

## Welcome to e-file



*Tina Stiles, an analyst with FTB's Processing Services Bureau, assists Daniel J. Caminata (standing) and Andrew R. Smith, with their e-file applications during an IRS/FTB e-file*

*seminar held November 16, 1998, in Sacramento. California's e-file program is growing. To find out why, please see the story on page 6. (FTB photo by Dan Chan.)*

## Renter's Credit Returns to California

Californians who rent their primary residence and owe taxes are now eligible to receive a nonrefundable credit when they file their 1998 California income tax return.

The renter's credit was reinstated, by statute, effective January 1, 1998 after being suspended for tax years 1993 through 1997. Assembly Bill 2797 amended the existing renter's credit to allow a nonrefundable credit amount of \$120 for married filing joint

returns, heads of household, and surviving spouses, if their adjusted gross income (AGI) is \$50,000 or less.

A credit of \$60 is allowed for individual taxpayers who file single or married filing separate returns if their AGI is \$25,000 or less.

Since the renter's credit is a nonrefundable credit that can only be used against a tax liability, a taxpayer must have a tax liability to claim it.

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## Tax News

Volume 99-1 January 1999

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

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## FTB Refunds SDI Overpayments

The Franchise Tax Board, in collaboration with the Employment Development Department, issued refunds to taxpayers who overpaid their State Disability Insurance, but failed to claim the amount on their 1997 California income tax returns.

The first refunds were mailed on December 30, 1998. FTB expects to issue more than 160,000 refunds to eligible taxpayers.

In order to qualify, the taxpayer must have met these requirements:

- Worked for two or more employers during the 1997 tax year.
- Received more than \$31,767 in California wages from the combined employers.
- Received a W-2 from each employer showing the amount of SDI withheld.
- Had a total amount of more than \$158.84 withheld from the combined employers during the 1997 tax year.

## Assessment Notices Available by Fax

Your client has lost the Notice of Proposed Assessment from the Franchise Tax Board and asks for your help. You need a copy.

You can get a copy by fax from FTB. Send a request by fax to FTB's Electronic Correspondence Unit at (916) 845-6377 with the following information:

- Your request for a copy of the proposed assessment.
- Your fax number.

- Your telephone number.
- A copy of your Power of Attorney.

FTB will send you a copy of the proposed assessment, by fax, within seven days.

If you do not receive a copy after seven days or if you have questions, please contact the FTB Tax Practitioner Support Unit at (916) 845-7057.

## Renter's Credit Returns as Nonrefundable Credit

CONTINUED FROM PAGE 1

Taxpayers must meet this criteria in order to qualify for the credit:

- Their California AGI cannot exceed \$25,000 if their filing status is single or married filing separate; or \$50,000 if their filing status is married filing joint, head of household, or qualified widow or widower.

- The taxpayer did not live with another person (such as a parent) who claimed him or her as a dependent in 1998.
- The taxpayer is not a minor living with and under the care of a parent, foster parent or legal guardian.
- The taxpayer rented property that was not exempt from California property tax in 1998.
- The taxpayer or spouse did not claim a homeowner's property tax exemption anytime during 1998.

For additional information about how to qualify for renter's credit, refer to the "Nonrefundable Renter's Credit Qualification Tax Record" in the 1998 California Resident Personal Income Tax Booklet.

### Refer to the "Nonrefundable Renter's Credit Qualification Tax Record" in the 1998 Income Tax Booklet.

- Taxpayers must have rented property in California for use as their principal residence for at least half the year in 1998.



## When Married Taxpayers Divorce Be Sure to Tell FTB How to Apply Payments

The Franchise Tax Board applies any estimated tax payments existing on an account to the first tax return processed. This policy can have an adverse impact on married taxpayers who divorce, or any couples that begin to file separately after they have jointly filed estimated tax payments.

For example: Mr. and Mrs. Taxpayer make three estimated tax payments during 1998. They then file for divorce and they each file a separate return for the 1998 tax year. Mr. Taxpayer files his return in February 1999 and claims all of the estimated tax payments as a credit against his tax liability. FTB will process Mr. Taxpayer's return and apply the credits as requested. This might include a refund of any excess payments available on the account.

If Mrs. Taxpayer subsequently files a return in March 1999 and claims the same estimated payments, she will be advised that there are no payments available on her account.

While this policy may not seem fair to the disadvantaged spouse who clearly has an interest in her share of the estimate payments, it is impossible for FTB to keep track of the marital status of its customers.

The courts have also recognized the difficulty faced by tax agencies in this regard. In Warner v. Commissioner (9<sup>th</sup> Cir. 1973) 526 f.2d 1, the court noted that the government, "confronted by millions of returns and an economy which repeatedly must be nourished by quick refunds, must first pay and then look."

In Gordon v. United States (11<sup>th</sup> Cir. 1985) 757 F.2d 1157 the court found that "a policy which would require the Commissioner to delay refunds until after audits were made would be economically burdensome, and is certainly not required by statute."

There are steps that taxpayers can take to lessen the harm from this policy. FTB will make every effort to eliminate or reduce the policy's adverse impact on a divorced or separated taxpayer if the department is put on notice that competing claims exist.

Tax practitioners can help by advising their clients to notify FTB, in writing, of any divorce agreements or court ordered settlements that have been filed with the court regarding their California taxes.

If FTB is notified before the tax filing season, the taxpayers' joint estimated tax payments can be allocated accordingly. In the absence of a formal court order, FTB will accept a statement showing the allocation of the payments along with the notarized signatures of both taxpayers. Send the statement to:

Joint Estimate Credit Allocation  
M/S F-225

Taxpayer Services Center  
Franchise Tax Board  
PO Box 942840  
Sacramento CA 94240-0040

## *Changing an Address?*

### *Use Form FTB 3533*

Taxpayers who have changed their home or business mailing address, or their business location, may now use form FTB 3533, "Change of Address."

This form is very similar to federal Form 8822, "Change of Address."

Generally, taxpayers need complete only one form FTB 3533 to change their home and business addresses. However, if the change also affects the mailing address for their children who filed separate returns, complete a separate form FTB 3533 for each child.

If you are a representative filing for the taxpayer, attach a copy of your power of attorney to the change of address form.

Form FTB 3533 is available at FTB's [www.ftb.ca.gov](http://www.ftb.ca.gov) Internet address, or you can write to:

Tax Forms Request  
Franchise Tax Board  
PO Box 307  
Rancho Cordova, CA  
95741-0307

## ***Modified Instructions for S Corporation Filers***

The Franchise Tax Board has discovered that the recently redesigned California Worksheets for form FTB 3801, "Passive Activity Loss Limitations," do not adapt well to reporting passive income and loss for S Corporations. Consequently, FTB suggests that when filing the 1998 Form FTB 3801, S Corporations should use and file the 1997 version of the California Worksheets.

## **Are Club Dues Deductible? Not Always**

Whether you're an individual filer or a corporation, you cannot deduct business expenses for expenditures in any club that restricts membership or the use of its services or facilities on the basis of age, sex, race, religion, color, ancestry or national origin.

Expenses include club membership dues and assessments, food and beverage expenses, expenses for services furnished by the club and reimbursements or salary adjustments to officers or employees for any of these expenses. (See California Revenue and Taxation Code Sections 17269 and 24343.2.)

If you made payments to a club that discriminates and then deducted the expenses on your federal return, the disallowed business expense deductions must be added back into your income

when you file your California return. For individuals, the expenses are added back on line 12, line 17 or line 18, column C, of Schedule CA 540, "California Adjustments For Residents," or Schedule CA 540NR, "California Adjustments For Nonresidents or Part-Year Residents."

For corporations, the expenses are added back on line 7 of form FTB 100, "California Corporation Franchise or Income Tax Return," or line 7 of form FTB 100S, "California S Corporation Franchise or Income Tax Return."

For more information on how to file, refer to FTB Pub. 1001, "Supplemental Guidelines to California Adjustments." For more information about clubs, see the related article entitled "Activity, Membership, Help Define Clubs."

## ***Activity, Membership, Help Define Clubs***

Unsure whether your club is really a club? The legal definition of "club" can be found in the California Business and Professions Code, under Division 9, commencing with Section 23000.

A club is defined as "a corporation or association which is the owner, lessee or occupant of an establishment operated solely for objects of a social or athletic nature but not for pecuniary gain, having a bona fide membership list and the majority of the members of which pay dues at least once in every year, and the property as well as the advantages of

which belong to the members and which sells alcoholic beverages only to its members and its bona fide guests."

Clubs defined in the California Business and Professions Code Section 23425, as American national fraternal organizations, are not included in the definition of clubs for purposes of applying the restrictions imposed by Revenue and Taxation Code Sections 17269 and 24343.2. For more information, refer to California Business and Professions Code Division 9, commencing with Section 23000.

## ***FTB Joins IRS at Tax Store in Milpitas***

The Franchise Tax Board is participating in the Internal Revenue Service's (IRS) prototype tax store in the Great Mall of the Bay Area located in Milpitas.

FTB's hours of operations during the 1999 filing season will be Monday through Friday, 10 a.m. to 7 p.m.; Saturday, 10 a.m. to 4 p.m.; and Sunday, 11 a.m. to 4 p.m.

The tax store has five kiosks equipped with agency databases and touch screen access to FTB and IRS Web sites.

Taxpayers can obtain tax forms and information, use available auto-dialers to contact FTB and IRS telephone centers, and meet with staff from both agencies.

The tax store concept stems from the IRS report, "Reinventing Service at the IRS," and addresses the issue of ways to improve customer service. Other federal, state, and local government agencies may participate in future tax stores.

# Tax Form Corrections Announced

Tax practitioners should note the following corrections to 1998 tax form information that has already been distributed:

**Form 100S, California S Corporation Franchise or Income Tax Return**, Side 4, Schedule M-2, column (c), lines 3 and 5.

**Correction:** Side 4, Schedule M-2, column (c), lines 3 and 5 should not be shaded. Shading should be added to column (c), line 7.

This error is in the paper version of the Package X only. All other versions are correct.

**Instructions for Form 109, California Exempt Organization Business Income Tax Return**, page 2, Section F, "When to File," reads: "However, education IRAs must file Form 109 on or before the 15th day of the 5th month after the end of the income year."

**Correction:** The information is incorrect. The entire sentence should be deleted.

This error is in the paper version of the Package X only. All other versions are correct.

**Form 541-ES, Estimated Tax for Fiduciaries**, Estimated Tax Worksheet, line 9b reads: "Enter 100% of the . . . Form 541."

**Correction:** The line should read: "Enter 100% of the . . . Form 541 (105% of that amount if the estate's or trust's AGI on that return is more than \$150,000, and less than 2/3 of gross income for 1998 or 1999 is from farming or fishing)."

The error is in the paper and CD-ROM (release 1 of 2) versions of the Package X, the Form 541 Booklet and the single-copy version. The Internet version is correct. The CD-ROM (release 2 of 2) version of the Package X will be correct.

**Form 565, Partnership Return of Income**, Side 3, Schedule K (565), column (b) and column (c):

- Line 13(a)(1) through line 14;
- Line 16b; and
- Line 22.

**Clarification:** The above-mentioned lines should be shaded.

The error is in the paper version of the Package X and the single-copy version. The Internet version, CD-ROM (release 1 of 2) version of the Package X and the Form 565 Booklet version are correct.

**Form 568, Limited Liability Company Return of Income**, Side 3, Schedule K (568), column (b) and column (c):

- Line 13(a)(1) through line 14a;
- Line 16b; and
- Line 22.

**Correction:** The above-mentioned lines should be shaded.

The error is in the paper version of the Package X and the Form 568 Booklet. The Internet version, CD-ROM (release 1 of 2) version of the Package X and the single-copy version are correct.

**Instructions for FTB 3521, Low-Income Housing Credit**, Side 2, third column, second paragraph, next to last sentence reads: "This credit cannot reduce . . . ."

**Correction:** The information is incorrect. The instructions should read: "This credit can reduce . . . ."

The error is in the paper version of the Package X and the single-copy version. The Internet version and CD-ROM (release 1 of 2) version of the Package X are correct.

## FTB Calendar

### January

- Demands to file 1997 tax returns are mailed to individuals.
- Package X is published and distributed.
- 15 Fourth quarter 1998 personal income tax estimate payments are due.
- 19 FTB e-file return transmissions begin.
- 20 Previous month withholding at source payments are due if total withholding exceeded \$2,500.
- 31 Deadline for applying to participate in California's e-file program.

### February

- Notices of Proposed Assessments are mailed to corporations that failed to comply with requests issued in prior months for 1996 tax returns.
- Notices of Proposed Assessments are mailed to individuals who have not filed their 1997 tax returns.
- 20 See January 20.

### March

- Notices of Proposed Assessments are mailed to corporations that failed to comply with requests issued in prior months for 1996 tax returns.
- Notices of Proposed Assessments are mailed to individuals who have not filed their 1997 tax returns.
- 20 See January 20.

### April

- 15 1998 personal income tax returns are due.
- 15 First quarter 1999 personal income tax estimate payments are due.
- 20 See January 20.

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## MAKING THE SWITCH



More than 1.1 million taxpayers filed their California tax returns electronically in 1998. Taxpayers who filed electronically through a tax practitioner or filed from their home computer using a third-party transmitter accounted for 846,118 returns in 1998. Taxpayers who used TeleFile accounted for another 299,225 electronic returns.

### FTB Offers e-pay Option

For the 1998 tax year, the Franchise Tax Board is offering an electronic payment (e-pay) option to taxpayers who file electronic returns with balances due.

With the new option, an e-filer with a balance due may authorize FTB to debit his or her bank account on a specified date for the amount due. Now, not only can your clients e-file, but e-pay also, eliminating the need to mail a check and form FTB 3582, "Payment Voucher for Electronically Transmitted Returns," by April 15.

## California's e-file Tops Milestone

### *Direct Deposit Refund Option Attracts More Taxpayers to Program*

A year ago, the Franchise Tax Board hoped that Californians would file one million paperless state tax returns in 1998.

Californians did more than just meet that milestone. They exceeded it. More than 1.1 million taxpayers filed their California tax returns electronically in 1998 and the outlook for 1999 is a favorable one.

The number of taxpayers who either filed electronically through a tax practitioner or filed from their home computer using a third-party transmitter grew significantly in 1998. Their numbers grew from 365,743 returns in 1997 to 846,118 in 1998, an increase of more than 130 percent.

Taxpayers who used TeleFile accounted for 299,225 returns in 1998, an increase of 36 percent over 1997's total of 220,125.

TeleFile is another paperless return program that allows certain taxpayers to file their California tax return by telephone.

According to Alison Adams, lead analyst in FTB's Electronic Document Services Unit, tax practitioners will see a greater

demand for e-file in 1999 because of the direct deposit program and increased marketing by FTB.

"We've already experienced an increase in the number of practitioners signing up for the e-file program," she added.

Direct deposit allows taxpayers to have their tax refunds deposited directly into their bank accounts and is only available with e-file. With direct deposit, the tax refund will normally be deposited in the taxpayer's bank account within 5-7 banking days from the date FTB acknowledges receipt of the e-file return. Direct deposit is available to nearly all taxpayers who use e-file, including first-time filers.

In addition to filing electronically, taxpayers must also meet the following criteria in order to use direct deposit:

- The return must not contain any errors that would change the refund amount or generate a Return Information Notice from FTB.
- The refund cannot be offset for state taxes, federal taxes or other obligations.

For more information about how to join the e-file program and take advantage of direct deposit, contact the e-file Help Desk at (916) 845-0353. Help Desk hours are 8 a.m. until 5 p.m., Monday through Friday.

# Tax Form Corrections Announced

CONTINUED FROM PAGE 5

**Instructions for FTB 3805Z, Enterprise Zone Booklet**, page 10, column 3, line 2, second line reads: "Enter the amount from line 2, column (b) . . ."

**Correction:** The information is incorrect. It should read: "Enter the amount from line 2, column (f) . . ."

The error is in the paper version of the Package X only. All other versions are correct.

**Instructions for FTB 3805Z, Enterprise Zone Booklet**, page 14, column 1, Line 11-Line 12, eighth line reads: "Multiply the gain or loss reported . . . line 4 . . ."

**Correction:** The information is incorrect. It should read: "Multiply the gain or loss reported . . .line 5 . . ."

The error is in the paper version of the Package X only. All other versions are correct.

**FTB 5805F, Underpayment of Estimated Tax by Farmers and Fishermen**, line 15 reads: "Penalty . . . x .08% x underpayment . . ."

**Correction:** The information is incorrect. It should read: "Penalty . . . x .08 x underpayment . . ." The percent sign should be deleted.

The error is in the paper version of the Package X and the single-copy version. The Internet version and CD-ROM (release 1 of 2) version of the Package X are correct.

**Form 5806, Underpayment of Estimated Tax by Corporations**, Side 1, line 22a reads: "Add amounts . . .line 17 . . ."

**Correction:** This information is incorrect. It should read: "Add amounts . . .line 18 . . ."

The error is in the paper version of the Package X only. All other versions are correct.

**Form 5806, Underpayment of Estimated Tax by Corporations**, Side 2, line 56 and line 57, column (d).

**Correction:** The information should be shaded.

The error is in the paper version of the Package X only. All other versions are correct.

**Instructions for Schedule P (540NR), Alternative Minimum Tax and Credit Limitations – Nonresidents or Part-Year Residents**, page 4, column 2, 5th line from the bottom reads: "Enter your itemized deductions from Schedule CA (540NR), line 40."

**Correction:** The information is incorrect. It should read: "Enter your itemized deductions from Schedule CA (540NR), line 39."

The error is in the paper version of the Package X only. All other versions are correct.

**Schedule P (541), Alternative Minimum Tax and Credit Limitations – Fiduciaries**

- Side 2, line 9a, line 9b and 9c.

**Correction:** The information is incorrect. Line 9a should be line 9. Lines 9b and line 9c should be deleted.

- Side 2, line 10 reads: "Subtract line 9c from line 8 . . ."

**Correction:** The information is incorrect. It should read: "Subtract line 9 from line 8 . . ."

The errors are in the paper version of the Package X only. All other versions are correct.

**Instructions for Schedule P (541), Alternative Minimum Tax and Credit Limitations – Fiduciaries**, page 5, Tentative Minimum Tax reads: "Line 9a"

**Correction:** The information is incorrect. It should read: "Line 9"

The error is in the paper version of the Package X only. All other versions are correct.

## FTB Developing 1099 TestWare

Filing information returns via magnetic media can save you time and money, but even magnetic media loses its effectiveness when your files have to be returned and resubmitted due to file format errors.

That's why the Franchise Tax Board is developing "1099 TestWare" for its information return magnetic media filers. The TestWare will be available by the end of January.

1099 TestWare is free software that enables you to test your data files before submitting them to FTB.

First, 1099 TestWare performs a pre-edit check on your file to ensure that it is in a format that can successfully pass FTB's mainframe edit programs. The software identifies problem areas that may prevent speedy processing.

Besides reviewing data sets for structural correctness, the software also performs data integrity edits and verifies calculated totals on the "C," "K," and "F" records of the file. However, the software will not verify the correctness of the data. Once the file has been edited and corrected, you can send it to FTB.

For more information about the 1099 TestWare, contact the Magnetic Media Unit at (916) 845-3778. Or visit our Web site entitled "Frequently Asked Questions About Information Returns (Forms 1098, 1099 series, 5498, W-2G) - Your Reporting Questions Answered." To access the Web site, go to [www.ftb.ca.gov](http://www.ftb.ca.gov), and type "information returns" into the search engine.

## Schedules K-1: Five Reasons Not to File on Paper

Partnerships with many partners now have five good reasons to stop filing paper Schedules K-1.

The first four reasons for eliminating paper Schedules K-1 are:

- CD-ROMS,
- Diskettes,
- Magnetic tape and
- Tape cartridges.

The fifth reason is a new, free software program for editing the schedules. The TestWare program allows partnerships to edit K-1 files on diskettes before sending them to FTB.

In the past, files that failed FTB's mainframe edit program were returned to partnerships for correction. Now partnerships can test files before sending them.

To obtain the free software, download it from FTB's [www.ftb.ca.gov](http://www.ftb.ca.gov) Web site.

Click on "Electronic Services" and then on "Businesses - Filing/Payments." Or call the electronic filing Help Desk at (916) 845-0353 between 8 a.m. and 5 p.m.

## Regulations Relax Water's-Edge Criteria

### Invalidated Elections Receive Second Chance

Taxpayers whose water's-edge elections were either invalidated or placed under review by the Franchise Tax Board are receiving a second chance as a result of amended regulations that went into effect in October 1998.

Retroactive amendments to the water's-edge election regulations, specifically sections 25111 and 25111-1, have relaxed the strict criteria that previously had to be met in order for a water's-edge election to be considered valid.

Consequently, in October, FTB began sending notices to taxpayers whose elections were previously "invalidated" or under review to explain the status of their elections under the new regulations.

Taxpayers who are considered to have valid water's-edge elections under the amended regulations are required to file on a water's-edge basis for the duration of their election terms.

Here are the most significant changes made to the regulations:

**A "substantial performance" test has been added.** If a taxpayer fails to comply with a procedural or statutory election requirement (e.g. failing to attach a contract to their original return), the water's-edge election will still be considered valid as long as there has been "substantial performance" of the election requirements.

Substantial performance exists when the tax is computed on a water's-edge basis and there is additional "objective evidence" to support the conclusion that the group intended to make a water's-edge election. Some examples of objective evidence include:

- The taxpayer has attached one of the water's-edge forms (e.g. form FTB 1116, "Notice of Nonrenewal of Water's-Edge Contract," or form FTB 2416, "Retained Earnings of Controlled Foreign Corporations," to the original return).
- The taxpayer included a statement on the return indicating that a water's-edge election was being made.

- The taxpayer checks the water's-edge election box on the return.
- The taxpayer files a form FTB 1117, "Request to Terminate a Water's-Edge Election," before January 1, 1997 and the completed form contains enough information to identify the beginning year of the contract.
- For income years beginning before January 1, 1994, the taxpayer files a domestic disclosure spreadsheet. The spreadsheet will be considered objective evidence as long as it was filed before January 1, 1997.

**The common parent election has been modified.** Previously, a common parent election could be invalidated if one of the members filed a separate worldwide return.

A common parent election now constitutes an election by all the members included within the commonly controlled water's-edge group, regardless of whether one of the members filed a separate worldwide return.

**The definition of an original return has been clarified.** If a taxpayer filed more than one return before the due date (or before the extended due date, if no return was filed by the original due date), the last such return filed will be considered the original return for purposes of the election.

The taxpayer must still make the water's-edge election or meet the substantial performance criteria on the original return.

**Deemed termination upon acquisition of a taxpayer with a previously invalidated election.** A taxpayer that becomes unitary with a water's-edge electing taxpayer will also become bound by that water's-edge election (although a request for termination of the election may be filed under certain circumstances).

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## Practitioner Awareness Deters Fraud

California taxpayers demand that tax practitioners are qualified to prepare tax returns properly.

The Franchise Tax Board's Fraud Prevention and Detection Group is encouraging tax practitioners to use education to help meet this demand.

During their routine site visits in 1998, the Fraud Prevention and Detection Group saw an increase in the number of tax practitioners who lacked the qualifications required by California law for preparing tax returns for the public.

"We conducted over 300 site visits and found that one out of every four tax practitioners we visited was not in compliance with the qualification requirements," said Andrew Erias, a fraud analyst at FTB.

Sections 22250-22259 of the California

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### **"Unregistered tax practitioners are responsible for most of the fraudulent activity."**

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Business and Professions Code state that tax practitioners must:

- Be a minimum of 18 years of age with a high school diploma.
- Post a \$5,000 surety bond.
- Complete an initial 60 hours of basic personal income tax instruction.
- Maintain 20 hours per year of continuing income tax education.
- Register with the California Tax Education Council (CTEC).

CTEC registration plays an important role in tax practitioner education. Created in 1997 by Senate Bill 1077, CTEC is a non-profit organization responsible for the administration of tax practitioner education requirements. Each year, CTEC issues education completion certificates to practitioners who meet their annual education requirements.

Beginning in 1999, the Fraud Prevention and Detection Program Group will work with CTEC and the Internal Revenue Service (IRS) to ensure that tax practitioners are aware of the legal requirements for preparing tax returns in California. They will send letters to tax practitioners who have not registered with

CTEC, advising them of the requirements and urging them to register with CTEC. FTB will keep a copy of the letter and will send copies to the IRS and CTEC.

Attorneys, certified public accountants, enrolled agents and designated bank officials are exempt from these requirements due to their own industry regulations.

According to the Fraud Prevention and Detection Group, unregistered tax practitioners are responsible for most of the fraudulent activity in the tax practitioner industry. This includes the sale and use of unauthorized tax return preparation software. Delays in processing occur when practitioners use forms that do not meet FTB's requirements. In some cases, FTB is not able to process the forms at all and has to contact taxpayers directly. "This is a major disservice to taxpayers who are expecting their refunds," said Erias.

For more information about CTEC, contact them at (916) 492-0457. For more information about FTB's Fraud Prevention and Detection Program, contact the Tax Practitioner Support Unit by phone at (916) 845-7057 or by sending them a fax at (916) 845-6377.

## Water's-Edge

CONTINUED FROM PAGE 8

However, the amended regulations contain a special provision that applies when a taxpayer whose election had been invalidated by FTB is acquired by a non-electing, non-affiliated entity and thereafter files on a non-water's-edge basis.

If the amended regulations cause the acquired taxpayer's water's-edge election to be valid, that election will be deemed to terminate as of the time that the taxpayer was acquired.

Note however, that this provision only applies to elections made for income years ending on or before January 31, 1997 and only if both the acquisition and the subsequent non-water's-edge filing occur before the effective date of the regulation amendments.

## *Satisfy Educational Needs With Video Courses*

Need continuing education credits? Prefer to study in your home or office?

The Center for Tax Education (CTE) offers three, three-credit video courses that can help satisfy your education requirements.

Course titles include "Office-In-Home Deductions," "California's Employment Factors" and "California Tax Rules for Nonresidents."

The programs are presented by CTE, a partnership of the School of Business Administration, California State University, Sacramento; the Internal Revenue Service; the Employment Development Department; the State Board of Equalization and the Franchise Tax Board.

Each course contains a one-hour videotape, textbook, workbook and a brief, open book examination for three credits. Each course costs \$60.

To order any of the courses, call (916) 845-7070, or visit FTB's CTE Web site at [www.ftb.ca.gov/education/Taxtalk.htm](http://www.ftb.ca.gov/education/Taxtalk.htm).

## *Stumped by Head of Household Questions? Attend HOH Workshop*

Franchise Tax Board's Head of Household (HOH) Program will conduct workshops throughout California in 1999. The workshops are geared at helping practitioners to better understand the HOH filing status. Workshop topics will include an HOH program overview, an explanation of the qualification criteria for using the HOH filing status and a discussion about important questions that practitioners should ask their clients who file HOH.

For additional information about HOH workshops in your area, contact FTB's HOH Unit at (916) 845-6874 or (916) 845-6265.

# Claiming Head of Household?

## Here are Common Errors to Avoid

Each year, approximately 1.7 million California taxpayers claim the Head of Household (HOH) filing status. Below are the most common errors made by taxpayers in claiming the filing status. The errors are listed in order of highest occurrence.

**Individual claimed as the "qualifier" did not live with taxpayer for more than half the year.** The individual who qualifies the taxpayer to claim the HOH filing status must have lived with the taxpayer for more than half the year. More than half the year is 183 days; in a leap year, it is 184 days. Anything less disqualifies the taxpayer from using the HOH filing status. Taxpayers also need to note that this differs when the qualifying individual is a foster child. The foster child must have lived with the taxpayer for the entire year.

**Lived with spouse the entire year or during last six months of year.** Taxpayers whose correct filing status should have been "Married Filing Joint" have often incorrectly used the HOH filing status. In the majority of cases, the taxpayer did not have a clear understanding of the term "head of household." The taxpayer perceives the HOH filing status to mean the head of his or her family. If the taxpayer lived with his or her spouse the entire year or at any time during the last six months of the year, the taxpayer does not qualify for the HOH filing status.

**May not qualify with dependent parent or relative unless legally divorced or legally separated by end of year.** This primarily occurs with married taxpayers who are living apart from their spouses and claiming a parent or relative as their qualifying individual. The parent or relative is not a valid qualifier unless the taxpayer is legally divorced, legally separated or met the requirements to be considered unmarried by December 31 of the year. (See FTB Pub.1540, "Head of

Household Filing Status Information," for the definition of the term "considered unmarried.")

### **Non-relatives may not be a qualifier.**

Taxpayers commonly list cousins as a qualifying relative for claiming the HOH filing status. Cousins are descendants of a brother or sister of the taxpayer's parents and do not qualify as a relative for claiming this filing status. Taxpayers also sometimes consider a person a relative simply because the person is a member of the household, such as a friend or a friend's child. Even if the taxpayer is providing a home and support for this individual, the individual may not qualify the taxpayer for the HOH filing status. A non-related child must be a foster child or an adopted child to be considered a qualifying individual.

### **Qualifying individual not a dependent.**

The taxpayer's qualifying individual did not meet the criteria to be considered the taxpayer's dependent. There are five tests the qualifying individual must meet in order to be claimed as a dependent. If all five tests are not met, the taxpayer will not qualify for the HOH filing status. The FTB Pub.1540 provides information about each of these tests:

- Relationship or Member of Household Test
- Citizenship Test
- Joint Return Test
- Gross Income Test
- Support Test

The Franchise Tax Board continues to improve its tax forms instructions to help taxpayers understand the HOH filing status. Major revisions have been made to the FTB Pub.1540, including the addition of self-tests to help taxpayers determine if they qualify for the filing status. The FTB Pub.1540 also contains definitions for terms used in the filing instructions.

To order a copy of the FTB Pub. 1540, call 1-800-338-0505.

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## Are Your 1998 Tax Forms Approved?

If you are planning to use scannable or substitute 1998 California tax forms, make sure your forms meet the Franchise Tax Board's requirements.

If they do not, delays may occur during processing. In some cases, FTB may not be able to process your clients' forms and will have to contact them directly.

All companies that produce or sell substitute or scannable California tax forms must file an agreement to comply with FTB requirements for the 1998 tax year. Form FTB 1096, "Agreement to Comply with FTB Publication 1098," states that the company agrees to follow certain rules for developing scannable and substitute forms.

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### The November Tax News contains a list of companies that have already filed forms FTB 1096 with FTB.

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The November Tax News contains a list of companies that have already filed forms FTB 1096 with FTB prior to November. Refer to the November issue for additional information about how to ensure that your forms have been approved for the 1998 tax year.

Below is a list of companies that filed forms FTB 1096 with FTB after October 31 1998:

2nd Story Software  
(319) 373-3600

5227 Tax Systems Inc.  
(626) 578-1978

ABC Tax  
(800) 683-7094

California Chamber of Commerce  
(925) 299-1930

National Computer Print, Inc.  
(205) 849-5200

PLM International Inc  
(800) 227-0830

PriceWaterhouseCoopers  
(Telephone number not available)

Prudential Securities, Inc.  
(Telephone number not available)

Republic Service Bureau  
(310) 978-6000

Resource/Phoenix Inc.  
(415) 485-4500

SS&C Technologies  
(312) 443-1316

Stallion Software, Inc.  
(513) 936-9771

Tax Forms, Inc.  
(Telephone number not available)

The Northern Trust Company  
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To order a copy by mail, write to:

Tax Forms Request Unit

Franchise Tax Board

PO Box 307

Rancho Cordova, CA 95741-0307

The FTB Pub.1540 is also available through the FTB Web site at [www.ftb.ca.gov](http://www.ftb.ca.gov). Click on "Tax Forms" and then go to "Miscellaneous California Forms, Instructions and Publications."

HOH filing status information is now available on CD-ROM. The disk includes interactive versions of the FTB Pub. 1540 self-tests. At the end of each test, you are informed if you qualify for the HOH filing status.

To use the disk, you will need a computer with Microsoft Windows 95. To obtain a copy of the disk, contact the FTB HOH Program through any of the following methods:

Fax: (916) 845-6756

Mail: Head of Household Unit

Franchise Tax Board

PO Box 1998

Rancho Cordova CA

95741-1998

You can also contact FTB's Head of Household Unit by calling Lonette Maiden at (916) 845-6874, or Peggy Willis at (916) 845-6265.

## 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.

Remember: Tax News is also available by e-mail at no charge and it can be viewed on FTB's Web site at [www.ftb.ca.gov](http://www.ftb.ca.gov).

If you have any questions about your Tax News subscription, call (916) 845-7070.

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## FTB Helps Taxpayers Report Changes

### Agency to Provide Forms, Guidance Needed For Compliance

The Internal Revenue Service routinely notifies Franchise Tax Board of changes made to taxpayers' federal income tax returns as a result of an IRS examination. After changes are made, the taxpayer is required by law to report the changes to FTB within six months.

FTB is trying a new approach to assist taxpayers in meeting this reporting requirement.

The new pilot project involves sending taxpayers a notification letter informing them of the requirement as well as forms and instructions to assist with reporting the federal changes. Besides the notification letter, the taxpayer will also receive:

- A form FTB 540X, "Amended Individual Income Tax Return" and the instructions for filling it out.
- An FTB Pub. 1008, "Federal Tax Adjustments and Your Notification Responsibilities."
- A self-addressed, stamped envelope.

The notification letter will outline several methods available for reporting the federal changes and will describe the most expedient way to meet the reporting requirements.

## Free Seminars for Businesses and Taxpayers

Several federal, state and local government agencies have joined together to sponsor a series of free seminars in 1999.

The seminars, entitled "Taxpayer Service Days and Small Business Fairs," are educational conferences featuring representatives from the State Board of Equalization, Franchise Tax Board, Internal Revenue Service, Employment Development Department, County Assessor's Office and several other local, state, and federal agencies.

The following seminars have been scheduled:

Friday, March 12, in Long Beach at the Long Beach Convention Center.  
(310) 516-4330

The letter asks the taxpayer to:

1. Complete a form FTB 540X for each year that was adjusted.
2. Include a copy of the IRS' final federal determination along with all underlying data and schedules. This could include copies of any preliminary notices issued by the IRS, any settlement and closing agreements and any applicable tax court decisions. (If the federal adjustments are lengthy or complicated, see FTB Pub. 1008.)
3. Use the self-addressed stamped envelope to mail a copy of the notification letter, the amended return, the IRS federal determination(s) and any applicable payment to FTB.

FTB's objective is to protect taxpayers rights regarding any refunds, reduce the accrual of interest, and to encourage self compliance.

For more information about the pilot project, call Lisa Close with FTB's Federal and State Special Audit Section at (916) 845-6296.

Thursday, March 18, in Stockton at the University of Pacific.  
(209) 932-2338

Tuesday, March 23, in Inland Empire at California State University, San Bernardino.  
(909) 680-6705

Wednesday, March 24, in Chico at California State University, Chico.  
(916) 227-1883

Saturday, March 27, in Sacramento at American River College.  
(916) 227-1883

Tuesday, March 30, in Ventura at Ventura Community College.  
(805) 677-2771

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Bakersfield College.  
(805) 334-3929

Thursday, April 1, in Fresno at California  
State University, Fresno. (209)  
248-4209

Saturday, May 1, in Hayward at  
California State University, Hayward.  
(510) 637-2473

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(Telephone number not available)

U S Tax Systems, Inc.  
(800) 966-8787

To attend a seminar, call the telephone number provided for the location of your choice. For-up-to-date information about these and other taxpayer education opportunities, visit the BOE Web site at [www.boe.ca.gov](http://www.boe.ca.gov) and click on "Taxpayer Education."

For more information about FTB's participation in the seminars, contact Alvaro Hernandez, FTB Small Business Tax Education Coordinator, at (916) 845-5257.

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