

1998 Law Means Changes to 1997 Tax Returns

A new tax law, enacted in 1998, means that certain California taxpayers must amend their returns or calculate their tax liabilities differently.

Senate Bill 519 – Lockyer (Stats. 1998 – Ch. 7) was enacted March 14, 1998, about two and a half months after California tax forms were distributed to taxpayers. As a result, California personal income tax law and bank and corporation tax law conform to certain provisions of the federal Taxpayer Relief Act of 1997 (Public Law 105-34) that are effective for 1997.

If the new law affects the income, deductions, credits or other information included on a

return that one of your clients has already filed, the client must file an amended return. Here, adapted from FTB Publication 1003, “1997 Tax Law Changes Enacted in 1998,” are highlights of the new law and what your clients may need to do:

Rollover of gain from the sale of California small business stock. California law now conforms to federal law by allowing a tax-free rollover of capital gain from the sale of California small business stock if all of these conditions are met:

- The sale occurs after August 5, 1997.

CONTINUED ON PAGE 2

Tax Returns by the Truckload



As April 15 approached, tax returns by the millions arrived at FTB's Sacramento headquarters.

Inside ...

- 2 ... Interest rates
- 3 ... Balance due electronic filers received notices in error
- 4 ... SBE opinions
- 4 ... Legislature looks at tax credits
- 5 ... FTB calendar
- 6 ... Nonresidents choose electronic filing
- 6 ... Direct deposit: The most-asked questions
- 6 ... Electronic filers like direct deposit
- 7 ... Electronic filing update
- 7 ... Electronic filing: Two-year review
- 8 ... 1995 corporation tax returns sought
- 8 ... The question column:
What is wife's filing status when non-citizen husband lives outside U.S.?
Does Keogh contribution, made after leaving state, reduce California source income?
- 8 ... California's tax filing season
- 9 ... Legislature considers tax deductions and more
- 9 ... Keeping in touch with FTB
- 9 ... Electronic filing calendar
- 10 ... Forty counties qualify as El Niño disaster areas
- 11 ... Interested in proposed law?
- 12 ... Tax News three ways
- 13 ... Water's-edge election problems move to resolution
- 14 ... Need a tax form fast?
- 15 ... Where to find SB 519 information
- 15 ... You can get there from FTB Web site
- 16 ... Planning to move?
- 16 ... Nonresident withholding: The rules for partnerships
- 17 ... FTB notice addresses S corporation issues
- 17 ... How to order Package X
- 18 ... Need electronic filing help?
- 18 ... Homeowner/renter assistance season to open
- 19 ... Some taxpayers need to file 1996 returns

CONTINUED ON PAGE 3

Tax News

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1998 Law Means Changes to 1997 Tax Returns

CONTINUED FROM PAGE 1

- The stock sold is from a small business located in California and held for more than six months.
- The proceeds from the sale are used within 60 days to purchase the stock of another small business located in California.

You do not need to make an adjustment for California purposes for your individual clients who meet these conditions. So, disregard the related instructions in the 1997 FTB Publication 1001, "Supplemental Guidelines to California Adjustments." Your clients that file business entity returns are not affected by this law change.

Survivor annuity benefits for a public safety officer killed in the line of duty.

Previously, survivor benefits received by a spouse, former spouse or child of a public safety officer killed in the line of duty on or after January 1, 1997, generally were includible in income for California purposes. Now, California law conforms to federal law providing that survivor benefits received in taxable years beginning after December 31, 1996, from deaths occurring after that date, are excluded from gross income.

For your individual clients who exclude these survivor annuity benefits from the 1997 federal return, disregard the 1997 "Instructions for Schedule CA, California Adjustments (540 and 540NR)" that pertain to the California adjustment for survivor annuity benefits.

Gain on the sale of livestock sold due to flood or other weather-related conditions. Previously, California allowed special treatment for gains on the sale of livestock after December 31, 1996, due to droughts. Now, California law conforms to federal law that allows the special treatment for livestock sales due to floods and other weather-related conditions in addition to droughts.

As a result, for both individual and business entity clients who make a federal election to defer recognition of gain or to treat the sale as an involuntary conversion, do not make an adjustment

for California purposes. For individual clients, disregard the instructions in the 1997 FTB Publication 1001.

Sale of principal residence. For 1997, SB 519 has reinstated the filing requirement for taxpayers who have gain from the sale of their principal residence.

Your individual clients now need to consider gain from the sale of a principal residence as gross income in determining whether they need to file a California return for 1997. They should check the filing requirements on page two of the 1997 personal income tax booklet under "Do I Have to File?"

CONTINUED ON PAGE 3

Interest Rates

For the last six months of 1998, the interest rate on under- and over-payments of California income taxes will continue to be 9 percent. The following table lists interest rates since 1988.

Effective date	Rate
1 Jan. 1988 - 31 Mar. 1988	11%
1 Apr. 1988 - 30 Sept. 1988	10%
1 Oct. 1988 - 30 June 1989	11%
1 July 1989 - 31 Dec. 1989	12%
1 Jan. 1990 - 30 June 1990	11%
1 July 1990 - 31 Dec. 1990	11%
1 Jan. 1991 - 30 June 1991	11%
1 July 1991 - 31 Dec. 1991	10%
1 Jan. 1992 - 30 June 1992	10%
1 July 1992 - 31 Dec. 1992	9%
1 Jan. 1993 - 30 June 1993	8%
1 July 1993 - 31 Dec. 1993	7%
1 Jan. 1994 - 30 June 1994	7%
1 July 1994 - 31 Dec. 1994	7%
1 Jan. 1995 - 30 June 1995	8%
1 July 1995 - 31 Dec. 1995	9%
1 Jan. 1996 - 30 June 1996	9%
1 July 1996 - 31 Dec. 1996	9%
1 Jan. 1997 - 30 June 1997	9%
1 July 1997 - 31 Dec. 1997	9%
1 Jan. 1998 - 30 June 1998	9%
1 July 1998 - 31 Dec. 1998	9%

1998 Law Means Changes to 1997 Tax Returns

CONTINUED FROM PAGE 2

Repeal of installment method alternative minimum tax (AMT) adjustment for farmers. Previously, California did not allow the installment method of accounting for California AMT purposes. Now, California conforms to federal law that allows farmers to use the installment method for payments received in taxable or income years beginning on or after January 1, 1997, for installment sales related to the sale of farm property made in taxable or income years beginning after December 31, 1987.

When you compute California AMT for your individual or fiduciary farmer clients who received qualifying installment sale payments, disregard the 1997 instructions for line 13e on both Schedule P (540), "Alternative Minimum Tax and Credit Limitations – Residents," and Schedule P (540NR), "Alternative Minimum Tax and Credit Limitations – Nonresidents or Part-Year Residents," and for line 4j on Schedule P (541), "Alternative Minimum Tax and Credit Limitations – Fiduciaries." For your business entity clients, disregard the 1997 instructions for line 2f of Schedule P (100), "Alternative Minimum Tax and Credit Limitations – Corporations." In all cases, no adjustment is necessary.

Waiver of estimated tax penalty. SB 519 waives any additions to tax that are due to any underpayment of tax or estimated tax for any period before April 15, 1998, and that result from any underpayment for the 1997 or 1998 taxable or income year, as long as the underpayment was created or increased by any SB 519 provision.

To request the waiver, your individual or fiduciary clients should:

- Complete either form FTB 5805, "Underpayment of Estimated Tax by Individuals and Fiduciaries," or form FTB 5805F, "Underpayment of Estimated Tax by Farmers and Fishermen," to compute the full penalty that would ordinarily be due.
- Check "Yes" on form FTB 5805, Part I, Question 1, or check the box on form FTB 5805F, Part II, line 16.

- Attach a statement to the form explaining that a waiver is requested because of tax law changes made by SB 519.
- Attach form FTB 5805 or form FTB 5805F and the statement, on top of all other attachments, to the front of Form 540 or Form 540A, both of which are a "California Resident Income Tax Return," or to Form 540NR, "California Nonresident or Part-Year Resident Income Tax Return," or Form 541, "California Fiduciary Income Tax Return."

To request the waiver, your business entity clients should:

- Complete form FTB 5806, "Underpayment of Estimated Tax by Corporations," to compute the full penalty that would ordinarily be due.
- Write "Waiver" in red across the top of form FTB 5806.
- Attach a statement to the form explaining that a penalty waiver is requested because of tax law changes made by SB 519.
- Attach form FTB 5806 and the statement to the front of Form 100, "California Corporation Franchise or Income Tax Return," or Form 100S, "California S Corporation Franchise or Income Tax Return."

Qualified Funeral Trusts (QFTs).

Previously, in California, trusts created to prepay funeral costs were considered grantor trusts. Trustees were required to issue Schedule K-1s to the beneficiaries, and beneficiaries were required to report their income on their tax returns. Now, California law conforms to federal law on the treatment of QFTs for tax years ending after August 5, 1997. The trustee of a pre-need funeral trust can elect special tax treatment for the trust. In such cases, the trust is not treated as a grantor trust and the amount of tax paid on the annual earnings of the trust is determined under the income tax rate schedule applicable to trusts.

To make the election for California purposes in 1997:

Balance Due Electronic Filers Received Notices in Error

Some taxpayers who electronically filed returns received notices from the Franchise Tax Board in error.

FTB's computer system automatically issues Return Information Notices (RINs) when an adjustment is made on a return or if a tax payment does not cover the amount due. In the case of electronic filers, some notices may not reflect all payments that the taxpayers sent separately on or before April 15.

Any of your clients who filed electronically and received the notices do not need to respond as long as their tax payments were mailed no later than April 15. FTB will mail an explanation to all taxpayers who received the RINs by mistake. FTB also will implement system changes to prevent the errors and confusion from occurring next year.

FTB's electronic filing program was very successful this year. Tax practitioners' support of the program led to a 124 percent increase in the number of electronic returns filed. □

Inside ...

CONTINUED FROM PAGE 1

- 19 ... Partnership Schedule K-1: Paper-free filing
- 19 ... Partnership Schedule K-1: File one way
- 20 ... Fax personal income tax collection queries
- 20 ... Tax Talk: Four hours = four credits

CONTINUED ON PAGE 15

SBE Opinions

Appeal of Zenith National Insurance Corp., 98-SBE-001, January 8, 1998. The taxpayer is the parent of an insurance corporation from which it received substantial dividends that were not included in its measure of franchise tax. During the years at issue, the taxpayer incurred substantial interest expense on corporate debentures. The taxpayer used the funds from the issuance of the debentures to acquire a diverse portfolio of preferred stock. Dividends from the preferred stock were included in the measure of the taxpayer's franchise tax.

The State Board of Equalization concluded that, based on the totality of the facts and circumstances of the case, the taxpayer, for three of the four years in issue, established a dominant purpose and a sufficiently direct relationship between the interest expense on the debentures and the investments in preferred stock to allow for a direct allocation of interest expense against income from preferred stock investments. □

Legislature Looks at Tax Credits

Among the measures being considered by the Legislature are some that would provide tax credits. They include bills dealing with these subjects:

Adoption.

AB 119 (Runner) would repeal the existing state adoption credit. It would create a new credit by conforming to modifications to the federal credit.

Agriculture.

SB 1402 (McPherson) would allow a tax credit, subject to specified limits, for purchasing and installing qualified water application or distribution equipment used in a business to produce farm income on agricultural land that the taxpayer owns or leases.

Child care.

AB 2026 (Leach) would create a credit equal to the greater of 30 percent of the federal child care credit or \$150 for child care expenses.

SB 1523 (Rainey) would make changes to the \$50,000 limit of the Child Care Program Credit and allow this credit to reduce regular tax below tentative minimum tax. The bill also would create a credit for banks and financial corporations based on foregone interest income on loans for child care centers.

SB 1815 (McPherson) expresses the Legislature's intent to allow a credit against personal income taxes and bank and corporation taxes for amounts incurred for child care programs or facilities for children of low income parents.

Computer donations.

AB 2219 (Battin) would allow a credit equal, within limits, to the fair market value of each qualified computer that a taxpayer donates to a public school.

Economic revitalization.

AB 2458 (Cedillo) would create a credit equal to the applicable percentage of the ad valorem property tax paid or incurred for real property certified as participating in the Los Angeles Live/Work Economic Revitalization Plan.

Education.

AB 1662 (Alquist) would create three credits related to donations to California community colleges of property, modifications of facilities and facility maintenance and upkeep.

AB 1713 (Cuneen) would allow a credit for lending a qualified employee to a public school or vocational institution to teach math or science. It also would provide a credit for allowing a public school teacher to attend an employer-sponsored education class by using an open enrollment space.

AB 1747 (Alquist) would allow an employee to exclude from gross income the amount, not to exceed \$5,250 per year, that an employer pays or incurs for the employee to take graduate level courses beginning on or after June 20, 1998.

AB 2109 (Kaloogian) would create a credit equal to the fees that a taxpayer pays to a California public school for extra curricular activities. The credit would be limited to \$500 per taxable or income year or to \$250 for a husband and wife who file separate returns.

AB 2110 (Kaloogian) would create a credit equal to voluntary cash contributions made during the taxable year to a school tuition organization.

AB 2735 (Cardenas) would create a \$100 credit for a taxpayer who volunteers a minimum of 40 hours in a public school that has any grades up to eight and that the taxpayer's child attends.

Enterprise zone.

SB 1881 (Monteith) would provide taxpayers operating a trade or business in a newly designated enterprise zone with a credit of 80 percent of the amount paid for research and development performed at the trade or business in the enterprise zone.

Farmworker health.

AB 2520 (Prenter) would provide a 25 percent credit for the costs of preventive health care for employees who are qualified farmworkers.

CONTINUED ON PAGE 5

Legislature Looks at Tax Credits

CONTINUED FROM PAGE 4

Household/dependent care expenses.

AB 1728 (Floyd) would create a credit equal to a specified percentage of the allowable federal credit for employment-related household and dependent care expenses. The federal credit varies according to adjusted gross income (AGI) and is not available to taxpayers with an AGI over \$100,000.

Internet.

AB 2221 (Machado) would allow Internet service providers a credit for the costs of purchasing and installing tiering or filtering software or gateway scanning devices.

Jurors.

SB 14 (Calderon) would create a credit equal to 50 percent of the compensation paid during the taxable or income year to an employee serving on a trial jury.

Manufacturer's investment.

AB 1976 (Campbell) would replace the existing Manufacturer's Investment Credit (MIC) carryover provision with a refundable provision. The excess credit would be applied first to all other amounts due. Any remaining excess would be refunded on a pro rata basis over three years.

AB 2441 (Campbell) would include in the definition of "qualified taxpayer" for the MIC specific kinds of businesses related to computer programming and software.

Military service income.

AB 1494 (Olberg) would reinstate in specified amounts the Military Service Income Credit that expired on January 1, 1992.

Mortgage savings accounts.

AB 1841 (Baldwin) would allow a qualifying individual a credit of specified maximum amounts deposited in a mortgage savings account for the purchase of a principal residence in California. The individual must be a first-home buyer. The bill also would exempt from taxation all interest earned on the mortgage savings account.

Newspaper investment.

AB 2370 (House) would create a one-time credit equal to the amount, within limits, of a capital investment in a qualified newspaper during the taxable or income year.

Property contributions.

SB 2080 (O'Connell) would allow a credit to taxpayers who contribute defined property or money for environmental preservation to certain government bodies or the nonprofit organizations that they designate.

Public transit subsidies.

AB 1702 (Figueroa) would give employers a credit equal to 40 percent of the cost of subsidizing public transit passes for California resident employees.

Research expense.

AB 1356 (Figueroa) would conform California to the federal percentage for the alternative incremental research expense credit.

Vehicle inspection.

AB 1914 (Ashburn) would create a credit for the costs of purchasing any Bar-97 equipment required for vehicle inspection. A second credit would equal \$50 for each taxpayer vehicle tested by the equipment during the taxable year.

Wage/property.

AB 1779 (Runner) would establish a wage credit and a property credit for the Joint Strike Fighter Program. The credits would apply to taxpayers under contract or subcontract to manufacture property in California for ultimate use in a joint strike fighter program.

AB 1708 (Leach) would provide employers with a 50 percent credit for qualified wages paid to an employee during the qualified time period in a qualified training program. □

FTB Calendar

May

- 100,000 demand to file notices are mailed to individuals who failed to file a 1996 tax return.
- 30,000 Notices of Proposed Assessment are issued to individuals who did not respond to demand to file notices issued in February for 1996 tax returns.
- Notices of Proposed Assessment are issued to qualified corporations that failed to file requested 1995 corporate returns.
- 15 First day to file Homeowner and Renter Assistance claims.
- 20 Previous month nonresident withholding payments are due if total withholding exceeded \$2,500.

June

- Demand to file notices are mailed to individuals who failed to file a 1996 tax return.
- 30,000 Notices of Proposed Assessment are issued to individuals who did not respond to demand to file notices issued in February and March for 1996 tax returns.
- 15 Second quarter 1998 personal income tax estimate payments are due.
- 20 Previous month nonresident withholding payments are due if total withholding exceeded \$2,500.

CONTINUED ON PAGE 7

Nonresidents Choose Electronic Filing

This year, for the first time, California nonresidents were invited to file here electronically. And a good number have accepted the proposal.

By April 15, 1998, 2,937 nonresidents had filed in California electronically. By the same date, a total of 185,514 nonresidents had used all available methods of filing here.

The Franchise Tax Board expects the number of nonresidents filing electronically to grow in the coming years. So, if your software provider did not include the Form 540NR, "California Nonresident or Part-Year Resident Income Tax Return," in your software package, you may want to request it for next year. □

Direct Deposit: The Most-Asked Questions

During the debut this year of a direct deposit refund program for taxpayers who file electronically, both tax professionals and taxpayers called with questions.

Here are the four most-asked questions and the Franchise Tax Board's answers:

When I filed, I incorrectly listed the Routing Transit Number (RTN) that identifies my bank. Can I change it?

No. Once your electronic return has entered FTB's system, you cannot make a change in the banking information. So you should always be sure that you are using the correct RTN, which is the nine-digit number usually located in the lower left area of a check and also known as an American Banking Association number. Also keep in mind that some banks have one number for Northern California and a different one for Southern California.

What does FTB do with my refund when I use the wrong RTN?

FTB attempts to deposit the refund based on the banking information that you provide. If the information is incorrect, the bank returns the money to FTB. FTB in turn sends the taxpayer a paper refund check. This process means that the refund will be delayed by up to one week.

I used the correct RTN. Why did I receive a paper check instead of a direct deposit refund?

You may have received a paper check for one of these three reasons:

- As a precaution against fraud, direct deposit is not available to taxpayers who are filing in California for the first time.
- Also as a fraud prevention method, only one direct deposit may be made per bank account. Someone else may already have requested a direct deposit to the account. However, your federal and state refunds may be deposited in the same account.
- FTB may have changed the amount of a refund because of an error on your return.

(Also, you may not receive a direct deposit or paper check refund if your refund is claimed, according to law, by another state agency to which you owe money.)

How will I know when my direct deposit refund is in my bank account?

You should wait seven to 10 banking days and then call the bank to verify that the funds have been deposited. A bank's telephone teller option may not be able to provide the information, so you may need to speak to a member of the bank's staff. FTB does not notify taxpayers that refunds have been deposited. □

Electronic Filers Like Direct Deposit

About a quarter of all taxpayers who file their returns electronically are asking to have their refunds deposited directly in their bank accounts.

By April 15, 1998, the Franchise Tax Board had received requests for direct deposit from 181,029 electronic filers. The number represents 23 percent of the total returns filed electronically and 28 percent of the electronically filed returns that qualified for refunds.

The direct deposit program is in its first year and is attracting taxpayers in greater numbers than anticipated. And electronic filing generally is drawing more taxpayers this year.

One reason for the success of the direct deposit program may be that many tax professionals are using it as a marketing tool to encourage clients to file electronically. Refunds are issued more quickly to taxpayers who file electronically than to those who file on paper. Direct deposit shaves even more time off the refund process. And in addition to speed, direct deposit gives

CONTINUED ON PAGE 7

Electronic Filing Update

Because taxpayers have until October 15 to file their tax returns electronically or in other ways, Franchise Tax Board reminders can help both you and your clients.

When you file your clients' returns electronically:

- You do not need to follow up an electronically transmitted return with a paper copy. The electronically filed return is all that you need to send FTB.
- Remind your clients that the copy of the return that you give them is for their files. They should not send it to FTB.
- Keep the signed copy of form FTB 8453, "California Individual Income Tax Declaration for Electronic Filing," in your files for four years from the later of the due date of the return or the date it is filed. Do not send the form to FTB.

If you are interested in participating in FTB's electronic filing program, you can apply any time. Look for an application

form on the Internet at FTB's <http://www.ftb.ca.gov/elecserve> address, or call the electronic filing Help Desk at (916) 845-0353.

Also, you will be offered a wider choice in the future for the modem transmission of electronic returns. FTB will purchase, install and test software that will accommodate Z as well as X modem transmissions. □

Electronic Filers Like Direct Deposit

CONTINUED FROM PAGE 6

clients an easier and safer way to receive their state tax refunds.

Because of the positive taxpayer reaction to the direct deposit of refunds when returns are electronically filed, FTB is considering expanding the program to 1998 tax returns that are TeleFiled and filed on paper and either image- or manually-processed. □

FTB Calendar

CONTINUED FROM PAGE 5

July

- 60,000 demand to file notices are mailed to individuals who failed to file 1996 tax returns.
 - 45,000 Notices of Proposed Assessment are mailed to nonfilers of 1996 personal income tax returns.
- 20 Previous month nonresident withholding payments are due if total withholding exceeded \$2,500.

August

- 25,000 demand to file notices are mailed to individuals who failed to file 1996 tax returns.
 - 15,000 Notices of Proposed Assessment are mailed to nonfilers of 1996 personal income tax returns.
- 20 Previous month nonresident withholding payments are due if total withholding exceeded \$2,500.
- 30 Last day to file Homeowner and Renter Assistance claims. □

Electronic Filing: Two-Year Review

	<u>1996 tax year</u> (as of April 15)	<u>1997 tax year</u> (as of April 15)	<u>Change</u>
Returns processed:	355,877	795,982*	124%
Electronic return originators (EROs) approved by FTB to produce the returns transmitted:	5,666	6,750	19%
EROs who participated:	3,360	4,056	21%
Transmitters accepted by FTB:	106	120	13%
Transmitters who participated:	97	106	9%
Balance due filers:	28,696	120,250	319%
Help Desk phone calls answered:	4,836	5,669	17%

* Includes 63,138 Transmitter/On-Line Service (TROLS) returns filed from personal computers via third party transmitters.

1995 Corporation Tax Returns Sought

What happens when a corporation appears to be doing business in the state but does not file a California tax return?

The Franchise Tax Board sends the corporation a demand to file based on information it receives from the Internal Revenue Service, the State Board of Equalization and the Employment Development Department.

In April, FTB sent approximately 4,000 nonqualified corporations a Notice of Proposed Assessment (NPA) for failing either to file a 1995 tax return or to show that they did not have a filing requirement. A nonqualified corporation has not registered with the California Secretary of State to do business here.

Another 10,000 corporations that received a demand to file a 1995 return in March will receive an NPA this month.

These corporations were registered or qualified with the Secretary of State to do business in California and failed to file a return or provide proof that a return was already filed.

The corporation has 60 days from the date of the notice to file the requested return or to protest the assessment. If the corporation does not respond within that time, the assessment becomes due and payable immediately. □

The Question Column

What Is Wife's Filing Status When Non-Citizen Husband Lives Outside U.S.?

If an American citizen taxpayer living in the United States is married to a non-U.S. citizen who does not live in the United States, does she qualify as head of household or should she file married filing joint?

That depends on several other factors.

The taxpayer could file as head of household if:

- Her spouse was a nonresident alien at any time during the tax year.
- She and her husband did not elect to treat the husband as a resident alien during the tax year or in a prior year.

- She had a qualifying relative and met the other tests for head of household. Keep in mind that her spouse cannot be the qualifying relative.

If the taxpayer elected to treat her spouse as a resident alien, she would be considered married and would be eligible to file as married filing joint. Once that election is made, it applies to all subsequent years unless it is somehow suspended, revoked, ended by legal separation or otherwise terminated.

CONTINUED ON PAGE 14

California's Tax Filing Season

January 2 - April 15

(Watch for an update in the July Tax News)

	<u>1997</u> *	<u>1998</u> *
Personal income tax returns processed:		
Paper	3,553,170	3,522,520
Scannable	2,852,907	2,790,219
Electronically filed	346,095	795,982
TeleFiled	218,955	282,973
Total	6,971,127	7,391,694
Electronic funds transfers:		
Amount	\$866,976,869	\$921,856,660
Volume	5,768	61,058
Amount deposited:		
Personal income taxes	\$2,996,911,914	\$3,746,656,625
Bank and corporation taxes	\$522,751,431	\$567,567,114
Partnership taxes	\$29,410,441	\$35,699,506
Total	\$3,549,073,786	\$4,349,923,245
Largest daily deposit:		
Personal income taxes — April 15	\$231,499,716	\$249,826,435
Bank and corporation taxes (includes electronic funds transfers) — March 18	\$335,708,357	\$347,716,085
Refunds:		
Total amount	\$1,349,442,374	\$1,553,341,563
Average amount	\$343	\$359
Volume	3,930,183	4,328,116

* Current-year returns only; no prior-year returns included.

Legislature Considers Tax Deductions and More

The California Legislature is considering a variety of tax deduction measures and proposals on other topics ranging from “amnesty” to “voluntary contributions.”

Among the measures that would give taxpayers additional or expanded deductions are:

- AB 1218 (Alquist), which would allow corporations commercially domiciled in California to deduct interest expense attributable to dividends that are received from an insurance company subsidiary and that are excluded from income.
- AB 1618 (Morrissey), which would provide a \$20,000 deduction from gross income to a resident individual at least 65 years of age.
- AB 2092 (Morrissey), which would allow taxpayers to deduct 100 percent of the amount they pay or incur for their children’s child care costs.
- AB 2165 (Bowen), which would conform to federal law regarding the election to treat qualified environmental remediation expenditures as a deductible expense for the taxable or income year in which they are paid.
- AB 2335 (Poochigian), which would provide that a taxpayer’s contributions to a California medical savings account would be deductible and that the interest and dividends earned would be excludable from gross income.
- SB 1985 (O’Connell), which would attempt to conform, with certain modifications, to the increased federal deduction for contributions of computer technology and equipment to schools.
- SB 1993 (Hurt), which would allow a deduction for the amount paid for federal income taxes and federal employment taxes.
- SB 2096 (Mountjoy), which would allow a deduction for an amount equal to any expenditures for free agent insurance.

CONTINUED ON PAGE 10

Electronic Filing Calendar

If you offer your clients the option of filing electronically, here are the dates to remember:

- October 15 - Last day to transmit timely filed returns.
- October 19 - Last day to retransmit returns rejected on October 15 or earlier. □

Keeping in Touch with FTB

January 2 - April 15

<u>1997</u>	<u>1998</u>	
22,714	39,855	Calls from tax practitioners
1,402	1,585	Faxes from tax practitioners
710,076	999,349	Calls from taxpayers answered by the Taxpayer Services Center
2,169,004	1,730,352	Tax-related calls to FTB’s automated telephone service
322,891	526,308	User sessions on FTB’s Internet Web site
475,359	2,017,324	Forms downloaded from FTB’s Internet Web site

Forty Counties Qualify as El Niño Disaster Areas

By press time, the President had declared 40 California counties federal disaster areas as a result of the 1998 storms and floods.

The designation allows storm and flood victims in the 40 counties to deduct disaster losses on either their 1997 or 1998 tax returns.

Disaster victims also can treat their losses as net operating losses. As a result, they may carry forward 50 percent of any excess disaster loss to future taxable years. Action by the Legislature and Governor would permit taxpayers in disaster areas to carry forward 100 percent of any excess disaster loss to future taxable years. At press time, disaster relief legislation, AB 2456 (Sweeney), had been introduced in the Legislature.

The 40 counties designated as disaster areas are: Alameda, Amador, Butte, Calaveras, Colusa, Contra Costa, Fresno, Glenn, Humboldt, Kern, Lake, Los Angeles, Marin, Mendocino, Merced, Monterey, Napa, Orange, Riverside, Sacramento, San Benito, San Bernardino, San Diego, San Francisco, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Solano, Sonoma, Stanislaus, Sutter, Tehama, Trinity, Tulare, Ventura, Yolo and Yuba.

For more information, see the March 1998 issue of Tax News. □

Legislature Considers Tax Deductions and More

CONTINUED FROM PAGE 9

In addition, here are highlights of some of the additional proposals before the Legislature (also see "Legislature Looks at Tax Credits" in this issue):

Amnesty.

AB 2635 (Martinez) would establish a tax penalty amnesty program from May 1, 1999, to August 31, 1999, for tax liabilities from taxable years beginning before January 1, 1998.

Appeals.

AB 2250 (Poochigian) would provide for a hearing for taxpayers who file a claim for reimbursement of fees and expenses related to a State Board of Equalization appeal, unless the taxpayer waives the hearing in writing.

SB 1520 (Kopp) would provide that ex parte communications shall be restricted in a petition or appeal that is or may come before the State Board of Equalization or a hearing officer.

Auto depreciation.

AB 2692 (Kuehl) would provide that cars and light trucks certified as ultra-low emission would not be subject to the depreciation limitations on luxury vehicles. They also could be depreciated as three-year, rather than five-year, property.

Burden of proof.

AB 1631 (Sweeney) would express the Legislature's intent to conform to federal law related to shifting the burden of proof in tax matters. It would provide that FTB would have the burden of proof, applying the clear and convincing standard, in asserting penalties for intent to evade or commit fraud.

SB 1425 (Hurt) would shift the burden of proof from the taxpayer to any state tax collection agency in litigation cases provided the taxpayer shows prima facie justification for the factual or legal contention and fully cooperates in disclosing all relevant evidence.

Child support.

AB 1823 (Cardenas) requires contractors or vendors who enter into a contract with

the state to certify that they have complied with all earnings withholding orders and notices for the collection of child, family or spousal support and with state and federal employment reporting requirements for their employees. The bill also would require that any payments due under a state contract would first be paid to FTB to satisfy any delinquent child support that the contractor or vendor owes.

AB 2094 (Morrissey) would make FTB responsible for administering the state's delinquent child, spousal and medical support collection programs and for determining paternity. In those roles, FTB would replace the Department of Social Services and county district attorney offices.

AB 2343 (Woods) would change the criteria under which the Department of Social Services may exempt a county from making mandatory referrals to FTB's child support collection program. A county would be granted an exemption if its collection program meets or exceeds the results of FTB's child support collection program instead of if its technology is similar or identical to FTB's.

SB 1508 (Rainey) would require state and local public agencies to notify FTB whenever they receive a claim so that FTB can determine if the claimant owes child, spousal or family support. If an amount is owed, FTB would be required to issue an order to withhold payment.

Disasters.

AB 2456 (Sweeney) would provide that losses sustained as a result of the February 1998 storms and flooding are eligible for special disaster loss treatment.

Drug abuse education.

AB 1733 (Machado) would extend the sunset date of the California Drug Abuse Resistance Education (D.A.R.E.) fund from January 1, 1999, to January 1, 2004.

CONTINUED ON PAGE 11

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Legislature Considers Tax Deductions and More

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CONTINUED ON PAGE 11

Legislature Considers Tax Deductions and More

CONTINUED FROM PAGE 10

Election fund.

SB 1953 (Vasconcellos) would create the State Candidate Election Fund. Taxpayers would be able to designate a portion of their tax liabilities to the fund via their tax returns.

SB 2106 (Watson) would create a Legislative Election Fund to which taxpayers could designate a portion of their tax liabilities when they file tax returns.

Employees.

AB 1630 (Sweeney) would expand the state's new employee registry by requiring more people and entities to register. Recipients of state loans or grants would need to report their social security numbers and employers' names. State agencies would have to report on each contractor with whom it has a contract. Contractors with a state contract would have to register their employees as well as their subcontractors who will work on a state contract.

Federal conformity.

SB 1496 (Alpert) would change from January 1, 1997, to January 1, 1998, the date from which California's personal income tax law conforms to the Internal Revenue Code (IRC).

AB 1613 (Scott) would partially conform California law to the federal non-refundable HOPE and lifetime learning credit. It also would conform to federal changes made by the Taxpayer Relief Act of 1997 relating to education loan interest deductions.

AB 2108 (Kaloogian) also would conform to the federal HOPE credit.

AB 2258 (Cardenas) would conform to the federal change that eliminated contributions of appreciated property as an alternative minimum tax adjustment or preference item.

AB 2266 (Baugh) would express the Legislature's intent to conform to and expand the availability of the medical savings account provisions of IRC Section 220.

AB 2267 (Baugh) would modify California conformity to federal law by providing that medical expenses do not have to exceed 7.5 percent of adjusted gross income (AGI) to be deductible.

AB 2330 (Poochigian) would reduce the 7.5 percent AGI limitation for medical deductions to 2 percent over a five-year period.

FTB restructuring.

SB 1739 (Kopp) would rename FTB the Department of Franchise Tax under the control of a director appointed by the Governor and confirmed by the Senate. It would transfer the Employment Development Department's tax collection functions to the new department. Also, the current three-member Franchise Tax Board would be renamed the Board of Franchise Tax Review; its role would include considering taxpayer appeals of department actions and adopting advisory resolutions.

Health care.

AB 2257 (Cedillo) would impose certain disclosure requirements on tax exempt health care service plans, related to transactions with subsidiary for-profit corporations.

Homeowner assistance.

SB 1464 (Brulte) would apply inflation adjustments to the gross and total household income amounts used to calculate a homeowner's claim to the Homeowner and Renter Assistance program that FTB administers.

Incentive zones.

SB 1814 (Karnette) would make four changes to the enterprise zone employer hiring credit. It would double the percent of "qualified wages" that qualify for the credit allowed for each taxable or income year. It would increase the amount of wages that qualify for the credit by changing the definition of qualified wages to the amount of wages paid to qualified employees, other than those employed in the Long Beach Enterprise Zone,

Interested in Proposed Law?

Would you like to know more about a legislative measure covered in this issue of Tax News?

For a copy of any legislative bill, write the Legislative Bill Room, Room B-32, State Capitol, Sacramento, CA 95814. Or call the Bill Room at (916) 445-2323.

On the Internet, you will find legislative measures at <http://www.leginfo.ca.gov>, which is the Official California Legislation Information Web site address. □

CONTINUED ON PAGE 12

Tax News Three Ways

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To subscribe to Tax News by E-mail, also contact the FTB Web site. Access the Education and Outreach page. Click on the Tax News logo and then on "Tax News by E-Mail." Insert your E-mail and other address information in the fields provided. Click on "subscribe" and then on "submit" to record your subscription. □

Legislature Considers Tax Deductions and More

CONTINUED FROM PAGE 11

that exceeds the minimum wage but does not exceed the "state average hourly wage." It would provide that qualified wages are the wage amounts that are paid to up to 1,350 qualified employees employed in the Long Beach Enterprise Zone in aircraft manufacturing activities and that exceed the minimum wage but do not exceed 125 percent of the "state average hourly wage. And it would provide that qualified wages include any amount paid by an employer for a qualified employee's health insurance premium.

AB 1937 (Murray) would require the Trade and Commerce Agency to designate an additional enterprise zone in a specified area of Los Angeles County. The zone would have to meet certain criteria involving the unemployment rate, household income, poverty rate and the decline in new business enterprises. It would be entitled to all existing enterprise zone tax incentives.

AB 2205 (Washington) would create the Compton Economic Development and Job Creation Program offering incentives similar to those available in the Los Angeles Revitalization Zone.

SB 2079 (Costa) would, among other things, extend the designation period from 15 to 20 years for an enterprise zone designated prior to 1990 and modify the method used to determine business income attributable to a zone.

In-lieu tax.

AB 511 (Migden) would require that a percentage of the revenues from the in-lieu tax be deposited into a new Financial Aid to Local Agencies Fund for disbursement to all cities and counties according to a specified formula.

Liens.

AB 2450 (Oller) would require FTB to issue a "notice of expungement" rather than a "release," if FTB determines it issued a tax lien notice in error.

Minimum franchise tax.

AB 27 (Bowen) would provide that a corporation would not be subject to the minimum franchise tax for the income year following the income year in which

the corporation files for dissolution if FTB's request for more documentation or adjustments delayed the dissolution.

SB 1435 (Hayden) would reduce the minimum franchise tax for income years beginning on or after January 1, 1999, for every bank or corporation that has 25 or fewer employees and gross receipts less than \$1 million and that meets certain other specifications.

Net operating loss.

SB 1994 (Hurt) would completely replace California's stand-alone net operating loss (NOL) provisions with federal NOL law.

Oil well recovery.

SB 1788 (Karnette) would allow taxpayers to elect either to exclude from gross income any income received from selling oil from a "recovered inactive well," which the bill defines, or to claim the enhanced oil recovery credit provided under current law.

Partnerships, limited liability companies, limited partnerships.

AB 1694 (Ackerman) would establish the due date of returns for partnerships and limited liability companies as on or before the 15th day of the fourth month following the close of their taxable or income year. It also would clarify FTB's right to suspend certain limited liability companies that fail to pay tax. FTB is a sponsor of the bill.

AB 1828 (Leach) would make minor changes to current law primarily regarding events that trigger the dissolution of limited liability companies and limited partnerships and the conditions required for an assignee of a limited partnership interest to become a limited partner. The bill also would allow limited liability companies to have only one member.

AB 2245 (Baldwin) would replace the general prohibition against a limited liability company rendering professional services with a list of specific professional services that may not be rendered.

CONTINUED ON PAGE 13

Legislature Considers Tax Deductions and More

CONTINUED FROM PAGE 12

SB 1741 (Alpert) would require FTB to notify a taxpayer that files a limited partnership return designated as its final return that the minimum franchise tax is due annually until the taxpayer files a certificate of dissolution or certificate of cancellation with the California Secretary of State.

SB 2234 (Senate Revenue and Taxation Committee) would clarify that FTB may suspend any limited liability company that is not classified as a corporation for California tax purposes and that fails to pay its tax. It would clarify the definition of "wages" that must be included in the Report of Wages. It would provide that nonresidents must prorate the deduction for alimony payments in the same way that nonresident tax is prorated. SB 2234 would retain the program to refund excess state disability insurance through the tax return, and it would ensure that taxpayers who fail to claim the credit on their returns would still be identified as quickly as possible to receive a refund of their excess contributions. The bill would make several changes relating to federal adjustments; they deal with the final federal determination date and taxpayers' requirement to notify FTB of any federal changes to their tax returns. And the bill would remove the commercial domicile restriction, permitting all corporations regardless of their commercial domicile to deduct dividends received from an insurance company subsidiary operating in California and subject to the gross premiums tax. FTB is a sponsor of this bill.

Refund offsets.

AB 2613 (Pacheco) would require that unpaid court-ordered fines, fees and costs be paid from income tax refunds before any other delinquent amounts except for child, family or spousal support or overpaid unemployment benefits.

Secured debt.

SB 1499 (Lewis) would exclude from gross income any income from the cancellation of a secured debt from the

sale of the taxpayer's principal residence in California to a person who holds a security interest in the residence.

Service earnings.

AB 2014 (Kuehl) would require certain "service recipients" to provide specified information to FTB within 20 days of either making or entering into a contract for payments of \$600 or more in a year. FTB would be authorized to use the information for enforcement purposes or for administering Welfare and Institutions Code provisions.

Standard deduction.

SB 1526 (Monteith) would double the standard deduction for each taxable year beginning on or after January 1, 1998.

Student loans.

AB 2004 (Wright) would increase the notification requirements for the Student Aid Commission and private debt collectors before they refer delinquent student loans to FTB for collection and would revise other aspects of current law relating to student loan collection.

Suspended corporation.

AB 1950 (Torlakson) would make changes to the law that imposes a penalty on any person attempting to exercise the corporate powers, rights and privileges of a suspended or foreign corporation whose privileges have been forfeited. The bill would provide that the penalty does not apply to any insurer or counsel to an insurer who defends the suspended corporation in a civil action regarding personal injury, property damage or economic loss.

Tax assessment.

AB 2678 (Pringle) would allow the taxpayer to use a restraining order or injunction to stop a tax assessment or collection if, among other things, the taxpayer pays all amounts due or files a bond equal to the amount.

Tax brackets.

SB 2197 (Rainey) would increase the threshold amounts for each personal income tax bracket by 10 percent.

Water's-edge Election Problems Move to Resolution

Taxpayers experiencing water's-edge election problems recently came closer to resolution.

At a March symposium, Franchise Tax Board staff and interested taxpayers drafted proposed amendments to current water's-edge regulations, California Code of Regulations Sections 25111 and 25111-1. The proposal will be the subject of a regulatory hearing this Spring.

Symposium participants agreed in concept on the proposed amendments, which presume that the Legislature's intent in formulating the water's-edge statute was to permit all taxpayers wishing to make a water's-edge election to do so regardless of mechanical election errors. Among other things, the proposal addresses what constitutes "substantial performance" in making a water's-edge election, the definition of "original return," implementation of "common parent elections" and situations where a deemed request to terminate a water's-edge election will be automatically granted.

Participants also compared the proposed regulation amendments to a list of identified invalidated water's-edge elections categorized by reason for invalidation. The amendments would resolve at least 87 percent of these invalidated elections.

When the date of the regulatory hearing is published, it will be posted on FTB's <http://www.ftb.ca.gov> Internet Web site. □

CONTINUED ON PAGE 14

Need a Tax Form Fast?

If you need a tax form or publication, you can request a copy from the Franchise Tax Board, order the Package X or visit a library or quick print shop.

If you are really in a hurry, however, the most direct route from your office to a California tax form is the Internet. Just contact FTB at its <http://www.ftb.ca.gov> Web site. □

Legislature Considers Tax Deductions and More

CONTINUED FROM PAGE 13

Tax simplification.

AB 1930 (Campbell) expresses the Legislature's intent to examine the complexities of California tax law and to reduce the need for audits by simplifying the tax code.

Tobacco/self-employment insurance deduction.

AB 1991 (Davis) would disallow any deduction for amounts paid to the National Tobacco Settlement Trust Fund pursuant to the federal Universal Tobacco Settlement Act. The bill also would increase the deduction for self-employed health insurance from 25 percent in 1998 to 80 percent in 2006. However, it would not increase the deduction to 100 percent by 2007, as the federal Tax Relief Act of 1997 did.

AB 2107 (Kaloogian) would increase the deduction percentage for self-employed health insurance from 25 percent to 45 percent in 1998 up to 80 percent in 2006.

AB 2131 (Morrissey) would extend the self-employed health insurance deduction to employees, if the employer does not provide health insurance. It also would increase from 25 percent to 100 percent the deductible percentage of an employee's health insurance.

SB 1928 (Knight) would provide that any funds that a state receives from a national tobacco settlement could be deposited into a special fund and returned to taxpayers as a personal income tax credit.

Voluntary contributions.

AB 2366 (Cedillo) would create a new voluntary contribution fund called the "Emergency Food Assistance Program Fund."

AB 2675 (Cardoza) would create a general voluntary contribution provision addressing unspecified designees and insufficient amounts for multiple designations. FTB is a sponsor of this bill. □

The Question Column

CONTINUED FROM PAGE 8

Does Keogh Contribution, Made After Leaving State, Reduce California Source Income?

A taxpayer is a resident of California for the first six months of the tax year. He is self-employed and earns \$10,000 while he is in California. After leaving the state, he earns another \$70,000 in self-employment income. Also after leaving the state, he makes an \$8,000 pension contribution to a federal Self-Employed Retirement Plan (Keogh). He files his California tax return by the extended due date in October. Does the pension contribution reduce his California source income?

Yes. An individual has until the due date of the return, including extensions, to make a contribution to a Keogh or Simplified Employee Pension (SEP) plan. As a part-year resident, the allowable amount of the California source income deduction is computed by multiplying the contribution by the ratio of California self-employment income to total self-employment income. In the example given, the taxpayer can claim a \$1,000 deduction from California source income for the contribution.

To calculate the deduction, divide the \$10,000 California self-employment income by the \$80,000 total self-employment income. Multiply the result by the \$8,000 Keogh contribution. The answer is \$1,000, the amount of the deduction that the taxpayer may claim from California source income. □

1998 Law Means Changes to 1997 Tax Returns

CONTINUED FROM PAGE 3

First, complete Form 541, "California Fiduciary Income Tax Return," by doing the following:

- Enter -0- on lines 3, 5, 6, 7, 10, 13, 18, 22 and 26.
- Make entries only on lines 1, 2, 4, 8, 9, 11, 12, 14, 15a, 15b, 15c, 16, 17, 20, 21a, 23, 24, 25 and 27 through 39.
- Sign the form at the bottom of Side 2.
- Write "QFT" in red across the top of Side 1.

Second, attach federal Form 1041-QFT, "U.S. Income Tax Return for Qualified Funeral Trusts," to the back of your Form 541.

If you file a composite return for California purposes, be sure to attach a copy of your federal composite Form 1041-QFT and all supporting schedules. A composite return is a single return for all QFTs of which you are a trustee.

Qualified Subchapter S Subsidiary (QSSS) tax subject to estimated tax payments. The new law provides that the QSSS tax is subject to the estimated tax rules and penalties and that the tax is due and payable when an S corporation's first estimated tax payment is due. If the QSSS was acquired during the income year, the QSSS tax is due with the S corporation's first estimated tax payment after the QSSS election date.

Your S corporation client that acquires a QSSS after the due date of the first estimated tax installment must include the QSSS tax amount in the payment for the next estimated tax installment. For example, a calendar-year S corporation acquires a QSSS on May 31, 1998. The \$800 QSSS annual tax should be entered on the Form 100-ES, "Corporation Estimated Tax," in the QSSS Tax Amount box for Installment 2, which is due on June 15, 1998.

Deferral of income for family farm corporations. Under SB 519, California has repealed the provision that allowed family farm corporations with income of more than \$25 million in any year to defer tax if the income resulted from changes in required accounting methods.

Suspense accounts established prior to SB 519's enactment for your calendar-year qualified family farm corporation clients should be recaptured starting in taxable or income years beginning on or after January 1, 1998. For fiscal year taxpayers with income years ending on or after December 31, 1997, suspense accounts should be recaptured starting in taxable or income years beginning on or after June 9, 1997.

Repeal of the 30 percent gross income test for regulated investment companies (RICs). Under SB 519, California also has repealed the 30 percent gross income test for taxable or income years beginning after August 5, 1997.

For your business entity clients, follow the instructions for federal Form 1120-RIC, "U. S. Income Tax Return for Regulated Investment Companies."

Modification of rules for real estate investment trusts (REITs). California now conforms to the REIT provisions for

CONTINUED ON PAGE 16

You Can Get There from FTB Web Site

You are browsing the Franchise Tax Board's Web site. You discover that you need information from another tax agency. Do you start your Internet surfing all over again?

No. From FTB's Web site you can link to the home pages of the Internal Revenue Service, the State Board of Equalization, the Employment Development Department, the Controller and the Secretary of State. You also can reach the California Home Page from the FTB site. □

Where to Find SB 519 Information

For a copy of FTB Publication 1003, "1997 Tax Law Changes Enacted in 1998," (see article beginning on page 1) visit FTB on the Internet at <http://www.ftb.ca.gov> or write Tax Forms Request, Franchise Tax Board, P.O. Box 307, Rancho Cordova, CA 95741-0307.

An analysis of SB 519 also is available at FTB's Internet address. And for a copy of the bill, write or visit the Legislative Bill Room, Room B-32, State Capitol, Sacramento, CA 95814. Or call (916) 445-2323. You also will find a copy of SB 519 at the Official California Legislation Information Web site at <http://www.leginfo.ca.gov> on the Internet. □

Planning to Move?

If you plan to move your office, be sure to alert Tax News.

Make sure the newsletter continues to reach you without delay. 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. □

Nonresident Withholding: The Rules for Partnerships

Are your partnership clients withholding taxes on California source income to nonresidents?

Recent Franchise Tax Board correspondence with partnerships reveals that many are not aware of nonresident withholding requirements or are confused about the requirements.

Partnerships, including limited liability companies classified as partnerships and limited liability partnerships, are required to withhold:

- 7 percent of the amount of California source income distributed to domestic nonresident partners. This rule does not apply when distributions during the year total \$1,500 or less or when FTB grants the partner a waiver.
- At the maximum tax rate for foreign partners. Currently, the rate for individuals is 9.3 percent of the amount of California source income allocated. For corporate partners, the maximum rate is 8.84 percent. Waivers are not available to foreign partners.

FTB considers waivers of the withholding requirements for domestic partners on a case-by-case basis. However, waivers generally are granted if the partner meets one of these conditions:

- Consistently files California returns and makes estimate payments.
- Is a partnership.
- Is included in a group return.
- Is a newly admitted partner.
- Can show that the 7 percent rate will result in more withholding than the amount required.

Waivers also are usually granted if the partnership meets one of these conditions:

- Is publicly traded.
- Is setting up a withholding program and experiencing administrative problems.

Partnerships that fail to withhold may be liable for the amount of taxes due from the partner. They also may be subject to penalties and interest charges as if the

withholding due was the partnership's tax

liability. However, FTB is working to help partnerships that are not aware of nonresident withholding requirements to establish withholding procedures. FTB will not assess penalties if the failure to withhold is due to reasonable cause.

For more information on the nonresident withholding requirements, see FTB Publication 1017, "Nonresident Withholding – Partnership Guidelines." The publication includes 78 questions and answers about nonresident withholding for both domestic and foreign partners, as well as six tax forms.

To obtain the publication, contact FTB at <http://www.ftb.ca.gov> on the Internet. Click on "Tax Forms" and then on "Miscellaneous Tax Forms." You also can obtain the publication by mail by writing Tax Forms Request, Franchise Tax Board, P.O. Box 307, Rancho Cordova, CA 95741-0307.

If you have questions that are not answered by Publication 1017, call FTB's Nonresident Withholding staff at (916) 845-4900. (FTB's Nonresident Withholding Section was formerly known as the Withhold-at-Source Section.) □

1998 Law Means Changes to 1997 Tax Returns

CONTINUED FROM PAGE 15

taxable or income years beginning after August 5, 1997, that are included in the federal Taxpayer Relief Act of 1997.

For your business entity clients, follow the instructions for federal Form 1120-REIT, "U. S. Income Tax Return for Real Estate Investment Trusts," for provisions related to the Taxpayer Relief Act of 1997.

California retains its nonconformity to various alternative taxes imposed on certain REIT income and activities, although such amounts remain includible in California taxable income. □

FTB Notice Addresses S Corporation Issues

The Franchise Tax Board has identified two concerns for financial corporations that use the reserve method of accounting for bad debts.

The concerns, which involve S corporation status and elections, stem from 1997 legislation. They are outlined in FTB Notice 98-3, "S Corporations – Change in Accounting Method from Bad Debt Reserve for Banks, Savings and Loan Associations, and Financial Corporations."

One issue involves the termination of S corporation status for financial corporations that validly elected the status under prior law but are not eligible S corporations under current law. The second issue involves treating an S corporation election as an automatic election to change the corporation's accounting method for bad debts.

Termination of S corporation status.

Before the Small Business Jobs Protection Act of 1996 was enacted, the federal definition of ineligible corporations for S corporation status included financial institutions. For federal purposes, financial institutions included banks and savings and loan associations. California conformed to the federal definition of ineligible corporations. However, California recognizes another type of financial institution, the financial corporation, which was not included in the federal definition of financial institutions. California tax law also allowed banks, savings and loan associations and financial corporations to report bad debts using the reserve method of accounting. So, under the prior law, if a financial corporation elected federal S corporation status, it could also be a California S corporation and use the reserve method for California tax purposes.

With the enactment of the Small Business Jobs Protection Act of 1996, the

definition of ineligible corporations was amended so that financial institutions that do not use the reserve method are now eligible for S corporation status for federal purposes. And California has conformed to the federal definition for income years beginning on or after January 1, 1997.

So, if a financial corporation using the reserve method of accounting for bad debts elected S corporation status for California tax purposes under prior law, it became ineligible for S corporation status in California beginning January 1, 1997. If the taxpayer does nothing, its S corporation status ends at the beginning of its income year, and it must pay tax on its income as a C corporation.

To avoid the termination of its S corporation status, a financial corporation may apply to change its method of accounting for bad debts from the reserve method to the specific charge-off method for its first income year beginning on or after January 1, 1997. It should complete and file federal Form 3115, "Application for Change in Accounting Method," with its California Form 100S, "S Corporation Franchise or Income Tax Return," by the return's extended due date. The taxpayer should write "Filed pursuant to FTB Notice 98-3" in red across the top of the first page of Form 3115. FTB has waived the requirement to file the application within 180 days after the beginning of the income year in which the corporation wants to make the change.

Automatic election. The federal Small Business Jobs Protection Act of 1996 allows a financial institution that does not use the reserve method of accounting for bad debts to elect S corporation status for taxable years beginning on or after January 1, 1997.

If a financial institution using the reserve method of accounting for bad debts files federal Form 2553, "Election by a Small Business Corporation," to elect federal

How to Order Package X

The 1997 Package X is still available.

If you would like to have a copy, call the Franchise Tax Board at (916) 845-7070 and ask for a Package X order form.

You may order the Package X in a CD-ROM version for \$19 and in a looseleaf or bound paper volume for \$12.□

Need Electronic Filing Help?

If you need assistance or have questions about electronic filing, you can find the information you need either by phone or on the Internet.

To talk to someone at the Franchise Tax Board's electronic filing Help Desk, call (916) 845-0353. Or contact FTB at its <http://www.ftb.ca.gov.electserve> address on the Internet. □

Homeowner/Renter Assistance Season to Open

The filing period for Homeowner and Renter Assistance claims is fast approaching.

The assistance is available to qualifying senior, blind and disabled individuals as a once-a-year reimbursement from the state of California for a portion of the property taxes assessed on a home or paid indirectly through rent. The Franchise Tax Board administers the program.

Homeowner and Renter Assistance claims may be filed any time after May 15, 1998, and before August 31, 1998.

To qualify for homeowner assistance, claimants must have owned and lived in their own homes in California on December 31, 1997. For renter assistance, claimants must have lived in a qualified rented residence in California and paid \$50 or more per month for rent during 1997. For either kind of assistance, claimants also must:

- Have been age 62 or older, blind or disabled on December 31, 1997.
- Have had a total household income of \$13,200 or less in 1997.
- Have had a gross total household income of \$24,000 or less in 1997.
- Be a citizen or designated alien, including a qualified alien, of the United States when the claim is filed.

FTB will mail claim forms to last year's claimants no later than May 15, 1998. After that date, other claimants may obtain forms from FTB's <http://www.ftb.ca.gov> Internet address, by calling (800) 338-0505 and selecting "Personal Income Tax Forms" at the voice prompt or by visiting an FTB district office. Claimants also may obtain a form by writing Tax Forms Request, Franchise Tax Board, P.O. Box 307, Rancho Cordova, CA 95741-0307.

In addition, free assistance is available from the Homeowner and Renter Assistance volunteer program. For information on program sites, call (800) 852-5711 or a local Senior Citizen Information and Referral Service or visit an FTB district office. □

FTB Notice Addresses S Corporation Issues

CONTINUED FROM PAGE 17

S corporation status, it will be deemed to have elected to change its method of accounting for bad debts to the specific charge-off method.

In general, a federal tax election is binding for California tax purposes unless the taxpayer makes a different election for California. If a corporation elects to become an S corporation for federal purposes but wants to remain a California C corporation, the C corporation election must be made no later than the last day for making the federal S corporation election.

However, because the last date for making a C corporation election for 1997 had passed before the legislation was enacted last year, special 1997 implementation provisions were included in the law. If a financial institution that did not qualify as an S corporation under prior law made a valid federal election to be an S corporation between January 1, 1997, and the date of the changes to California law in October 1997, the corporation will be treated as an

S corporation for California tax purposes for its first income year beginning on or after January 1, 1997. To retain its C corporation status for California purposes, a corporation must have elected to do so no later than April 1, 1998, which was 180 days after the date that the legislation was enacted.

For more information, read FTB Notice 98-3, published on February 20, 1998. It is available from FTB's <http://www.ftb.ca.gov> Internet address. It also has been published by most tax services. □

Some Taxpayers Need to File 1996 Returns

Although the deadline for filing 1997 tax returns has come and gone, some taxpayers have not yet filed their 1996 tax returns.

The Franchise Tax Board currently is contacting 1996 nonfilers, asking them to file returns. Taxpayers who fail to respond will receive a proposed assessment based on available information.

The accuracy of the proposed assessments has improved because the information that FTB receives has improved. The Employment Development Department has a new method of reporting withholding amounts to FTB so that the assessments account for most, if not all, of the taxpayer's withholding credits from employers. Assessment accuracy also has improved due to a new method of estimating income for self-employed taxpayers.

A client who receives a proposed assessment should still file a tax return.

Even though the assessments are more accurate than previously, they are still technically "estimates." When a taxpayer files a return, FTB makes any necessary adjustments to the tax, penalties and interest due. Also, filing a return is the only way for taxpayers to obtain all of the deductions, exemptions and other credits to which they are entitled.

A client who has a filing requirement but cannot pay the tax due should file the return without a payment and apply to pay in installments. Most taxpayers qualify for an installment plan after filing a return. A new form FTB 3567, "Installment Agreement Request," is available at FTB's <http://www.ftb.ca.gov> Internet address and in the 1997 Package X. Or call (800) 338-0505 to access "Personal Income Tax Forms" at the voice prompt and enter code 949. Or write Tax Forms Request, P.O. Box 307, Rancho Cordova, CA 95741-0307. □

Partnership Schedule K-1: Paper-Free Filing

The good news is that in 1997 the Franchise Tax Board received via magnetic media 1.3 million of the Schedule K-1s that partnerships file in California.

The bad news is that approximately 2.7 million more of the partnership Schedule K-1s were filed on paper. That's a lot of paperwork for partnerships to produce and for FTB to process manually and store.

The approximately 1,200 partnerships that file the Schedule K-1 (565), "Partner's Share of Income, Deductions, Credits, etc.," with California have 100 or more partners. Any of the partnerships that want to trade their current method of filing Schedule K-1s for a simpler, paper-free method should contact their software developer and/or the vendor who produces the K-1s. Technical information

is available in an updated FTB Publication 1062, "Guide for K-1 (565) Filing by Diskette or Magnetic Media." It has 1997 specifications and record layouts. For a copy, contact FTB's Internet Web site at <http://www.ftb.ca.gov/elecserv>, and click on "Businesses-Filing/Payments." Or call FTB's electronic filing Help Desk at (916) 845-0353.

At the federal level, the Internal Revenue Code now requires partnerships with 100 or more partners to file not only their Schedule K-1s but federal Form 1065, "U.S. Partnership Return of Income," by magnetic media. The requirement is effective for tax years beginning after December 31, 1997. Although California does not have a similar provision, FTB is studying potential impacts of conforming to the federal law. □

Partnership Schedule K-1: File One Way

To save time, money and paper, partnerships should file their Schedule K-1s preferably by magnetic media or disk. Filing on paper is less preferable but still allowed. However, partnerships should not file on magnetic media *and* paper.

Some partnerships are following up their magnetic media filing of the Schedule K-1 (565), "Partner's Share of Income, Deductions, Credits, etc.," by sending the Franchise Tax Board paper copies of the same schedules.

Filing both ways creates duplications on FTB's reporting system, cancels the savings that the partnership reaped by choosing magnetic media and wastes paper. As a result, ask your partnership clients to send all Schedule K-1s for limited and general partners on magnetic media only. □

***Fax Personal
Income Tax
Collection
Queries***

Now you can fax the Franchise Tax Board your questions about personal income tax collection.

The fax number, which is for tax professionals only, is (916) 845-0494. □

Tax Talk: Four Hours = Four Credits

The new four-hour Tax Talk home study course for 1998 is an opportunity for you to obtain four continuing education credits.

The course, which includes a video, textbook and an examination, covers federal and state tax issues.

The home study course features “When the Smoke Clears,” information on recent tax law changes from both the federal and California perspectives. An enrolled agent participates in the discussion. Also included are “Do-It-Yourself Audits: SBE’s New Managed Audit Program,” “Help Wanted: Apply Your Situation Here – How California’s Employment Factors Work” and “What Your Clients Get Out of Partnerships...and How.”

All presentations on the video include a question-and-answer session. Tax professionals who gathered for the videotaping at Cosumnes River College in Sacramento pose the questions to the state and federal tax experts.

The home study course costs \$80. To obtain an order form, contact FTB’s <http://www.ftb.ca.gov/education> Internet site or call (916) 845-7070.

Tax Talk is a program of the Center for Tax Education, sponsored by the Internal Revenue Service, the Franchise Tax Board, the State Board of Equalization, the Employment Development Department, the California State University, Sacramento, School of Business Administration and California Community Colleges. □

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