTB 3516, "Request for Copy of Personal Income Tax or Fiduciary Return," or form FTB 3516, "Request for Copy of Bank and Corporation or Partnership Return."

Disaster victims will not be charged for copies of their tax returns if "Firestorms '96" is printed at the top of the letter or form. For other taxpayers, the charge for a copy of a tax return is \$10. □

Inside

CONTINUED FROM PAGE 1

- 14 ... Look for tax forms on the Internet
- 15 ... Power of attorney: Notarization not required
- 16 ... Small Business Protection Act: Will California conform?
- 16 ... Taxpayer Service Centers open
- 16 ... Did you order Package X?

**Information
Directory
Published in
Tax News**

Telephone numbers and addresses that you may need are included in the California Franchise Tax Board 1997 Information Directory.

The directory is a pull-out section in the center of this issue of Tax News. □

Partnerships: Make the K-1 Connection

Because the number of Schedule K-1s filed in California is increasing, the Franchise Tax Board has published "The K-1 Connection," a guide designed to help partnerships file accurately and on time.

The publication encourages partnerships to file their K-1s on diskettes or other magnetic media. In 1996, nearly 500,000 K-1s were filed that way, saving partnerships both paper and money. This year, some partnerships are participating in an electronic data exchange that collects and stores the electronic K-1 data and forwards it to FTB. FTB continues to accept approved paper K-1s, but electronically-generated information

leads to faster processing and greater accuracy.

"The K-1 Connection" also notes that, if K-1s are filed with incomplete information or in an inappropriate format, FTB may need to contact the partnership for more information or to return the K-1s. In either case, the failures could lead to penalties.

You can obtain a copy of the publication by contacting FTB's Tax Practitioner Support Unit; call (916) 858-0571 or fax (916) 845-6377. Or if you have access to the Internet, you can view, download and print the publication. It is available at FTB's <http://www.ftb.ca.gov> Internet address. □

Doing Business: Limited Partnership, Yes Limited Partners, No

A corporate limited partner is not considered to be doing business in California and is not subject to California minimum franchise tax by virtue of holding an interest in a limited partnership that *is* doing business in California.

That's the decision in a recent case, Appeal of Amman & Schmid Finanz AG, et al., that came before the State Board of Equalization. And the Franchise Tax Board is applying the decision to all limited partners, including corporate and limited partnership limited partners. For California franchise tax purposes, a limited partner is not considered to be doing business in California simply because it holds an interest in a limited partnership that does business in California.

FTB will apply the decision to a limited liability company only to the extent that it is a limited partner in a limited partnership.

"Doing business" in California is defined as actively engaging in any transaction

for the purpose of financial or pecuniary gain or profit within this state.

Corporate limited partners that paid California's minimum or annual tax and that were not doing business in California according to the SBE decision may file a refund claim for all open statute years.

To claim a refund, a corporation may send FTB a letter or file a Form 100X, "Amended Corporation Franchise or Income Tax Return." Limited partnerships may send FTB a letter or file Form 565, "Partnership Return of Income." They should check the "Amended Return" box at the top of the form and complete all of the questions on the return. Entities that send letters must state the basis for their claim, which may be that they were not registered, organized or doing business in California. They do not have to attach a Schedule K-1 (565) or a partnership agreement. In all cases, taxpayers must write "FINANZ" at the top of the letter or form. □

Corporations: New Laws Mean New Procedures

For some corporations, two new laws may lead to new procedures. Here's what some of your clients may need to know and do.

Assembly Bill 744 - Kuykendall (Ch. 96-505). AB 744 requires the Franchise Tax Board to cancel or waive any tax, penalty, interest and additions to tax that have accumulated since January 1, 1987, for any bank or corporation that meets all of these conditions:

- Was incorporated prior to January 1, 1987.
- Was suspended in an income year beginning on or before December 1, 1987, and has not been doing business since January 1, 1987.
- Has an outstanding liability for tax, penalty, interest or additions to tax of more than \$200.
- Has a tax liability for each income year for which a waiver is requested that does not exceed the minimum tax for that year.
- Applies for full corporate dissolution and waiver of tax, penalty and interest and pays a fee of \$200.

The law applies to the period between September 16, 1996, and December 31, 1998. Your clients must file within this time period.

Even if a corporation has an outstanding tax liability for years prior to 1987 in addition to amounts accumulated since 1987, it may qualify for the waiver benefits for the qualifying years. However, a suspended corporation must be revived before it can dissolve. The corporation must pay all tax, penalty and interest for any year to which the statute does not apply. Once all pre-1987 outstanding taxes and other amounts are paid, FTB can revive the corporation.

Then, in order to dissolve, the corporation must submit to the Secretary of State form FTB 3555W, "Request for Corporate Dissolution and Waiver Certificate," and a \$200 check that is payable to the Franchise Tax Board. The Secretary of State will forward the form and the \$200 to FTB, which verifies the corporation's qualifications under the law. FTB then notifies the corporation and the Secretary of State that the corporation has been cleared of tax liability.

If you have any questions about AB 744 procedures, contact FTB's Tax Practitioner Support Unit by calling (916) 858-0571 or faxing (916) 845-6377.

Senate Bill 38 - Lockyer (Ch. 96-954). SB 38, among other things (see "One Law, Many Provisions for Small Businesses, Others" in the November 1996 Tax News), reduces a qualified new corporation's initial prepaid minimum tax from \$800 to \$600. The SB 38 provision applies to income years beginning on or after January 1, 1997.

A qualified new corporation is a corporation that reasonably estimates that, for the income year, it will have both of the following:

- Gross receipts, less returns and allowances, reportable to California of \$1 million or less. To determine gross receipts of a corporation that files a combined return, include each member of the controlled group. Gross receipts, less returns and allowances, reportable to California means the sum of the gross receipts from the production of business income and gross receipts from the production of nonbusiness income.
- A tax liability, measured by net income, of not more than \$800.

However, a corporation does not qualify for the \$600 prepaid minimum tax if, during the income year, another corporation owns 50 percent or more of its stock.

If a corporation pays the \$600 and then finds that during its first income year gross receipts are more than \$1 million and its tax liability is more than \$800, it must pay an additional \$200 of initial tax. The \$200 is due and payable on the original due date of the corporation's return, not the extended due date.

Before opting for the \$600 prepaid minimum tax, corporation officials should consider that:

- Newly incorporated companies pay the \$600 prepaid minimum tax to the Secretary of State for the privilege of doing business in California for their first income year. It cannot be claimed as a credit against the tax reported on the corporation's first

FTB Calendar

January

- FTB begins using improved system to verify withholding amounts claimed on personal income tax returns against withholding amounts reported by employers to EDD.
 - Notices issued to corporations that failed to file 1994 tax returns.
 - Package X in both paper and CD-ROM versions mailed.
 - Requests for personal income tax returns mailed to 1995 nonfilers.
- 10 FTB begins accepting electronically filed returns.
- 15 Personal income tax estimate payments due.
- 20 Previous month withholding at source payments due if total withholding exceeded \$2,500.

February

- Notices of proposed assessment mailed to 1995 nonfilers who failed to respond to December requests for tax returns.
- 20 See January 20.

March

- Package X CD-ROM update mailed.
- 20 See January 20.

April

- 15 First 1997 personal income tax estimate payment due.
- 15 Personal income tax returns due.
- 20 See January 20. □

Remind Electronic Filers to Pay Balance Due

If your clients file their tax returns electronically, make sure they remember to pay their taxes as well.

Last year, for the first time, taxpayers were able to electronically file tax returns with balances due. And some of them forgot to pay the balance on April 15.

Electronic filers' tax payments should be sent to the Franchise Tax Board with form FTB 3582, "Payment Voucher for Electronically Transmitted Returns."

Be sure to give your clients this form when they pick up their tax returns. It is available in the 1996 Package X, may be downloaded from FTB's <http://www.ftb.ca.gov> Internet address and may be ordered by calling F.A.S.T. (Fast Answers about State Taxes) at (800) 338-0505. □

Electronic Filers: Hang on to Declarations

When you file electronically on behalf of your clients, keep the forms they sign to declare that the information on their tax returns is "true, correct and complete."

Last year, a number of tax professionals sent form FTB 8453, "California Individual Income Tax Declaration for Electronic Filing," to the Franchise Tax Board in error.

As an "electronic return originator," the person who transmits the return to FTB, you must keep the declaration in your files for four years from the return's due date. □

Electronic Filers Have Low Error Rate

Electronically filed California tax returns have fewer errors than returns filed in other ways, and the Franchise Tax Board is aiming for a perfect record.

FTB is working to eliminate the most common errors that tax practitioners make on electronically filed (ELF) tax returns.

During the last filing season, the state employer identification number (SEIN) accounted for 64 percent of all errors that cause the ELF system to reject tax returns. This year, in an attempt to forestall errors, the SEIN field has been expanded to accommodate all characters from Box 16 of the taxpayer's form W-2. The field also now accepts spaces, dashes and other punctuation marks and symbols that may be in Box 16 along with alpha characters. If Box 16 is blank, put "N.A." in the SEIN field.

When ELF returns are rejected, they can be corrected and retransmitted. But to avoid rejection, make note of the next five most common ELF errors. Be sure that:

- All fields contain the type of data specified in the "type" column of the record layouts.
- Your electronic filing identification number (EFIN) is correct.

- The fields on a record are not longer than specified in the California Record Layouts.
- The W-2 fields, which include name, address and wages, are present according to the record layouts.
- The federal Form 1040 information is included if the federal indicator in field 063 equals "X."

In early December, FTB mailed a diskette of its Publication 1345, "Electronic Filing Handbook, File Specifications and Record Layouts for State of California Individual Income Tax Returns," to 5,000 ELF participants. The diskette was used to save paper and expedite delivery; paper copies of the publication take an additional four weeks to produce. If you have not received your diskette or would prefer a paper version, call the ELF Help Desk at (916) 845-0353. The Help Desk is open Monday through Friday from 8:00 a.m. to 5:00 p.m.

If you have Internet access, you may download, view and print the publication from FTB's <http://www.ftb.ca.gov> address. □

Corporations: New Laws Mean New Procedures

CONTINUED FROM PAGE 5

return or used as an estimated tax payment.

- The \$600 prepaid minimum tax applies only to the first year of incorporation. In all following years, the corporation is subject to the annual minimum franchise tax of \$800.
- All banks and corporations must make one or more payments of estimated tax each year, unless they are exempt under the law. They must use Form 100-ES, "Corporation Estimated Tax," and the first installment cannot be less than the minimum franchise tax of \$800.
- On its annual tax return, the corporation will be asked whether its gross receipts are greater than \$1 million and whether another

corporation owns 50 percent or more of its stock. A "yes" answer to either question means that the corporation should have made an \$800 instead of a \$600 prepaid minimum tax. The corporation should pay the additional \$200 along with its regular tax liability. If it does not, FTB will issue a bill.

- If the \$600 payment is adjusted to \$800 and the \$200 is not paid on the original due date of the corporation's return, an underpayment and other penalties may be assessed from that due date. □

When to Take Enterprise Zone, LARZ and LAMBRA Incentives

Taxpayers operating in enterprise zones, the Los Angeles Revitalization Zone (LARZ) or a Local Agency Military Base Recovery Area (LAMBRA) are entitled to certain incentives. But when may they take them?

Some credits and deductions may be taken only on an original tax return. Others may be taken on an original, an amended or a delinquent return. The guiding principle is whether the taxpayer is required to make an election to obtain the incentive.

When an election is required, the taxpayer must decide which incentive to claim, and the election must be made on an original return that is filed on time. An election may be revoked only with the Franchise Tax Board's consent.

When no election is required, the taxpayer may take the incentive on an original, an amended or a delinquent return.

Hiring credit. Taxpayers operating in the LARZ or in an enterprise zone are not required to make an election to claim the hiring credit, so the incentive may be taken on an original, an amended or a delinquent return. In a LAMBRA, however, taxpayers may have an election requirement. A taxpayer that qualifies to take the LAMBRA hiring credit and any other credit for the same wage expense under the personal income tax law or the bank and corporation tax law must make an election as to which credit it chooses to claim. If the taxpayer must elect a credit, the election must be made on the original tax return. If the taxpayer is qualified to claim only one credit for the wage expense incurred, the credit may be claimed on an original, an amended or a delinquent return.

Net interest deduction. For taxpayers operating in the LARZ or in enterprise zones, this deduction may be taken on an original, an amended or a delinquent return. This deduction is not available to taxpayers operating in a LAMBRA.

Net operating loss and business expense deductions. Whether the taxpayer is in a LARZ, a LAMBRA or an enterprise zone, these deductions may be claimed only on the original tax return. An election to take these deductions is required.

Sales or use tax credit. Taxpayers that operate in an enterprise zone generally may claim the sales or use tax credit on an original, an amended or a delinquent return. However, if these taxpayers also operate in the LARZ or a LAMBRA, the sales or use tax credit may have to be claimed by an election made on the original return. For taxpayers that operate in a LARZ or a LAMBRA, an election on the original to claim the sales or use tax credit is required if the expense that qualifies the taxpayer to claim the LARZ or LAMBRA sales or use tax credit also qualifies the taxpayer for any other credit under the personal income tax law or the bank and corporation tax law. If the expense qualifies the taxpayer to take only the LARZ or LAMBRA sales or use tax credit, the credit may be claimed on an original, an amended or a delinquent return.

When an election is made on an original return, a taxpayer may subsequently file an amended return to correct a deduction or credit amount. However, the taxpayer may not file an amended return to include the qualified cost of other properties that were not included on the original return. For example, Corporation Z purchases property and estimates the total qualified costs to be \$900. Actual costs are \$950. The corporation may file an amended return to take the additional \$50 deduction. However, if Corporation Z had purchased properties A and B and then claimed only the cost of property A as a business expense deduction on its tax return, it may not file an amended return to add the cost of property B to the business expense deduction.

(The three-member Franchise Tax Board has voted to sponsor legislation to remove the election requirements from the LARZ and LAMBRA sales or use tax credits and the LAMBRA hiring credit, retroactive to the dates the credits were enacted.

Program Areas Converted

Beginning this month, a new Enterprise Zone Act in effect converts program areas to enterprise zones.

The act actually repeals enterprise zone and program area tax incentives and creates a new set of incentives for the new enterprise zones. The incentives are blends of the current enterprise zone and program area incentives with some modifications. For more information, see "What's New in Tax Law?" in the November 1996 Tax News. □

Electronic Funds Transfer a Must for Installment Payments

Starting in January 1997, your clients who have been approved to pay their taxes in installments must make the payments, in most cases, using electronic funds transfer (EFT).

The Franchise Tax Board may approve installment arrangements for individuals who show that they are unable to pay their tax bills because of a financial hardship. With EFT, funds are transferred directly from your client's bank account to the state's bank account. Your client may decide whether the payment is deducted from a checking or savings account and choose the day of the month that the payment is withdrawn.

With EFT, your clients can save time and money by not writing monthly checks for approved payment arrangements. If your client is out of town, payments will still be made on time. And your clients will not have to wonder whether the payment was received and credited to their account; FTB and your client's financial institution will make certain the payment is properly transferred. □

Withholding Amounts To Be Verified On-line

Tell your clients to make sure their W-2 forms accurately reflect their wages earned and withholding paid throughout the year.

Why? Because if wages and withholding do not match, your clients may receive a return information notice (RIN) stating that the California withholding they claimed has been modified and that their refund has been reduced or that a balance is now due.

Starting this month, withholding amounts on 1996 California tax returns are being verified on-line as a result of a cooperative Franchise Tax Board/ Employment Development Department automated information exchange. The exchange is part of a continuing effort to integrate California's personal income tax and employment tax systems. (For more information, see "FTB/EDD Looking at W-2 Data" in the November 1996 Tax News.)

During return processing, accounts referred for on-line verification will be verified using W-2s and employment information from EDD. If necessary, FTB will contact employers to substantiate withholding information reported to EDD. Taxpayers' withholding may be adjusted based on information obtained from W-2s, EDD information and employer contacts.

As a result of the new on-line validation process, FTB anticipates fewer erroneous RINs being issued because a W-2 either was not attached or was separated from the returns during processing. In the past, if a W-2 was not attached and FTB's automated system referred the return for manual withholding verification, the taxpayer would receive a RIN because the W-2 did not substantiate the amount claimed.

In addition, FTB is employing five former EDD staff members. They have extensive experience with the various EDD files and in contacting employers. These staff additions should minimize employer contacts and help reduce potential burdens on taxpayers and employers.

Taxpayers who receive a RIN stating that an expected refund has been reduced or

that a balance is now due should call the telephone number on the RIN if they have questions or disagree with the adjustment. If you want information about a client's RIN, contact FTB's Tax Practitioner Support Unit by calling (916) 858-0571 or faxing (916) 845-6377. Keep in mind that the Support Unit numbers should not be given to clients; they are for tax professionals only.

In 1998, FTB will begin verification of wages as well as withholding amounts. (See "What Are PIT Wages?" on this page.) □

What Are PIT Wages?

Do your employer-clients know what "PIT (personal income tax) wages" are? Do they know why reporting them properly is important to their employees?

If you have employer-clients, they need to know the definition in order to correctly fill out the Employment Development Department's Form DE6, "Quarterly Wage and Withholding Report." Beginning with the DE6s for the first quarter of 1997, which are due April 30, employers must report PIT wages to EDD. Then, in 1998, employing an automated process, the Franchise Tax Board will use the information to verify wages during the initial processing of returns.

The wage reporting and verification procedures are part of an ongoing FTB/EDD effort to integrate California's personal income tax and employment tax systems. (For more information, see "FTB, EDD Looking at W-2 Data" in the November 1996 Tax News.)

You may want to give your clients this definition of PIT wages: PIT wages are remuneration that employees receive for their services and that is subject to California personal income tax. PIT wages are reported in Box 17, "State Wages, Tips, etc.," on the federal Form W-2.

CONTINUED ON PAGE 15

SBE Opinions

Appeal of AMP Incorporated, October 10, 1996. The State Board of Equalization denied the appellant's claim of lack of unity of ownership with Pamcor, a Puerto Rico corporation. The appellant's stock was "tied" to Pamcor's stock through a trust. The SBE overruled the "single individual or entity" test of Appeal of Douglas Furniture of California, Inc. (SBE, January 31, 1984) as the exclusive test for unity of ownership. The SBE found unity of ownership because common shareholder voting patterns demonstrated that the two corporations were operated as an integrated business enterprise. The appeal involved years prior to the 1994 amendment to Revenue and Taxation Code Section 25105, effective in 1995, which provided a per se rule for unity of ownership for corporations that constitute "stapled entities."

Appeal of Rapid-America Corporation, October 10, 1996. In upholding the respondent's proposed assessments, the SBE ruled that the basis of stock in a unitary subsidiary sold by the appellant may not be increased by the amount of retained earnings held in the sold subsidiary.

Appeal of George and Leanne Roberts, et al., October 10, 1996. In denying the appellants' claimed exclusion from preference tax, the SBE held that the appellants did not sell small business stock because the parent holding company and its subsidiaries could not be combined for purposes of the gross receipts test contained in former Revenue and Taxation Code Section 18162.1(f)(1).

Appeal of Michael and Zorine Lewis, October 10, 1996. In granting the appellants' claim for refund, the SBE held that the Franchise Tax Board's assessment was issued beyond the statute of limitations under the former statute that required assessments to be issued within four years of a final federal determination. As the amount was paid under protest for the purpose of challenging the timeliness of the assessment, the payment of the untimely assessment could be treated as an overpayment and could be refunded without regard to the underlying merits of

the assessment. FTB has filed a petition for rehearing.

Appeal of Kenneth B. and Ilene Bonilla, December 4, 1996. Disability benefits paid from a qualified Internal Revenue Code Section 401 pension plan may not be excluded from income under IRC Section 105. The fact that a distribution may be made from such a plan in the event of illness or physical loss does not change the character of the distribution from one of deferred compensation to one of accident or health benefits to which IRC Section 105 applies. In its decision, the SBE cited federal Revenue Ruling 69-141, 1969-1 C.B. 48 with approval.

Appeal of Capitol Architectural Products Co., December 4, 1996. In upholding FTB's denial of claimed refunds of estimated tax penalties and late filing penalties, SBE followed the rationale of FTB Legal Ruling 94-4, published September 30, 1994, holding that an overpayment shown on a delinquent return as a credit to a subsequent year does not exist until the delinquent return claiming the overpayment is filed. Therefore, the late payment and estimated tax penalties were properly assessed with respect to the later years because the amounts due for those years were not "paid" until the delinquent prior year returns showing overpayments were actually filed.

At press time, case numbers had not been assigned to these opinions. □

When to Take Enterprise Zone, LARZ and LAMBRA Incentives

CONTINUED FROM PAGE 7

Although this would continue to limit the taxpayer to one credit, it would allow the taxpayer to claim the credit on an original, an amended or a delinquent return.) □

Wanted: 1995 Tax Returns

This month, the Franchise Tax Board will ask at least 200,000 individuals where their 1995 personal income tax returns are.

FTB notices requesting the 1995 returns are part of a series of mailings to potentially delinquent taxpayers that began in December (see "Did Your Client File Late" in the November 1996 Tax News).

The notices advise the individuals that information from various sources indicates that they are required to file a 1995 return. A client who receives a notice but has already filed a return should complete the questionnaire on the back of the notice and mail it to FTB. Or, the client may call the FTB filing enforcement interactive voice response telephone system at (800) 545-5009.

Beginning in mid-February, individuals who did not respond to the notices sent in December will receive notices of proposed assessment. They will show not only the tax due, based on available information, but penalties, interest and a fee to cover the cost of enforcing the individual's filing requirement. □

No Business License Tax Offsets for Financial Corporations

May financial corporations offset against the franchise tax amounts paid as business license taxes? FTB Notice 96-4 reminds taxpayers that the answer is "no."

Because the California Supreme Court in 1991 determined that financial corporations are exempt from personal property and business license taxes, the state has no authority or requirement to provide an offset for payment of these taxes. Payments that cannot be offset include those made by financial corporations in discharge of personal property taxes according to lease agreements.

The Supreme Court determination came in *California Federal Savings and Loan Association v. City of Los Angeles*. The financial corporation exemption from personal property and business license taxes is stated in Revenue and Taxation Code Section 23182.

FTB Notice 96-4, which updates a portion of Legal Ruling 89-1, was issued on October 3, 1996. It has been published by most tax services. □

FTB Approval Needed for Scannable and Substitute Forms

If the scannable or substitute state tax forms you use do not meet Franchise Tax Board requirements, FTB may not be able to process them. And FTB may need to contact your clients directly, especially in the case of unapproved Schedule K-1 forms.

All companies that publish, produce or sell electronically-processed substitute California tax forms and image-processed scannable Forms 540 and 540A must file an agreement to comply with FTB requirements for the forms. Then, FTB must approve the forms before they are sold or provided to tax preparers. (Companies that photocopy official FTB forms do not need approval before selling or providing the forms.)

The following companies have filed a form agreeing to follow the rules for developing scannable and substitute tax forms. However, filing the form does not constitute approval from FTB. So, ask to see a company's FTB approval letter before you use its forms. Do not accept a general statement that the forms are approved. Give the company a list of the forms you plan to use, and make certain each is approved.

5227 Tax System, Inc. (800) 592-5227
 Abel-Wagner Inc. (714) 572-8585
 Accountant Stationers & Printers (800) 423-9717
 Accountware
 Alpine Data Inc. (800) 525-1040
 AM Software (816) 741-7848
 American Tax Services
 Applied Information Solutions (303) 893-8936
 Arthur Andersen LLP (941) 365-9469
 ATX Forms (207) 455-4603
 Block Financial Corporation (816) 932-7500
 Brass Tax Presentations (619) 487-2553
 BSoft Corporation (408) 438-7071
 CCH Incorporated (Torrance) (310) 543-6200
 CCH Incorporated (Wichita) (316) 685-8100
 CFS Income Tax (800) 522-1157
 CLR/FastTax (214) 250-7000
 CLR Professional Software (770) 432-1996, ext. 9600
 Compucraft Data Services (310) 542-6646 (714) 846-9124
 Consolidated Business Systems (800) 262-4461
 CPASoftware (904) 434-2685
 CPSystems, Inc. (804) 346-0640
 Creative Solutions Inc. (313) 426-5860
 Curtis Publications Inc.

D.A. Bailey & Sons Publishing Co., Inc. (540) 672-7015
 Dalton Tax Software (208) 877-1161
 Data Technology Group, Inc. (617) 661-1118
 Deloitte & Touche LLP (Washington, D.C.) (202) 955-4000
 Deloitte & Touche Tax Technologies LLC (818) 316-2400
 DRAKE Enterprises LTD. (800) 890-9500
 Duplex Products Inc.
 Electronic Filing Services (301) 929-3129
 EXACTAX Inc. (800) 352-3638
 Federated Tax Service, Inc. (773) 561-4400
 Gear-Up Tax Seminars (916) 268-6508
 Gemisys/Trust Company of America (303) 705-6000
 H&R Block Tax Service (816) 753-6900
 HowardSoft (619) 454-0121
 Independent Preparer Services, Inc. (818) 701-3090
 Inland Society of Tax Consultants
 Intuit, Inc. (619) 784-4274
 ITS, Inc. (714) 692-7076
 Jackson Hewitt Tax Service (757) 473-3300
 JCF Systems (415) 731-7793
 JTR Bookkeeping and Tax (308) 534-5922
 KPMG Peat Marwick LLP
 Lacerte Software (214) 490-8500
 Les Blend Co. (415) 917-0558
 Lyons and Associates
 Mavric Management Systems Inc.
 Mercury Printing Co. (800) 421-2220
 Micro Vision Software (516) 232-1040
 National Tax Training School (718) 871-9120
 Nelco, Inc. (414) 337-1000
 ORRTAX Software Inc. (800) 377-3337
 Owens Financial Group, Inc.
 Parsons Technology (319) 395-9626
 Pencil Pushers Tax Software (800) 370-2500
 Petz Enterprises, Inc. (209) 835-2720
 Prestige Graphics, Inc. (619) 560-8213
 Price Waterhouse LLP (214) 754-7900
 Probate Software Co., Inc. (970) 330-3260
 Professional Stationers Inc. (818) 982-5222
 RealNet Software, Inc.
 Rock Creek Technologies (202) 872-0295
 SCS/Compute (800) 736-4587
 Service Data Corporation
 Short Form Software (914) 353-7719
 Spidell Publishing, Inc. (714) 776-7850
 Stallion Software, Inc. (888) 242-0288
 STF Services Corporation (800) 541-7197
 Sunrise Software, Inc. (800) 223-2379
 Tax And Accounting Software Corporation (800) 998-9990
 TAX BIZ (408) 243-1472
 TAXBYTE, Inc. (800) 245-8299
 Tax Forms Inc. (541) 772-6666
 Tax Forms Library (800) 466-9110
 Tax Link, Inc. (614) 457-1949
 Taxtor Educators
 Taxware Systems Inc. (800) 877-1065
 Taxworks by Laser Systems (801) 552-8800
 Technology Funding Inc. (415) 345-2200
 TFP Data Systems (formerly Tax Forms Printing)
 T K Publishing, Inc. (Tax Shop) (407) 351-0966
 TMI Tax Services, Inc. (612) 935-6111
 Universal Tax Systems (800) 755-9473

CONTINUED ON PAGE 11

Follow Special Rules for Computer-Generated Returns

During the last filing season, the Franchise Tax Board used optical character recognition technology to scan and capture information from more than 4.8 million tax returns that tax preparers and taxpayers generated by computer. Scanning with imaging equipment means fast processing, but only if the returns are properly prepared.

Image processing equipment relies on the quality and appearance of the scannable tax form to ensure that the data is scanned and interpreted correctly. Your tax preparation software typically should include features and edits to help you complete your clients' returns properly. In addition, to make sure that your clients' returns will be processed accurately:

- Do not attach the label that FTB supplies on the non-scannable forms it sends your client. Instead, computer-print the client's name and address.
- Send FTB the original printout of the return. Do not send a photocopy.
- Do not put a space or dash on any name field except for noting such things as "Jr.," "Sr." and "II." For example, if your client's name is "Jean-Paul De Marco II," write "JEANPAUL" in the first name field and "DEMARCO II" in the last name field. For more information, see FTB Publication 1095D, "Tax Practitioner Guidelines for Computer Prepared Returns."
- Do not include apartment information in the street address field. Use the "apartment" and "apartment number" fields instead.

FTB Approval Needed

CONTINUED FROM PAGE 10

U S Tax Systems, Inc. (800) 966-8787
Visible Computer Supply (630) 377-2586
Wallace Computer Services, Inc. (630) 377-2586
Weaver Tax Service (408) 258-0912
Westpro, LTD.
William H. Downs, CPA (818) 981-4313
Xpress Software, Inc. (800) 285-1065 □

- Use 1996 software for 1996 tax returns. Do not use software from a previous year, and be sure you are using the latest update of your 1996 software.
- Mail scannable returns to the correct address. If a refund is due or no amount is owed, send to Image Processing, Franchise Tax Board, P.O. Box 942840, Sacramento, CA 94240-0009. If an amount is owed, send the return to Franchise Tax Board, P. O. Box 942867, Sacramento, CA 94267-0001. Be sure to include the last four digits of the zip code.

Also keep in mind that:

- Starting this year, Form 540-ADS, "California Automated Data Sheet," is obsolete. Only Forms 540 and 540A, "California Resident Income Tax Returns," may be generated by computer for scanning.
- Your identification number, either a social security number or a federal employer identification number (FEIN), must now be printed in the "scanband" and be among the data captured on all scanned returns. The scanband is an area containing numbers and data that the image processing equipment reads. The software program will prompt you to enter the identification number in the proper place.
- Most available software for computer-generated tax returns cannot be used with dot matrix printers.

For more information, see FTB Publication 1095D, which is included in the 1996 Package X. Also, if you have Internet access, you may download, view and print Publication 1095D and other publications and forms. The publication is available on the Internet at FTB's <http://www.ftb.ca.gov> address. You also may order the publication by contacting FTB's Tax Practitioner Support Unit; call (916) 858-0571 or fax (916) 845-6377. Or write Tax Forms Request, Franchise Tax Board, P.O. Box 307, Rancho Cordova, CA 95741-0307. □

Hotline: Same Number, New Name

If you want information, get in touch with the Franchise Tax Board's Tax Practitioner Support Unit.

You can reach the Support Unit by phone or fax. The telephone number, (916) 858-0571, was formerly known as the Tax Practitioner Hotline; and the fax number, (916) 845-6377, was previously the Tax Practitioner Electronic Correspondence fax number.

Both the telephone and fax numbers are intended for tax practitioners only, not for their clients. □

Index Lists 1996 Tax News Articles

The "1996 Tax News Index" at right lists articles published in Tax News during 1996. The articles are categorized by subject matter, from "Accounting Methods" to "Water's-edge." □

1996 Tax News Index

Accounting Methods

Accounting Method: FTB Departs from Federal - November, p. 11.

Ruling Considers Securities Dealers' Accounting Methods - January, p. 8.

Adjustments

Moving Expense Treatment: Not the Same as Federal - March, p. 15.

California Tax Forms

Addition Made to Form 568 - May, p. 3.

Companies Agree to Meet Scannable and Substitute Forms Requirements - September, p. 10.

Companies That Agree to Meet Scannable and Substitute Forms Requirements - November, p. 10.

Definition of Zone Income Clarified - March, p. 4.

Form 3565 Alert - January, p. 7.

Form FTB 3565 Filing Is Modified - July, p. 2.

FTB Must Approve Scannable, Substitute Forms - November, p. 10.

More Companies Agree to Comply with Scannable and Substitute Forms Requirements - January, p. 12.

Schedule P, Credit Limitation Worksheets Revised - January, p. 5.

Substitute Forms Not Approved - May, p. 13.

Watch for Errors on 1995 Tax Forms - March, p. 4.

Compliance

1994 Tax Returns Filed - May, p. 8.

Assessments Proposed for a Quarter Million People - March, p. 7.

Assessments Proposed for Nonfiling Corporations - November, p. 10.

Corporations Asked for 1994 Returns - July, p. 5.

Did Your Client File Late? - November, p. 7.

More Individuals Get Notices for Failing to File - July, p. 6.

New Reasons to Interact with FTB - March, p. 2.

Sham Trusts Are New Tax Dodge - September, p. 1.

Where Are 1994's Half Million Nonfilers? - January, p. 3.

Corporations

How to Make a Comeback: Corporate Revivors - March, p. 5.

The Question Column - March, p. 7.

Court Cases

Court Decisions - May, p. 4.

Credits

Does Your Client Qualify for Credit for Increases in Research Activities? - January, p. 10.

Manufacturers' Investment Credit: Finding the Right SIC Code - July, p. 5.

Manufacturers' Investment Credit Regulations Adopted - May, p. 15.

Deductions

Remember to Adjust Itemized Deductions - January, p. 8.

Disasters

Eight Counties Declared State Disaster Areas - March, p. 6.

Electronic Filing

Avoid Electronic Filing Errors - May, p. 7.

Correction - January, p. 9.

Electronic Filing Can Be Good for Business - January, p. 6.

Electronic Filing: Dates to Remember - September, p. 11.

Electronic Filing Facts You Need to Know - January, p. 6.

Electronic Filing Gains Fans - May, p. 4.

Electronic Filing: Sign Up Now for 1997 Season - September, p. 11.

Electronic Filing: The Time is Right - March, p. 12.

Electronic Filing: Two-Year Review - May, p. 7.

Electronic Filing: What Inquiring Minds Want to Know - November, p. 2.

How Refunds for Electronic Filers Measure Up - July, p. 4.

Important Electronic Filing Dates - March, p. 12.

Make a Date with Electronic Filing - January, p. 6.

More Are Filing Electronically - March, p. 12.

Some Electronic Filers Forgot to Pay Tax - May, p. 7.

Test Electronic Filing Software - July, p. 4.

Watch for Electronic Filing News - July, p. 4.

Electronic Funds Transfer

Electronic Funds Transfer Program Expands - January, p. 7.

Employment Development Department

EDD Offices Emphasize Customer Service - January, p. 10.

News from EDD - May, p. 12.

News from EDD - July, p. 6.

Fiduciaries

Death and Taxes - July, p. 10.

FTB Calendar

January, p. 5.

March, p. 5.

May, p. 5.

July, p. 5.

September, p. 5.

November, p. 5.

FTB Information

Brown Joins Franchise Tax Board - May, p. 2.

FTB, BOE, EDD Develop Strategic Plan - September, p. 2.

CONTINUED ON PAGE 13

1996 Tax News Index

CONTINUED FROM PAGE 12

- FTB Has Speakers - May, p. 10.
 Getting Closer - March, p. 8.
 Getting in Touch - March, p. 13.
 Hotline Hours Extended - March, p. 16.
 Legal Branch Has New Address - January, p. 13.
 Questions Answered, Tax Form Requests Taken - July, p. 10.
 Tax Practitioner Contacts - November, pp. 13, 14.
 Taxpayer Service Center to Open in Ventura - November, p. 6.
 Telephone Numbers to Cut Out and Keep - November, p. 13.
 When to Call the Hotline - May, p. 16.
- Head of Household**
 Do You Have Head of Household Questions - July, p. 9.
 Head of Household Status Studied - July, p. 9.
 New Reasons to Interact with FTB - March, p. 2.
 Who Qualifies for Head of Household - July, p. 9.
- Image Processing**
 FTB (S)can Do - May, p. 10.
- Information Returns**
 1099s: When Is Magnetic Filing a Must? - September, p. 7.
 FTB, EDD Looking at W-2 Data - November, p. 4.
- Insurance**
 Ruling Addresses Obtaining Insurance from Nonadmitted Insurers - September, p. 6.
- Interest**
 Interest Rates - May, p. 8; November, p. 2.
- Internal Revenue Service**
 Electronic Employment Tax Deposits: No Immediate Penalties - September, p. 8.
 Employment Tax Deposits Mandated - July, p. 8.
 Employment Trust Funds Abused - July, p. 8.
 News from the IRS - March, p. 12.
- Internet, Electronic Bulletin Boards**
 Bulletin Board Is Closed - July, p. 8.
 Bulletin Board Update - January, p. 5.
 FTB on the Internet: Dial Direct - May, p. 14.
 Internet Address - July, p. 6.
 Need a Tax Form Quickly? - March, p. 14.
 Remember: Bulletin Board Is Closed - September, p. 9.
 Tax Forms in Cyberspace - May, p. 15.
 What's Located at FTB's Internet Address? - January, p. 8.
 What's New on the Internet? - July, p. 5.
- Legislation**
 A Look at New Laws - January, p. 2.
 Call, Write for Copy of Proposed Law - July, p. 12.
 Interested in Copy of New Law? - January, p. 4.
 Legislation to Watch - May, p. 11; July, p. 12.
 Need a Copy of Proposed Law? - May, p. 11.
 New Laws on the Books - September, p. 11.
 New Laws Deal with Reparations - July, p. 12.
 One Law, Many Provisions for Small Businesses, Others - November, p. 5.
 The Question Column - May, p. 8.
 Update for Military in Bosnia - November, p. 9.
 What's New in Tax Law? - November, p. 11.
 Where to Get Copy of New Law - September, p. 10.
 Where to Get More SB 38 Information - November, p. 6.
- Limited Liability Companies**
 The Question Column - July, p. 11.
- Limited Liability Partnerships**
 Limited Liability Partnership: How It Compares - March, p. 11.
- Net Operating Loss**
 Ruling Addresses NOL Terminology - September, p. 8.
- Nonresidency**
 Group Nonresident Returns: No Advance Approval Needed - March, p. 2.
- Package X**
 1996 Tax News/Package X Order Form - November, p. 16.
 California Package X on CD-ROM Includes IRS Forms, Costs Less - November, p. 1.
 For Package X Delivery, Provide Your Street Address - November, p. 3.
 How to Order Package X, Tax News - November, p. 3.
 Package X: Q & A - November, p. 4.
 Package X Update - March, p. 15.
 Package X: Wait for 1996 Order Form - September, p. 8.
 Package Xs Shipped This Month - January, p. 14.
 Paper Package X: Faster Deliveries - November, p. 3.
 Should You Order Package X on CD-ROM? - November, p. 3.
 Want Package X on CD-ROM? - January, p. 15.
- Payment Arrangements**
 Around-the-Clock Answers to Payment Arrangement Questions - July, p. 11.
 Call FTB Toll Free to Pay Taxes in Installments - May, p. 1.
- Penalties, Fees**
 Cost Recovery Fees May Dip - July, p. 7.
 Disclosure Closes Door on Accuracy-Related Penalty - May, p. 5.

Is Your Tax News Subscription Expiring?

Is your Tax News subscription about to expire? If so, you will find a message near your account number, name and address on the last page of this issue.

To renew your subscription, send Tax News a check or money order for \$12 for a one-year subscription. Also send your account number, name, mailing address and telephone number. Mail to:

Tax News
 P.O. Box 520
 Rancho Cordova, CA
 95741-0520. □

CONTINUED ON PAGE 14

Look for Tax Forms on the Internet

Check the Internet for California tax forms.

All tax forms included in the 1996 Package X are available on the Internet. To download the forms, go to the Franchise Tax Board's
<http://www.ftb.ca.gov>
 address. □

1996 Tax News Index

CONTINUED FROM PAGE 13

Failure to Pay Taxes Can Be Expensive - March, p. 3.
 Rulings Explain When Certain Penalties Will/Won't Be Imposed - September, p. 6.
 "Substantial Authority" Can Ward Off Accuracy-Related Penalty - January, p. 11.

Power of Attorney

New Power of Attorney for Combined Report Members - May, p. 7.

Real Property

The Question Column - September, p. 12.

Refunds

Education Assistance Exclusion: Is Refund Due? - November, p. 12.
 Why Some Refunds Never Reach Taxpayers - January, p. 1.

Retirement Income

Reminder: California Retirement Income Not Taxable to Nonresidents - September, p. 9.
 Taxing of Retirement Income Stops at the Border - March, p. 3.

Sales Factors

Ruling Advises on Double-, Single-Weighted Sales Factors - May, p. 2.

SBE Opinions

January, p. 12
 March, p. 6.
 May, p. 16.
 July, p. 10.
 September, p. 5.

Schedule K-1

Advice for Schedule K-1 Filers - March, p. 11.
 Clarification - November, p. 14.
 Don't Underestimate Value of Schedule K-1 Data - March, p. 10.
 Follow Schedule K-1 Filing Guidelines - May, p. 3.
 How to Avoid Last Year's Mistakes on Schedule K-1 - January, p. 10.
 How to Avoid Schedule K-1 Penalty - November, p. 14.
 Make Schedule K-1 a Priority - September, p. 9.
 Producing a Schedule K-1 Substitute? - May, p. 3.
 Schedule K-1: No Filing on Microfiche - January, p. 11.
 Use an Approved Schedule K-1 Form - July, p. 1.

Small Business

One Law, Many Provisions for Small Businesses, Others - November, p. 5.
 S.F. Fair Is All (Small) Business - March, p. 6.

State Board of Equalization

News from the State Board of Equalization - March, p. 13; November, p. 8.

Statistics

California's Tax Filing Season (January 2 through April 15) - May, p. 6.
 California's Tax Filing Season (January 2 through May 31, 1996) - July, p. 6.
 Practitioners Phone, Fax - May, p. 6.
 Tax Return Error Rate - July, p. 7.
 Tax Return Errors by Type - July, p. 7.

Tax Education

Eight Reasons to Attend Tax Talk - September, p. 3.
 How to Register for Tax Talk - May, p. 3.
 Register Now for Tax Talk - September, p. 3.
 Tax Practitioners' Institute Has Nine Sites - September, p. 7.
 Tax Practitioners' Institute Sets Program - September, p. 7.
 Tax Practitioners' Institute Sets 1996 Program - May, p. 10.
 Tax Talk at Home - November, p. 9.
 Tax Talk Is October 8 - May, p. 9.
 Tax Talk Is Scheduled for 24 Sites - May, p. 9.
 Tax Talk Presentations Finalized - July, p. 3.
 Where Is Tax Talk? - September, p. 3.

Tax News Newsletter

1995 Tax News Index - January, p. 13.
 1996 Tax News/Package X Order Form - November, p. 16.
 FTB Information Directory Coming - November, p. 9.
 Have You Already Renewed Your Tax News Subscription? - November, p. 3.
 Inside Tax News: The 1996 Information Directory - January, p. 12.
 Keep Tax News Coming - July, p. 11.
 Renew Your Tax News Subscription - September, p. 6.
 Subscribe to Tax News - November, p. 3.
 Tell a Colleague About Tax News - January, p. 16.
 Watch for Tax News Index - November, p. 9.

Tax Practitioner Hotline

Hotline Extends Hours - January, p. 13.
 Hotline Works Nine-Hour Day - July, p. 8.

Tax Returns

FTB, IRS Look at Erroneous Schedule C Filings - May, p. 9.
 How to Assemble Scannable Returns - January, p. 16.
 Planning for Scanning - January, p. 16.
 Tax Return Errors: Business as Usual - July, p. 7.
 Tips for Filing a Correct Return - March, p. 14.

Tax Technology

FTB Places Its BETS - March, p. 16.
 What's Next in Tax Technology? - January, p. 9.

CONTINUED ON PAGE 15

FTB Refund Fraud Unit Saves Millions

CONTINUED FROM PAGE 1

FTB's approach to combating fraud is known as "DDD" or "detect, deny and deter." In working to detect fraud, FTB uses technology to review massive amounts of tax data for filing trends and patterns that could indicate fraudulent activity. Partnership and information exchange arrangements with other California tax authorities and the Internal Revenue Service also provide tools for verifying a tax return's or W-2's authenticity. This month, FTB will begin receiving tax withholding amounts on-line from the Employment Development Department in order to match them against amounts claimed by taxpayers (see "FTB, EDD Looking at W-2 Data" in the November 1996 Tax News and "Withholding Amounts to Be Verified" in this issue). In 1998, wage amounts reported on tax returns also will be electronically compared to EDD files.

In denying opportunities for defrauding the tax system, FTB works to seal all doors that could lead to refund fraud. For example, when reports of prison inmate successes in income tax refund fraud in

other states surfaced in the national media last year, FTB was already working on a process to routinely check prisoner names against tax refund returns.

In deterring fraudulent activity, FTB's fraud detail works closely with tax preparers. The technological advances that provide new, easier ways for honest taxpayers to file their tax returns and obtain quick refunds also can increase the risk of potential fraud. As a result, FTB's strategy includes presenting seminars with the Internal Revenue Service to show preparers both the advantages of electronic filing for their clients and their businesses and how they can help detect fraudulent identifications and information. FTB's fraud staff also is working to educate tax preparers through newsletters, round table discussions, conferences and other means, including meetings in the last two years with 250 preparers involved in electronic filing.

You can help stem income tax refund fraud in California by checking new clients' identification and W-2s. For more information, contact FTB's Tax Practitioner Support Unit by calling (916) 858-0571 or faxing (916) 845-6377. □

1996 Tax News Index

CONTINUED FROM PAGE 14

Taxpayer Advocacy

Take Tax Law Proposals to Taxpayer's Bill of Rights Hearing - September, p. 5.

Taxpayer Information

New Technology Speeds Data Exchange - January, p. 3.

Tax Preparer Program

Tax Preparer Program to Shut Down - November, p. 1.

Telefiling

100,000 May Dial for Dollars - January, p. 9.

First Telefiler Is a Night Owl - March, p. 1.

Telefile: Just a Phone Call Away - November, p. 8.

Unitary Issues

FTB Rulings Address Unitary Issues - March, p. 9.

Water's-edge

Water's-edge Companies and Bad Debt Reserve Calculations - November, p. 13.

Water's-edge Election: Acquired Companies Don't Leave Home Without It - September, p. 4.

Water's-edge Glossary - September, p. 4. □

Power of Attorney: Notarization Not Required

Powers of attorney submitted to the Franchise Tax Board no longer need to be notarized.

Some individuals, partnerships, corporations or limited liability companies use the power of attorney to notify FTB that they have appointed an attorney-in-fact to represent them in tax matters. Until now, FTB required the taxpayers to have the form acknowledged by a notary public.

Notarization sections will be removed from forms FTB 3520 and 3520A, "Power of Attorney." In the meantime, taxpayers may ignore those sections on the current forms. □

What Are PIT Wages?

CONTINUED FROM PAGE 8

PIT wages are compensation for all services, including agricultural and domestic services, that an employee performs for an employer. They include, among other things, salaries, fees, bonuses, commissions and payments made in ways other than cash or checks, such as lodging or meals. Wages in forms other than cash or checks are measured by their fair market value.

For more information, see the "Personal Income Tax Booklet for California Resident Forms and Instructions," which is included in the 1996 Package X. The "Instructions for Schedule CA (540), Line 7 - Wages, Salaries, Tips, etc." describe in detail the wage items that differ for federal and California income taxes. Or call FTB's Taxpayer Services Center at (800) 852-5711 for information. □

Small Business Protection Act: Will California Conform?

At press time, California had not conformed to the federal Small Business Job Protection Act that changed the Internal Revenue Code's S corporation provisions.

Watch future issues of Tax News for information on any California legislative action toward conformity. □

Taxpayer Service Centers Open

Two Taxpayer Service Centers, joint endeavors of the Franchise Tax Board, Employment Development Department and Board of Equalization, are scheduled to open during the first two weeks of this month.

The new centers, in Bakersfield and Ventura, are planned to give tax professionals and taxpayers a one-stop shopping opportunity for tax information and assistance.

The Bakersfield Taxpayer Service Center will be located at 1800 30th Street, Bakersfield, CA 93301. The Ventura center, which earlier had been scheduled to open in December, will be at 4820 McGrath Street, Ventura, CA 93003.

The centers replace an FTB office in Santa Barbara and one at another location in Bakersfield. □

Did You Order Package X?

If you ordered a 1996 Package X in either a paper or CD-ROM version during November, look for it to be delivered this month.

Although orders were processed beginning in November, Package X was not available for shipment sooner because of the time needed to incorporate on the tax forms all tax law changes enacted this year.

If you have not yet ordered a Package X but plan to, use the order form on the back page of the November Tax News. If you have misplaced that issue, call (916) 845-7070 for a substitute copy of the order form. Be sure to state that you are a Tax News subscriber so that your account number will be used to facilitate your order. □