

Taxpayers Reminded to Report Premature Distributions

When taxpayers take a premature distribution of retirement funds, they may end up with an assessment notice from the Internal Revenue Service. At the same time, some Californians will also receive a special reminder from the Franchise Tax Board.

The IRS will include an FTB insert with its premature distribution notices. The insert tells taxpayers that they must notify FTB when IRS tax adjustments affect their state tax liabilities.

The inserts, instituted as a pilot project, will be distributed beginning this month. They will be included in 10 percent of the approximately 10,000 IRS notices that will be issued.

Generally, distributions from such retirement vehicles as 401(k) and 457 deferred compensation plans and Individual Retirement Arrangements (IRAs) are considered premature if the taxpayer is under age 59½. California, however, has exceptions

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Sorting for Savings



Handling outgoing mail is a nonstop activity at the Franchise Tax Board. Now, mail is getting out the door more efficiently and cost effectively. A new Multi-Line Optical Character Reader barcodes mail and sorts it for delivery nationwide.

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Tax News

Volume 98-1 January 1998

TAX NEWS is a bimonthly publication of the Taxpayer Advocate Bureau, 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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Taxpayer Suggestions Aired at Bill of Rights Hearing

Responding to a taxpayer's suggestion at the 1997 Taxpayer Bill of Rights hearing, the three-member Franchise Tax Board voted to support Assembly Bill 417 that would permit elective combination. The board also indicated that it is not in favor of a unitary definition for non-electors.

At this year's hearing, held in Sacramento on November 17, other taxpayers called for:

- FTB staff to work with the Employment Development Department to simplify forms so that "Nanny tax" payers could more easily comply with tax laws.

- A definition of "final federal determination," which FTB currently is working on.
- Adding to the Taxpayer's Bill of Rights language that states California's intent to collect taxes in a "fair and impartial" way.

Franchise Tax Board members State Controller Kathleen Connell, who serves as the board's chair, State Board of Equalization Chair Ernest J. Dronenburg, Jr. and Department of Finance Director Craig L. Brown attended the November meeting. □

SBE Opinions

Appeal of Eugene and Lily Heller, November 20, 1997. SBE upheld the imposition of a late filing penalty for nonresident partners who filed a late return reporting California-source limited partnership income. Explaining that limited partners of a partnership that has California source income have a California filing requirement, SBE reconciled the ambiguous language in the *Appeal of Amman & Schmid Finaz AG*, 96-SBE-008, with the fundamental principle set forth in *Appeal of H.F. Ahmanson & Co.*, 65-SBE-013 that the source of a limited partner's distributive share is where the partnership business is carried on. To the extent that *Amman* suggested that a distributive share of California source partnership income did not give rise to a California filing requirement and so conflicted with *Ahmanson*, *Amman* was disapproved. In response to appellants' assertion that they lacked the information necessary to determine if they had a California filing requirement prior to the due date of their 1990 return, SBE held that taxpayers have an obligation to make a reasonable attempt to gather the information needed to file their federal and state returns and that taxpayers must make an affirmative

evidentiary showing of attempts made to ascertain their California filing requirement before the due date of the return. The SBE also stated that taxpayers had an obligation to cooperate with the FTB during the appeal process and to respond to the FTB's requests for supporting information concerning taxpayers' allegations of reasonable cause.

Appeal of Louis P. Halvas, November 20, 1997. The State Board of Equalization's opinion in *Appeal of Michael Curtis*, 97-SBE-012, August 1, 1997, was clarified. Although a child who was unrelated to the taxpayer lived with the taxpayer and the child's mother in the taxpayer's home throughout the year and qualified as the taxpayer's dependent, because the child lived with his mother during the year, the child cannot be considered the taxpayer's foster child. Therefore, the taxpayer is not entitled to head of household filing status.

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

Part 1

What to Expect During Partnership Audits

This is the first of two articles on partnership audits.

When your partnership clients learn that the Franchise Tax Board is about to audit the partnership at the entity level, their first reaction may be surprise.

However, FTB has reviewed and examined many partnership returns during the last two years. And several areas have been identified as compliance issues for both partnerships and partners, particularly when the partnership involves numerous tiered entities and multiple activities.

The most notable areas involve:

- **Exclusion of income from the discharge of indebtedness.** The main issues are the determination of insolvency and the reduction of tax attributes, which must be made at the partner level. Some taxpayers fail to properly calculate their insolvency. Others fail to properly reduce tax attributes such as net operating losses and various credits, use the wrong amounts or make the reductions in the wrong order.
- **Partnership liquidation.** Often, a partner's gain or loss on liquidation was incorrectly computed, and some partners did not reduce their basis in a distributed property accurately or at all. In addition, some taxpayers incorrectly characterized income or loss when the property was disposed of; although the sale of a capital asset generates a capital gain or loss, partners must "recapture" the amount of depreciation that was taken in the past and report it as ordinary income.
- **Abuses of partnership law.** In some cases, sales or transfers between related parties or controlled entities were disguised; these transactions were motivated solely by tax considerations and had no economic substance.
- **Partner's basis.** Some partners did not properly maintain their records or track their basis in the partnership

interest.

- **Nonfiling nonresident partners.** In some cases, California partnerships clearly generated California source income, but nonresident partners did not report their distributive shares on California tax returns. Because California-source income rules may be confusing to nonresidents, FTB has improved the way that a partnership's California source income is identified on the Schedule K-1.

Depending on the nature of the partnership, if your clients are involved in a partnership audit, they will probably need to show FTB some or all of these documents:

- The partnership agreement and all amendments.
- The partnership prospectus or other offering statement.
- All Securities and Exchange Commission filings related to the partnership.
- The partnership's books and records and, if they do not reconcile with the entity's tax returns, an explanation of the disparity.
- Any other documents that relate to the issues being examined during the audit. For example, if the sale of a partnership asset is being examined, FTB will ask to see, among other things, the sales agreement and evidence that supports the computation of the adjusted basis in the asset.

Your clients also can expect FTB to:

- Work with them on the audit's logistics because, in some cases, merely notifying all the partners of the audit can be a considerable task.
- Work with them on setting timelines and due dates for information, correspondence and other major milestones. FTB will want to

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New Taxpayer Service Centers Open

The Franchise Tax Board is participating in two new Taxpayer Service Centers with other state tax authorities.

New centers in San Bernardino and Stockton allow tax practitioners and taxpayers to get a variety of tax information and assistance at one location.

In San Bernardino, FTB has moved to a new location with the Employment Development Department. The joint office is located in the lobby of the San Bernardino Government Center Building, which is the CalTrans District 8 Headquarters. The address is 464 West 4th Street, Room 4541, San Bernardino 92401-1419.

In Stockton, EDD and the State Board of Equalization have joined FTB at its current office. The address is 31 E. Channel Street, 2nd floor, Stockton 95202-2394.

The new centers join Taxpayer Service Centers already established in Bakersfield and Ventura. □

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Electronic Funds Transfer: A Win/Win Situation

How to Order Package X

Have you ordered your 1997 Package X?

The order form that you should use to order the California Package X in either a paper or CD-ROM version was printed on the last page of the November 1997 issue of Tax News. Do not use an order form from another year.

If you have misplaced the November Tax News, you can obtain another order form by calling (916) 845-7070.

With the form, you may order the Package X in a paper version for 1997 or for previous years. The cost is \$12. If you order the Package X on a CD-ROM, you will receive California Package X forms and instructions for 1997 and the three previous years, 1997 Internal Revenue Service Package X forms and information on California electronic filing. The CD-ROM is \$19.

The Package X in both paper and CD-ROM versions are available now, and orders are being shipped on a first-come, first-served basis. □

Everyone using the Franchise Tax Board's electronic funds transfer (EFT) program comes out a winner.

Individuals using the program never have to worry about writing a check on time, because the funds are automatically transferred. Employers who must garnish wages and financial institutions that process checks and other transactions realize significant savings once their manual processing procedures are reduced or eliminated. The state saves by reducing both the amount of paper it receives and processes and the number of errors associated with paper transactions; the state also receives its revenues faster and more efficiently. And finally, the environment is a winner because EFT is a paper-free process.

Are your clients taking advantage of EFT? Individuals and business entities that must or may use EFT include:

- **Corporate taxpayers.** Bank and corporation taxpayers must pay their taxes by EFT if their total tax liability is more than \$80,000 or if any single estimated or extension tax payment exceeds \$20,000. Taxpayers that have smaller tax liabilities and payments can join the EFT program voluntarily. By the end of 1997,

approximately 14,000 corporate taxpayers were routinely remitting their tax payments by EFT. And 75 percent of all tax revenue from corporations is collected by EFT.

- **Individuals.** Starting in 1997, individuals who were approved to pay their tax liabilities in installments usually must pay by EFT. During the first six months, FTB received 21,375 payments totaling approximately \$3.3 million. And since the EFT program was instituted, the default rate for installment payments has been reduced from 40 percent to 5 percent.
- **Banks and employers.** FTB is working on an EFT process that will enable employers and financial institutions to electronically remit payments that are required by wage garnishments and bank levies.

Employers who would like to participate in a pilot program for wage garnishment payments should call the EFT Help Desk at (916) 845-4025. Call the Help Desk, too, for information on the other EFT programs. (Also see "Wage Garnishments Set for Electronic Data Exchange" on page 16.) □

What to Expect During Partnership Audits

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- conduct the audit as efficiently and effectively as possible.
- Acknowledge that its responsibility does not end when the audit does. FTB staff will be available to answer questions that may come up once the case is closed.
- Continue to analyze the results of audits so that it can develop cost-effective ways to improve compliance with tax laws. Along these lines, FTB already has made some clarifications and redesigned

the partnership tax forms to increase their usefulness and encourages compliance by means of articles in various publications and speaking engagements at community forums.

If you have questions or comments, send a letter with "Partnership Audits" written at the top to Division Chief, Audit Branch, Mail Stop D-15, P.O. Box 1779, Rancho Cordova, CA 95741-1779. □

“Striking Gold” for Small Businesses

Each year, approximately 60,000 small businesses start up in California. And approximately 60,000 go out of business.

For many, a lack of awareness of tax laws is a contributing factor. But help is on the way.

The Small Business Tax Connection has produced a series of items designed to educate new and prospective small business people to their various tax requirements and responsibilities. The Small Business Tax Connection is a committee of representatives from the California Franchise Tax Board, Internal Revenue Service, Employment Development Department and State Board of Equalization.

The Connection’s first educational package, “Striking Gold in California,” includes a:

- **Video.** The video runs 23 minutes and features a gold rush theme. Practical tax information is interspersed with historical vignettes starring such successful members of California’s small business community of the 1850s as Levi Strauss, Domingo Ghirardelli, “Wheelbarrow Johnny” Studebaker, Henry Wells and William Fargo.
- **Booklet.** A 40-page booklet is a companion to the video. It also will stand alone on the State Board of Equalization’s <http://www.boe.ca.gov> site on the Internet at the end of January.
- **Directory.** The Small Business Development Center produced this guide to information and services that small business owners and hopefuls can use.

By the end of January, all three elements in the “Striking Gold” package will debut statewide at seminars and counseling sessions. These free events will be provided by participating local offices of the Service Corps of Retired Executives (SCORE), the California Society of Enrolled Agents (CSEA) and the Small Business Development Center (SBDC), the project’s three community sponsors. To find out when and if an event is

scheduled in your area, call your local SCORE, CSEA or SBDC office.

Before being distributed statewide, the “Striking Gold” materials were part of a pilot test in the greater Sacramento area for 14 months. □

Small Business Tax Day Set for Long Beach

If you or your clients live in the Long Beach area, you can take advantage of a free event for small business owners.

February 20 is the date of the Long Beach/South Bay Small Business Tax Day at the Long Beach Convention and Entertainment Center. The event is designed to help small business owners and prospective ones understand and comply with their tax responsibilities.

The Tax Day, which runs from 8:30 a.m. to 3 p.m., will feature information booths and a variety of workshops. Topics for the workshops include bad check enforcement, the worker’s compensation insurance fund, independent contractor/employee issues, state income tax, federal deposit rules for employment returns, property assessment, social security requirements, immigration and naturalization requirements, sales tax returns and exemptions, exporting, starting a business and ways to have a profitable business.

The Franchise Tax Board is among the participants, along with the Employment Development Department, Immigration and Naturalization Service, Internal Revenue Service, Los Angeles County Assessor, Los Angeles District Attorney, Small Business Development Center, Social Security Administration, State Board of Equalization, State Compensation Insurance Fund and U.S. Department of Commerce.

For more information on the Long Beach/South Bay Small Business Tax Day, call (310) 516-4330. □

FTB Calendar

January

- Demands to file 1996 tax returns are mailed to individuals.
- Package X is published and distributed.
- Tax News debuts on the Internet.
- 12 Electronic filing return transmissions begin.
- 15 Fourth quarter 1997 personal income tax estimate payments are due.
- 20 Previous month withholding at source payments are due if total withholding exceeded \$2,500.
- 31 Deadline for applying to participate in California’s electronic filing program.

February

- Notices of Proposed Assessment are mailed to corporations that failed to comply with requests issued in prior months for 1995 tax returns.
- 20 Long Beach/South Bay Small Business Tax Day.
- 20 See January 20.

March

- Notices of Proposed Assessment are mailed to corporations that failed to comply with requests issued in prior months for 1995 tax returns.
- 20 See January 20.

April

- 15 1997 personal income tax returns are due.
- 15 First quarter 1998 personal income tax estimate payments are due.
- 20 See January 20. □

Where to Get Copies of New Laws

Are you interested in learning more about the new laws affecting economic development areas?

You can obtain copies of these laws (see article on this page) and others by writing the Legislative Bill Room, Room B-32, State Capitol, Sacramento, CA 95814. Or call the Bill Room at (916) 445-2323.

If you have Internet access, you also will find new laws at <http://www.leginfo.ca.gov> which is the Official California Legislation Information Web site address. □

Electronic Filing Application Deadline Extended

The deadline for applying to participate in California's electronic filing program has been extended to January 31, 1998.

The deadline was changed in order to accommodate tax professionals who have not yet received their Electronic Filer Identification Number (EFIN) from the Internal Revenue Service. Tax professionals must be accepted into the IRS electronic filing program before applying with California and must provide an EFIN on their applications.

To obtain an electronic filing application or information, call the Help Desk at (916) 845-0353. □

New Laws Affect Economic Development Areas

A series of new laws have changed some of the rules for economic development area businesses.

Your clients operating in enterprise zones, the Los Angeles Revitalization Zone (LARZ) or a Local Agency Military Base Recovery Area (LAMBRA) should know about new laws dealing with:

Carryover deductions. According to Senate Bill 1106 (Ch. 97-604), when an enterprise zone or the LARZ expires, it is deemed to remain in existence for the purpose of claiming a carryover net operating loss and determining the zone income that can be offset by the loss. A previously enacted law instituted a similar provision for LAMBRA's.

Sales or use tax elections. Assembly Bill 1040 (Ch. 97-605) removed the election language from the LARZ and LAMBRA sales or use tax credits and the LAMBRA hiring credit. These changes are considered to reflect the original intent of the LARZ Act and the LAMBRA Act, so they are retroactive to all open years. Prior law required taxpayers to elect on the original return which one credit they were going to take if an item of qualified property or wages for a qualified employee qualified the taxpayer to take more than one credit for the same item of property or the same qualified employee under the California Revenue and Taxation Code. Generally, this election language impacted taxpayers qualifying for the LARZ sales or use tax credit, the enterprise zone sales or use tax credit and the manufacturer's investment tax credit; they were limited to claiming only one credit. Now, if the property qualifies the taxpayer to take all three credits, the taxpayer can either claim the LARZ sales or use tax credit *or* claim both the enterprise zone sales or use tax credit *and* the manufacturer's investment tax credit. Taxpayers are limited to one credit for qualified property or wages only if they claim the LARZ or LAMBRA sales or use tax credit or the LAMBRA hiring credit.

New economic incentive areas. Both SB 200 (Ch. 97-609) and AB 1217 (Ch. 97-602) created new economic incentive areas. The designations are

binding for a 15-year period beginning January 1, 1998. SB 200 provides for two Manufacturing Enhancement Areas. Businesses that operate in the areas are entitled to take a hiring credit based on the hiring and employment of qualified disadvantaged individuals. AB 1217 provides for one Targeted Tax Area. Businesses that operate in the area and that are engaged in specific businesses including manufacturing, warehousing, certain transportation fields or the wholesale trade may take a hiring credit based on hiring and employing qualified disadvantaged individuals, a sales or use tax credit for the purchase of qualified property, a business expense deduction for the purchase of qualified property and a 100 percent net operating loss carryover. Businesses that qualify for these incentives must operate under certain Standard Industrial Classification (SIC) Codes.

Tax credit reports. AB 797 (Ch. 97-461) requires the Franchise Tax Board to report to the Legislature and the Trade and Commerce Agency the dollar value of the enterprise zone tax incentives claimed each year. To meet this requirement, FTB will use information that taxpayers provide on form FTB 3805Z, "1997 Enterprise Zone Deduction and Credit Summary," which is part of the "Enterprise Zone Business Booklet." The Legislature and the Trade and Commerce Agency use the information for a number of purposes including evaluating the incentives' usefulness and benefits to taxpayers, determining whether the incentive programs need improvement and making decisions about the future of the programs and whether they should be continued. Previously enacted laws provide that taxpayers operating in the LARZ should report this credit information on form FTB 3806, "Los Angeles Revitalization Zone Deduction and Credit Summary," and that taxpayers operating in a LAMBRA should use form FTB 3807, "Local Agency Military Base Recovery Area Deduction and Credit Summary." □

Tax News on the Web

Tax News is now in cyberspace.

Starting this month, Tax News is part of the Franchise Tax Board's Home Page on the Internet. To view the publication on the World Wide Web, contact FTB at its <http://www.ftb.ca.gov> Internet address. □

Voucher Developed for Personal Income Tax Payments

Individuals who owe taxes for the 1997 tax year should include a new voucher with their tax payments.

The voucher, Form 540-V, "Return Payment Voucher for Individuals," will be published in all 1997 personal income tax booklets.

Taxpayers who include the new payment voucher with their checks or money orders will assist the Franchise Tax Board in processing payments accurately and efficiently. Although FTB encourages use of the Form 540-V, there is no penalty for not using it.

The voucher should be attached to Forms 540, 540A, 540EZ and 540NR. It also

can be attached with a payment to scannable Forms 540 and 540A, which are computer-generated.

Originally, a similar voucher was intended for use by business entities as reported in the November 1997 issue of Tax News. However, the business entity voucher will be introduced next year instead.

Form 540-V is available on the Internet at FTB's <http://www.ftb.ca.gov> address. It also may be ordered from Tax Forms Request, P. O. Box 307, Rancho Cordova, CA 95741-0307. □

The Question Column

What Are Common Itemized Deduction Errors?

The Franchise Tax Board has compared state and federal itemized deductions to determine whether taxpayers correctly adjusted their federal deductions on the Schedule CA. What kinds of problems were identified?

Most of the mistakes involved state and local income taxes. Taxpayers usually did not adjust their federal itemized deductions by subtracting any state and local income taxes on the Schedule CA. Or they subtracted only state disability insurance and not state income tax.

Other problems involved:

- **Mathematics.** Addition and subtraction errors occurred both on the federal Schedule A and the California Schedule CA.
- **Transfers.** Taxpayers transposed numbers when copying amounts from the federal Schedule A to the California Schedule CA.
- **Itemized deduction breakdown.** Taxpayers failed to break down the various components of the total itemized deductions claimed on the federal Schedule A. As a result, the IRS disallowed the items because it

could not identify them and then recomputed the federal taxable income. Taxpayers then failed to amend their state returns with the revised federal amount.

- **Medical and miscellaneous itemized deductions.** Taxpayers failed to limit these deductions by the applicable percentages of the adjusted gross income. Or they added on the California Schedule CA the amount not allowed on the federal Schedule A for medical and miscellaneous deductions.
- **Mortgage interest.** Taxpayers who reduced their federal mortgage interest deduction by a mortgage interest credit should have added back on the Schedule CA the amount of the credit.

As a result of the comparison of state and federal itemized deductions, FTB has issued more than 120,000 notices, alerting taxpayers of changes to their tax returns. The program began as a pilot in late 1995 and is now fully implemented. □

A Matter of Trust

Which trusts can your clients trust?

The answer is: Most of them. Your clients probably use legitimate trusts for such purposes as estate planning, making a genuine transfer of property to charity or holding property for minors and people declared incompetent.

Recently, however, some trust arrangements that appear to be abusive have surfaced. Abusive trusts claim to reduce or eliminate federal and state taxes in ways that are illegal. They also have no economic substance.

How can your clients spot an abusive trust? Promoters of the trusts often market their products by promising features that will:

- Reduce or eliminate income that is subject to income tax.
- Create tax deductions for nondeductible personal expenses.
- Provide excessive depreciation deductions.
- Step up the basis for property put in the trust.
- Disguise the true ownership of assets and income.

You can help your clients avoid getting involved in abusive trust arrangements. Tell them that, if they are in doubt about a trust arrangement's legitimacy, they should:

- Check out the promoter with the consumer protection department of either the local district attorney's office or the state attorney general's office. They also can call the Better Business Bureau. These organizations may be able to tell your clients if any complaints have been registered against the promoter.
- Ask the promoter for references and verify them.
- Get a second opinion about the trust arrangement before going ahead.
- Consider that, if the arrangement seems too good to be true, it probably is.

Clients who believe a promoter of abusive

trusts has defrauded them should contact the nearest state attorney general's office. They may call either (800) 952-5225 or (916) 322-3360. Or they may register a complaint about an abusive trust promotion by writing Attorney General's Office, P.O. Box 944255, Sacramento, CA 94244-2550.

If your clients participated in an abusive trust arrangement, they should file a correct tax return for 1997 and amend returns for any other years that they were included in the trust arrangement.

For more information, see the September 1996, July 1997 and September 1997 issues of Tax News. □

Taxpayers Reminded to Report Premature Distributions

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to the general rule. The insert, form FTB 1121, states that "California law is similar to federal tax law on the premature distribution tax. But, there are differences in the way we compute the taxable amount of the distribution and some premature distributions are exempt from this tax." It also notes that premature distributions of retirement funds are subject to a 2.5 percent tax.

For additional information, the insert refers taxpayers to FTB Publication 1005, "Pension and Annuity Guidelines," which may be ordered at no charge by calling FTB at (800) 338-0505. The publication also is available in the 1997 Package X and from FTB's <http://www.ftb.ca.gov> address on the Internet. □

Are You Moving?

Do you plan to move soon?

Be sure to alert Tax News if you change your address. Send your new address and telephone number to: Tax News, P.O. Box 520, Rancho Cordova, CA 95741-0520.

Also include the account number that is printed above your name and address on the last page of this issue. □

Need a Tax Form Fast?

Do you need some tax forms quickly?

If you neglected to order a Package X and want a particular tax form today, look on the Internet.

California tax forms are available on the Internet at the Franchise Tax Board's <http://www.ftb.ca.gov> Web site. □

Two Reminders for Electronic Filers

Do you have clients who file electronically?

If so, the Franchise Tax Board has two suggestions:

- Remind your clients to pay any tax liability by April 15. For the last two years, taxpayers were able to file electronically even though they had balances due. Unfortunately, once the electronic filing transaction was completed, some forgot to send in their checks.

Electronic filers who owe taxes should send their checks to the Franchise Tax Board with form FTB 3582, "Payment Voucher for Electronically Transmitted Returns." The form is available in the 1997

Package X, may be downloaded from FTB's <http://www.ftb.ca.gov> Internet address or may be ordered by calling F.A.S.T. (Fast Answers about State Taxes) at (800) 338-0505.

- Be sure to keep the forms that your clients must sign when they file electronically to declare that the information on their tax returns is "true, correct and complete." In the past, some tax practitioners have sent them to FTB instead of keeping the forms in their own files. You must keep any form FTB 8453, "California Individual Income Tax Declaration for Electronic Filing," for four years from the return's due date. □

More Invited to Phone in Tax Returns

This year, more taxpayers may use the Franchise Tax Board's TeleFile program to file their personal income taxes.

California's TeleFile program is now open to some taxpayers whose filing status is married filing joint and who have no dependents. Previously, only single taxpayers without dependents could file by telephone.

In all cases, taxpayers can participate in the TeleFile program only if they qualify to file a Form 540EZ, "California Resident Income Tax Return for Single and Joint Filers With No Dependents,"

and if FTB sends them a 1997 TeleFile Tax Booklet.

As a result of the additional potential market for the TeleFile program, FTB is mailing 1.8 million TeleFile booklets to taxpayers, an increase of 200,000 over last year.

Taxpayers who qualify for the program can phone in their tax data any hour of the day or night, seven days a week, from January 2 through October 15. However, any tax amount due must be paid by April 15. □

One Million Paperless Returns?

Will Californians file one million paperless state tax returns in 1998?

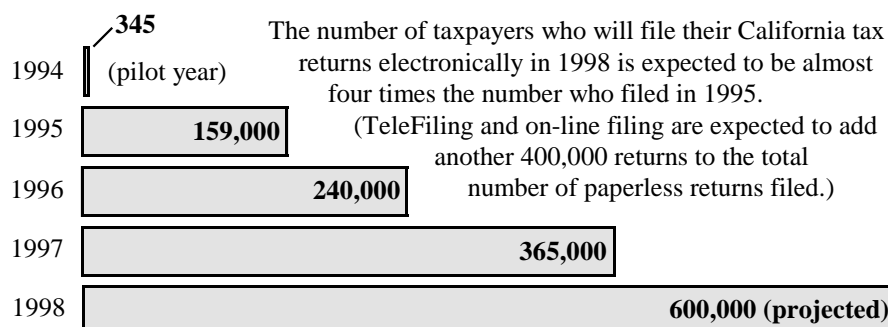
This could be the year that returns filed through one of the Franchise Tax Board's three paperless options will hit the one million mark.

Taxpayers may send FTB a paperless tax return by:

- Filing electronically.
- TeleFiling.
- Filing from personal computers and using a third-party transmitter through FTB's Transmitter/On-Line Service (TROLS).

Although paper returns are expected to diminish greatly in the coming decades, in 1997 they still accounted for about 95 percent of all returns filed. □

Electronic Filing



File Schedule K-1s Without Paper

Last year, 28 percent of the partnership Schedule K-1s filed with the Franchise Tax Board were provided on magnetic tape or diskette.

This year, will you help increase the number?

For the 1997 tax year, the second year that FTB offered magnetic media filing for Schedule K-1s, more than 200 partnerships took advantage of the simpler, paper-free method of filing. In all, FTB received 1.3 million Schedule K-1s via magnetic media or on disk and 1.4 million on paper.

If you prepare Schedule K-1s for large or small partnerships, you can find out more about FTB's magnetic media program by reading FTB Publication 1062, "Guide for K-1 (565) Filing by Diskette or Magnetic Media." To obtain the publication, download a copy from FTB's <http://www.ftb.ca.gov> Internet address. Or call FTB's Electronic Filing Help Desk at (916) 845-0353. □

Are Your Scannable/Substitute Forms Approved?

Are you planning to use scannable or substitute 1997 state tax forms?

If so, make sure they meet the Franchise Tax Board's requirements. Otherwise, the software you use may produce forms that cannot be processed quickly. Processing problems are especially likely to happen when unapproved Schedule K-1 forms are filed.

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

To date, the companies listed below have filed form FTB 1096, "Agreement to Comply with FTB Publication 1098," for the 1997 tax year. The form states that the companies agree to follow certain rules for developing scannable and substitute forms. Filing form FTB 1096, however, does not constitute approval from FTB.

Be sure to ask a company to show you FTB's letter of approval before you use its forms. Do not accept a general statement that the forms have been approved. Instead, give the company a list of the forms you plan to use, and make sure that each one is approved.

Companies that have filed form FTB 1096 to date are:

AEI Fund Management, Inc.
Abel-Wagner Inc. (714) 572-8585
Accountant Stationers & Printers (800) 423-9717
Accountware (513) 561-1881
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
Atilla M. Taluy (805) 984-0248
ATX Forms (207) 455-4848
Block Financial Corporation (Tax Cut) (913) 599-2885
Brass Tax Presentations (619) 487-2553
Bryan Cave LLP
BSoft Corporation (408) 438-7071

CCH Federal and State Tax Unit
CCH Incorporated (Torrance) (310) 543-6200
CCH Incorporated (Wichita, KS) (316) 685-8100
CLR/Ace Division (770) 432-1996
CLR/Fast Tax (800) 327-8829
CompuCraft Tax Services (800) 435-7829
Computer Systems Analysis Corporation
Consolidated Business Systems (800) 262-4461
CPASoftware (800) 434-2685
CPSystems, Inc. (804) 346-0640
Creative Solutions Inc. (313) 426-5860
Cronos Capital Corporation (415) 677-8990
Curtis Publications Inc.
D.A. Bailey and Sons Publishing Co., Inc. (800) 665-7402
Data Technology Group, Inc. (617) 661-1118
Dave Gomberg's JCF Systems (415) 731-7793
David Osman's Tax and Accounting
Deloitte & Touche Tax Technologies LLC (800) 966-1639
DRAKE Software (704) 524-8020
EXACTAX Inc. (800) 352-3638
Federated Tax Service Inc.
Gear Up Tax Seminars (916) 268-6508
Gemisys Corporation (303) 705-6000
Hambrecht & Quist (415) 576-3300
H&R Block/Tax Systems Development (816) 753-6900
Hayden R. Wisdom, E.A. (916) 888-1040
Hogan & Hartson, L.L.P. (202) 637-8566
HowardSoft (619) 454-0121
Independent Preparer Services, Inc. (818) 701-3090
Inland Society of Tax Consultants
Intuit, Inc. (619) 784-4274
ITS, Inc. (800) 487-8291
Jackson Hewitt Tax Service (757) 473-3300
JTR Bookkeeping & Tax (888) 869-4017
KPMG Peat Marwick LLP
Lacerte Software Corporation (972) 490-8500
Les Blend Co. (650) 917-0558
MAVRICC Management Systems (248) 614-4500
Mercury Printing and Stationery Co. (800) 421-2220
Micro Vision Software, Inc. (800) 829-7354
Nelco, Inc. (920) 337-2848
ORRTAX Software (800) 377-3337
Pencil Pushers Tax Software (617) 273-4556
PETZ Enterprises, Inc. (209) 835-2720
Prestige Graphics (619) 560-8213
Price Waterhouse LLP (214) 754-7900
Professional Stationers Inc. (800) 874-7383
Probate Software Co., Inc. (970) 330-3260
RealNet Software, Inc.
Reynolds & Reynolds (formerly Duplex

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Better Late Than Never: File 1996 Returns

The due date for 1996 personal income tax returns has come and gone, even for people who had filing extensions. Even so, many individuals have not used the time to file their returns.

The Franchise Tax Board began sending notices to these nonfilers in December 1997, and notices will continue to go out to almost 700,000 people during the coming year. The notices advise taxpayers that FTB is unable to locate their 1996 tax returns although outside sources, such as W-2 forms filed by employers and 1099s filed by financial and other institutions, indicate that they have received income and/or conducted business activities during 1996.

Here are a few suggestions that you can pass along to clients who receive a notice or who know that they have not filed a 1996 personal income tax return:

- Contact FTB before FTB contacts you. If you have not filed yet, file now before you receive a notice requesting the tax return. Once the filing enforcement process starts, you may end up with a higher penalty and fees for failing to file.
- Do not ignore the notice. If you do not respond to the notice by filing a return or showing that you are not required to file, you are subject to additional penalties and fees. If you believe that the notice is erroneous, contact FTB at the telephone number given on the notice. FTB will investigate and get back to you.
- If you filed the return that FTB is requesting, check your copy. Is the social security number on the return the same one stated on the notice? If not, that may be the problem. You may be able to resolve the issue quickly by calling (800) 545-5009, and entering both of the social security numbers at voice prompts. If that does not solve the problem, you should send FTB a copy of the front page of your tax return and the notice. However, if the social security numbers on your tax return and on the notice are identical, you probably will need to send FTB a complete copy of the return.
- Whenever you move, notify FTB. FTB needs your most current address in order to contact you quickly whenever a problem with your tax account comes up. Even if you plan to move out of state, make sure FTB has your new address. □

Are Your Scannable/ Substitute Forms Approved?

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Products, Inc.) (408) 934-8540
 Roseberg Escobar Services (213) 563-0497
 Service Data Corporation (402) 691-6338
 Short Form Software (914) 353-4177
 Spidell Publishing Inc. (714) 776-7850
 STF Services Corporation (800) 541-7197
 Tax-Aid, Inc. (612) 888-2712
 Tax And Accounting Software Corporation (800) 998-9990
 Tax Biz (408) 243-1472
 Tax Form Library (800) 466-9110
 Tax Forms, Inc.
 Tax Link, Inc. (614) 457-1949
 Tax Systems, Inc. (713) 682-1791
 TAXBYTE, Inc. (800) 245-8299
 Tax\$imple, Inc. (800) 989-8955
 Taxware Systems, Inc. (800) 877-1065
 Taxworks by Laser Systems (801) 552-8800
 Technology Funding, Inc. (505) 982-2200
 TFP Data Systems
 TK Publishing Inc. (Tax Shop) (407) 351-0966
 TMI Tax Services, Inc. (612) 935-6111
 Total Peripherals, Inc.
 Universal Tax Systems (706) 232-7757
 U.S. Tax Systems, Inc. (800) 966-8787
 Visible Computer Service (630) 377-2586
 Wallace Computer Service (630) 377-2586
 Weaver Tax Service (408) 258-0912
 Westpro LTD
 William H. Downs, CPA (818) 981-4313
 XPRESS Software, Inc. (800) 285-1065 □

New Rules for Excluding Gain in Home Sale

California has conformed to new federal law that changes the rules for excluding gain when taxpayers sell their homes.

Generally, for sales and exchanges of personal residences that take place after May 6, 1997, joint filers may exclude up to \$500,000 in gain. Single taxpayers may exclude up to \$250,000. The new law replaces the former rollover rules and the one-time exclusion for taxpayers age 55 and older.

Under the new rules, a seller must own and use the property as a principal residence for combined periods of two or more years within a five-year period.

In California, two recently enacted legislative bills combine to effect the conformity to the new federal home sale exclusion. Senate Bill 5 – Lockyer (Ch. 97-610) allows the exclusion from May 7, 1997, through June 30, 1998. SB 1233 – Lockyer (Ch. 97-612) continues the exclusion past June 30, 1998. □

Keep Tax News Coming

Is your Tax News subscription about to expire?

If so, the Franchise Tax Board will send you a renewal form by mail. Be sure to return the form immediately so that you will not miss any upcoming issues. □

Clarification

In a November Tax News article titled "Reducing the R&D Credit: S Corporations and Shareholders Use Different Rates," an incorrect tax year was used in the example. The reduced credit for shareholders is 89 percent of the full credit for tax years prior to 1996 and 90.7 percent of the full credit for tax year 1996 and subsequent years. □

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New Name for Withhold-at-Source

The Nonresident Withholding Section is the new name for the Franchise Tax Board's Withhold at Source Unit.

The section's telephone and fax numbers and address remain the same.

To contact the Nonresident Withholding Section, call (916) 845-4900 for an interactive voice response. Or you can fax the section at (916) 845-4831. The address is Nonresident Withholding Section, Franchise Tax Board, P.O. Box 651, Sacramento, CA 95812-0651. □

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Order Tax Talk Videos

Two Tax Talk learn-at-home video courses are now available.

“California Tax Rules for Nonresidents” is the second home study course developed this year. The first in the series was “Office-in-Home Deductions.”

Each course includes a one-hour videotape, textbook, workbook and brief, “open book” examination. If you correctly complete the examination, you will earn three continuing education credits. Each course is an expanded adaptation of a Tax Talk seminar presentation and costs \$60.

To order one or both of the videos, call (916) 845-7070 for an order form. Or you may place your order at the Franchise Tax Board’s <http://www.ftb.ca.gov/Education/taxtalk.htm> Internet address. □

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Report Non-California Muni Bond Interest Income

Payers of interest or interest-dividend income earned on non-California municipal bonds held by California taxpayers must file an information return with the Franchise Tax Board.

The information returns, required by Revenue and Taxation Code (R&TC) Section 18639, are due June 1, 1998, for the 1997 tax year.

The new law primarily affects banks, mutual funds and brokerage houses. The non-California municipal bonds on which they will be reporting are issued by another state or entity such as a county, city, sewer facility or school district outside California.

Although it is exempt from federal income tax, the interest and interest-dividend income earned on non-California municipal bonds are taxable to California residents, according to R&TC Section 17143. The information returns will be used to verify that this income is being properly reported.

New York state has had a similar information return requirement for the

past 10 years. FTB staff has worked closely with New York state staff and the financial services industry to eliminate as many implementation problems as possible for the banks, mutual funds and brokerage houses that are required to comply.

Payers with 250 or more returns must provide the information to FTB on magnetic media. Payers with fewer than 250 returns may report the information on magnetic media or paper. Detailed instructions about the specific information to be provided and its format will be available by January 15, 1998, from FTB's Magnetic Media Office at (916) 845-3778. California payers that are headquartered out of state or that use a clearing facility in another state may wish to contact their clearing facility to determine if software programs are already available to report the information to FTB and what they will need to do to fulfill the filing requirement. For more information about the reporting requirement or its implementation, call FTB at (916) 845-6600. □

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News from the State Board of Equalization

Have you visited the State Board of Equalization's Internet site lately?

You will find more information than ever before. Contact the SBE at its <http://www.boe.ca.gov> address, and you can access these recent home page enhancements:

- An expanded Publication section with more than 60 different forms, regulations and publications that you can view and download.
- An expanded California City and County Sales and Use Tax Rates section.
- A new How to Contact Us section with details on where to call or write.
- A new Registration section with information on sales and use tax and special taxes registration.
- A new Taxable Sales in California section showing taxable sales by type of business, city and county.
- A new Frequently Asked Questions section about sales and use tax.
- A new Legislation section featuring laws that impact tax programs administered by the SBE and that were enacted during the first half of the 1997-1998 legislative session. □

***Interest Rate
Reminder***

The interest rates on under- and overpayments of California income taxes will be 9 percent for the first six months of 1998.

For a table of interest rates since 1986, see the November 1997 issue of Tax News. □

Wage Garnishments Set for Electronic Data Exchange

Things may soon become simpler for your employer clients who occasionally hear from the Franchise Tax Board about wage garnishments.

FTB is developing a program that will allow the agency and employers to exchange wage garnishment information through an electronic data interchange (EDI). EDI is a technology that allows data to move between systems in machine-readable formats with a minimum of human intervention.

The benefits of processing wage garnishments using EDI include simplified workload management and a

reduction in personnel costs, paper processing and the errors that come with handling paper.

FTB is seeking employers interested in reducing the burden of the current process, which is heavy with paperwork, by participating in a pilot program. For information about the EDI wage garnishment pilot program, call (916) 845-6670 or e-mail laurie_rhea@ftb.ca.gov.

For information on wage garnishments and electronic funds transfer, see "Electronic Funds Transfer: A Win/Win Situation" on page 4. □

Tax News

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