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CALIFORNIA FRANCHISE TAX BOARD

Tax News

State Conforms on Roth IRAs

Before Governor Gray Davis signed Senate Bill 93 into law on April 12, 1999, California did not conform to federal law regarding how taxpayers report the conversion of their traditional Individual Retirement Arrangement to a Roth IRA.

For California purposes (prior to the April 12, 1999 enactment of SB 93), the taxable amount of a rollover contribution from an IRA into a Roth IRA had to be reported ratably over four tax years, and a surviving spouse beneficiary could not use the four year spread if a decedent's spouse made a rollover from a traditional IRA to a Roth IRA in 1998.

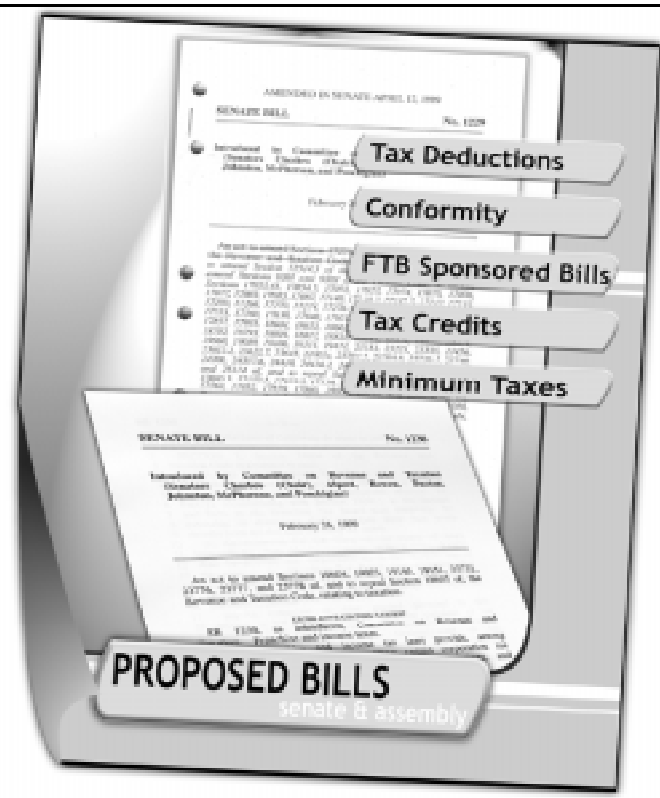
Current federal law requires taxpayers to report ratably over four years the taxable income that results from a 1998 Roth IRA conversion, or allows them to elect to include the entire amount as 1998 income on their 1998 return. If a taxpayer made a 1998 rollover to a Roth IRA and dies at any time during the four year spread, the entire amount not previously included in taxable income is taxable on the return for the year of the decedent taxpayer's death. If a taxpayer dies in 1998, all of the income from a 1998 rollover is taxable on the decedent's tax return for 1998.

Federal law allows surviving spouse beneficiaries to elect to defer (up to four years) any remaining deferred taxable income that resulted from a 1998 conversion.

(CONTINUED ON PAGE 2)

AB 1635 (Assembly Revenue & Taxation Committee) would clarify that FTB may revise the California return to reflect the proper filing status (even if different from federal) when the filing status used on the taxpayer's federal income tax return is determined to be incorrect.

For a summary of this and many other proposed bills, go to page 13.



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Tax News

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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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Tips for Reporting IRA Contributions

Here are some tips for completing the worksheet on page 3 of the FTB Pub 1005A:

Part B, Line 6

Enter only the post-1986 contributions made to traditional IRAs on Line 6. **DO NOT** include 1998 contributions made to a Roth IRA.

Part B, Line 8

If your client has recovered any California post-1986 basis in prior years, subtract it from the total on line 8.

For example, the client took a partial distribution from his or her traditional IRA in 1996, and recovered $1,000 of post-1986 California basis in that distribution, you would reduce the total on line 8 by the amount of California post-1986 basis previously recovered, as follows:

- Enter the total IRA contributions made after 1986 on Line 6. (Assume the amount is $10,000)
- Enter the California deductions claimed after 1986 on Line 7. (Assume the amount is $7,000)

  Subtract the amount on Line 7 ($7,000) from the amount on Line 6 ($10,000).
- Subtract from the remainder ($3,000) the amount of post-1986 California basis you recovered in the partial distribution you took in 1996 ($1,000). Enter this amount ($2,000) on line 8.*

***** ***(If no California post-1986 basis had been recovered, the amount on line 8 would be $3,000 (10,000 – 7,000). However, since you recovered $1,000 of California post-1986 basis in a previous year, the amount on line 8 must be reduced by the amount of post-1986 basis previously recovered (3,000 – 1,000 = 2,000).***

Part B, Line 13

When inputting an amount on Line 13, carry the decimal to four places. (_._ _ _ _).

Part C

If your client elects **NOT** to use the four-year spread and instead wants to include the entire amount of taxable income on his or her 1998 return, you must adjust Part C as follows:

Skip line 18; and on line 20, use the amount from line 17 in each place where the line instructions refer to line 18.

CA Conforms on Roth

(Continued from page 1)

Here are the answers to some of the frequently asked questions about SB 93 and Roth IRAs:

How does SB 93 affect California taxpayers filing a 1998 state tax return?

As result of this legislation, California conforms to current federal law regarding Roth IRAs, as amended by the IRS Restructuring and Reform Act of 1998 (which allows taxpayers the elections described earlier). Furthermore, California now requires that taxpayers use the same election for California that was elected for federal purposes. Any federal election made is binding for California.

For example, if a taxpayer elected to report all of the federal taxable income that results from a 1998 Roth IRA conversion on his or her 1998 federal return (instead of spreading it over four years), he or she must also report all of the California taxable income that results from the 1998 Roth IRA conversion on his or her 1998 California return.

NOTE: The federal election is made on federal form 8606, Nondeductible IRAs, and cannot be made or changed after the filing due date (including extensions) for the 1998 return. There is no separate California form to file regarding the election.

How does conformity impact FTB Pub. 1005A?

The differences relating to Roth IRA conversions that are explained in FTB Publication 1005A, California Treatment of Roth IRA, **no longer apply.**

However, taxpayers may still use the worksheet on page 3 of the publication to

(Continued on page 3)

CA Conforms on Roth

(CONTINUED FROM PAGE 2)

compute their California income adjustment if they had a difference between the California basis and the federal basis of their IRA.

What if the California basis of the IRA converted to a Roth IRA is different than the federal basis?

Taxpayers who have a different IRA basis for California than for federal purposes for tax year 1998(on the traditional IRA that was converted to a Roth IRA) will need to make an adjustment on their 1998 California return. Although the differences explained on pages 1 and 2 of FTB Publication 1005A no longer apply, taxpayers may still use the worksheet on page 3 to compute the California adjustment.

NOTE: Taxpayers who elect not to use the four-year spread and instead want to include the entire amount of taxable income in their 1998 return must adjust the amounts on Part C of the worksheet as follows:

Skip line 18; and on line 20, use the amount from line 17 in each place the line instructions refer to line 18.

When is an amended return required for the 1998 tax year?

Taxpayers must file an amended California return for the 1998 tax year if the 1998 California return was filed reflecting a tax treatment different than the federal tax treatment that was elected for federal purposes for the 1998 tax year. Here are two examples.

Example #1

If the taxpayer:

- Filed a 1998 federal return with an election to include 100 percent of the taxable income that resulted from a 1998 Roth IRA conversion, and
- Filed a 1998 California return which included only one-fourth of the taxable income that resulted from a 1998 Roth IRA conversion, then;

the taxpayer must file a 1998 amended California return (Form 540X) to include the remaining three-fourths of the California taxable income that resulted from the Roth IRA conversion.

Example #2

The taxpayer is a surviving spouse and the sole beneficiary of a Roth IRA and he or she:

- Filed a 1998 federal return in which he or she elected to use the four-year spread of the taxable income that resulted from the decedent spouse's Roth IRA conversion in 1998, and
- Filed a 1998 California return in which he or she reported all the deferred taxable income that resulted from the decedent spouse's Roth IRA conversion in 1998, then;

the taxpayer must file an amended California return (Form 540X) for 1998 and adjust the reported amount of taxable income that resulted from the 1998 Roth IRA conversion to one-fourth of the remaining deferred taxable income.

1998 Tax Form Corrections

Tax practitioners should note the following corrections to the 1998 tax form information:

Form 541 Credit Chart

"Farmworker Housing – Loan, credit code 208"

Delete "Farmworker Housing – Loan, credit code 208" and its description from the chart. (Estates and Trusts do not qualify to take the "loan" credit, it applies to corporations.)

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2) and Form 541 Booklet are incorrect.

FTB 3805Z, Enterprise Zone Business Booklet, Worksheet VI, Section B, line 1 reads: "Net loss for state purposes…; or Form 109, line 1. Apportioning corporations, enter the amount from Schedule R, line 13b for corporations doing business in the zone. Enter as a positive number..."

It should read: "Net loss for state purposes…; or Form 109, line 1. Enter as a positive number. Note: Apportioning corporations, enter the amount from Schedule R, line 12 for the corporations doing business within the zone."

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2) and FTB 3805Z Business Booklet are incorrect.

(CONTINUED ON PAGE 19)

Free Tax News

There are a number of ways you can get your Tax News free of charge.

To download, view and print Tax News from the Internet, contact the Franchise Tax Board at its *www.ftb.ca.gov* Web site.

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.

Need e-Filing Assistance?

If you need assistance or have questions about FTB's e-file or e-pay programs, you can get the information you need either by phone or on the Internet.

To talk to someone at the e-file Help Desk, call (916) 845-0353. Or visit the FTB Web site at www.ftb.ca.gov/elecserv.

Making Payments Electronically

Frequently Asked Questions About e-Pay

The Franchise Tax Board now allows e-file balance due taxpayers the option of having their payment debited directly from their bank accounts.

Taxpayers that elect to e-pay have the option of choosing the date to have FTB deduct their payment from their bank account. For the 1998 tax year, taxpayers can select any day between January 15 and October 15, 1999.

As is the case with paper payments, late payment penalties and interest will apply to e-pay payments made after April 15, 1999.

> "Taxpayers can request to stop an e-pay transaction by calling the e-file Help Desk."

Here are some of the most frequently asked questions about FTB's e-pay program:

Can an e-pay request be cancelled?

Yes. Taxpayers can request to stop an e-pay transaction by calling the e-file Help Desk at (916) 845-0353 at least two business days prior to the chosen e-pay debit date.

Can e-pay information be changed after FTB has accepted the e-file return?

No. e-pay information cannot be changed. If a taxpayer determines that the banking information provided was invalid, he or she can call to have the e-pay cancelled. The taxpayer will then have to mail in the payment in the traditional manner.

Will the taxpayer receive anything from FTB confirming the e-pay payment has been received?

No. FTB does not issue a statement confirming withdrawal of an e-pay payment. Confirmation of withdrawal will be reflected on the taxpayer's bank statement.

How will taxpayers be notified if their e-pay request is not honored by their financial institution?

If the e-pay request is returned from the taxpayer's bank for insufficient funds, account closed, invalid account number or any other reason, the taxpayer will be issued a Notice of State Income Tax Due stating that the taxpayer's payment has been returned by his or her bank.

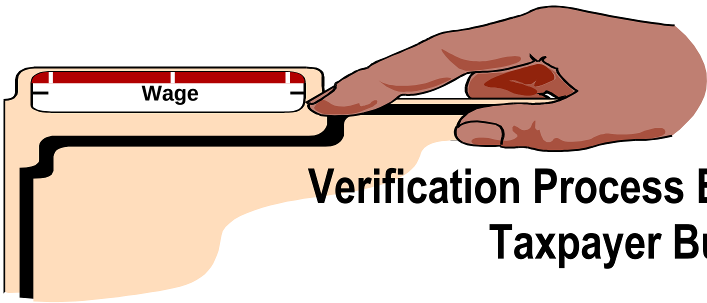
If the taxpayer receives a return information notice from FTB advising of a change to the tax due, will the e-pay request be changed?

No. If the taxpayer receives a notice from FTB showing an increase in liability, the taxpayer can remit the difference by check or the taxpayer can cancel the e-pay request and mail a check for the revised liability. If the liability decreases, the taxpayer can cancel the e-pay request and mail a check. If the e-pay occurs and the liability has decreased, the taxpayer will receive a refund of the overpayment.

Can any date between January 15 and October 15, 1999, be chosen as the debit date?

Yes. However, for the payment to be considered timely, the e-pay date must be on or before April 15, 1999. If the taxpayer chooses a nonbanking day as the debit date, the e-pay request will occur on the first possible business day following the debit request date. If a return is transmitted with a debit request date that is prior to the actual date the return is filed, the e-pay request will occur on the first possible business day and the payment received date will be considered the return filed date.

For more information regarding e-pay or the e-file program, please visit the FTB Web site at www.ftb.ca.gov or contact the e-file Help Desk at (916) 845-0353. The Help Desk's hours are 8 a.m. until 5p.m., Monday through Friday.



Verification Process Eases Taxpayer Burden

Not so long ago, when the Franchise Tax Board received a tax return that lacked the proper Form W-2, our only option was to disallow the taxpayer's withholding claim.

Today we can verify a claim for withholding with or without the taxpayer's Form W-2. We now resolve discrepancies with a telephone call to the taxpayer's employer instead of a notice to the taxpayer.

"Best of all, we sent fewer withholding adjustment notices to taxpayers."

These are just a few of the benefits of Assembly Bill 3086 and our new wage and withholding verification process.

AB 3086, which was enacted in 1994, made two significant changes to the filing requirements for California's employers. It reduced the number of payroll tax returns that employers were required to file and it required employers to report personal income tax withholding amounts, personal income tax wages and each employee's full first name to the Employment Development Department on a quarterly basis.

The new law also gave us an opportunity to improve the way we exchanged information with employers and EDD.

Big changes occurred in 1997. First, EDD implemented a new automated system that allowed it to pass on information it received from employers directly to us on a daily basis.

At the same time, we developed a new wage and withholding verification process that allowed us to receive the wage and withholding information from EDD on a daily basis, compare the information to the wage and withholding amounts claimed on the taxpayer's personal income tax return and resolve discrepancies in the reported amounts by contacting the taxpayer's employer instead of the taxpayer.

The new process has been a success. During 1998, the first full year of implementation, we performed 450,000 fewer manual withholding verifications on tax returns than in the previous year.

In addition, the number of adjustments we performed that resulted in an increase to the taxpayer's withholding claim grew under the new process.

Best of all, we sent fewer withholding adjustment notices to taxpayers.

In 1999 we have turned our focus to verifying wage information. We are evaluating the accuracy of the wage information received from employers as well as the accuracy of the adjustments we make to taxpayers' returns when the information does not match.

As we continue to improve the wage and withholding verification process, there is one thing you can do to help reduce the chance of one of your clients being contacted during the process.

Make sure that we have all the proper information about your clients' wages, by attaching or transmitting copies of all the appropriate state and federal schedules and attachments that document adjustments to their adjusted gross income based on wages. For example, if one of your clients has treated any wages included on a Form W-2 as business income, attach or transmit a copy of his or her federal Schedule C, "Profit or Loss From Business," with the return.

FTB Calendar

May

- Requests for Tax Return are mailed to individuals who have not filed their 1997 personal income tax return.
- Notices of Proposed Assessment are mailed to individuals who have not filed their 1997 tax returns.

20 Previous month nonresident withholding payments are due if total withholding exceeded $2,500.

June

- Requests for Tax Return are mailed to individuals who have not filed their 1997 personal income tax return.
- Notices of Proposed Assessment are mailed to individuals who have not filed their 1997 tax returns.
- Requests for Tax Return are mailed to corporations who have not filed their 1997 corporate tax return.
- Demands to file 1997 corporate tax returns are mailed to nonqualified and qualified corporations.

15 Second quarter 1999 personal income tax estimate payments are due.

20 See May 20.

July

- Requests for Tax Return are mailed to individuals who have not filed their 1997 personal income tax return.
- Notices of Proposed Assessment are mailed to individuals who have not filed their 1997 tax returns.

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Wanted: New FTB e-filers

More and more practitioners are joining the FTB e-file program.

To join the FTB e-file program, access form FTB 8633, “California Application to Participate in the e-file Program,” from the FTB Web site at www.ftb.ca.gov/forms.

Download the form, complete it and send it by fax to FTB at (916) 845-0287.

For more information, call the FTB e-file Help Desk at (916) 845-0353. Help Desk hours are Monday through Friday, 8 a.m. until 5 p.m.

Software Woes? Visit an e-file Workshop

The Franchise Tax Board and the California Districts of the Internal Revenue Service are sponsoring a series of free e-file software workshops beginning in June.

The e-file Software Workshop and Exhibit series will provide tax practitioners an opportunity to learn first-hand about the various FTB and IRS accepted e-file software packages.

Experts from major software companies will be available to discuss their software’s features, technical requirements, compatibility with the California e-file program, required forms, costs and customer support services.

The workshops run from 9 a.m. until 4 p.m. and are divided into morning and afternoon sessions.

During the morning session, practitioners can ask questions during a panel discussion with e-file software vendors.

In the afternoon session, practitioners will have an opportunity to visit the individual exhibits and see demonstrations of software programs.

Practitioners are encouraged to bring their laptop computers and try out some of the software packages.

For more information about workshops in your area, contact the FTB e-file Help Desk at (916) 845-0353. Help Desk hours are 8 a.m. until 5 p.m., Monday through Friday. Beginning May 11, you can register on line at www.ftb.ca.gov.

Listed below are the confirmed dates and locations of the workshops:

Tuesday, June 22, in Oceanside at
Mission San Luis Rey Parish
4070 Mission Avenue
Oceanside, CA

Wednesday, June 23, in Riverside/Inland Empire at
Jack Kramer's Los Serranos
Golf and Country Club
15656 Yorba Avenue
Chino Hills, CA

Thursday, June 24, in Los Angeles at
The Holiday Inn
150 East Angeleno
Burbank, CA

Tuesday, June 29, at
The Four Points Sheraton Hotel
5115 Hopyard Road
Pleasanton, CA

Wednesday, June 30, in Fresno at
Pardini’s
2257 West Shaw Avenue
Fresno, CA

Thursday, July 1 in Sacramento at
The Holiday Inn
5321 Date Avenue
Sacramento, CA

BOE Implements New Tax Practitioner Hotline

News From the State Board of Equalization

The Board of Equalization has announced a new toll free tax practitioner hotline to offer practitioners faster access to information, duplicate tax returns and other forms and publications. Customer service representatives and tax opinion experts are available to answer your questions from 8 a.m. to 5 p.m., Monday through Friday, except on state holidays. Duplicate tax returns, forms and publications can be requested through automated services 24 hours a day, seven days a week. Tax practitioners are encouraged to call the hotline at (800) 401-3661.

HRA Program Increases Income Limits

California has increased the income limits for Homeowner and Renter Assistance claimants.

Chaptered on August 20, 1998, Assembly Bill 2797 (Cardoza) increased the income limits for HRA claimants from $13,200 to $33,132 for total household income and from $24,000 to $60,240 for gross household income.

The income limits will be adjusted annually for inflation. The inflation factor used in determining the income amounts for the 1999 claim year is 2.51 (The inflation factor is 2.51 because the bill adjusts for all prior years when there was no adjustment for inflation). This factor will be adjusted each year on or before February 1.

The assistance is available to qualifying senior, blind or disabled individuals as a once-a-year payment from the State of California based on a portion of the property taxes paid by a homeowner or paid indirectly by a renter.

Homeowner and Renter Assistance claims may be filed any time after May 15, 1999, and on or before August 31, 1999.

To qualify for homeowner assistance, claimants must have owned and lived in their own homes in California on December 31, 1998. For renter assistance, claimants must have lived in a qualified rented residence in California and paid $50 or more per month for rent during 1998. For either kind of assistance, claimants also must:

- Have been age 62 or older, blind or disabled on December 31, 1998.
- Have had a total household income of $33,132 or less in 1998.
- Have had a gross total household income of $60,240 or less in 1998.
- Be a citizen or designated alien, including a qualified alien, of the United States when the claim is filed.

FTB will mail claim booklets to last year's claimants no later than May 15, 1999. After that date, other claimants may obtain forms from the FTB Web site at www.ftb.ca.gov, 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 booklet by writing to:

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

Magnetic Media: Faster, Better, Cheaper

Four Options, TestWare Makes Filing a Breeze for Schedule K-1 (565) Filers

If you have been filing Schedule K-1s on paper, stop! It is time to enter the electronic era and file via magnetic media.

Last year the number of partnerships that filed Schedule K-1s (565) by magnetic media increased by almost 60 percent. Today, filing K-1s (565) on magnetic media has never been easier. You now have a choice of four types of media to use: CD, diskette, cartridge or tape reel. In addition to current year K-1 information, FTB also accepts amended current year Schedules K-1 and K-1 data for short period participants.

An enhanced version of FTB's K-1 TestWare is also available. K-1 TestWare edits the records before submitting them to FTB, allowing the transmitter to file error free records.

The improved version also can expand files from a delimited format to one that meets FTB's requirements (standard fixed length).

A year ago, one transmitter spent several months submitting and re-submitting 180,000 K-1 records due to errors in the record layout. This year, that same transmitter used our new K-1 TestWare for their Schedules 1997 K-1 and every one of their files passed the FTB edit program on the first attempt.

The K-1 TestWare is available to download from the FTB Electronic Services Web site located at www.ftb.ca.gov/elecserv**.**

HRA Help Available

The Franchise Tax Board has made it easier for eligible individuals to make a claim for Homeowner and Renter Assistance.

In accordance with the Americans with Disabilities Act, FTB provides the FTB 9000, "Homeowner Assistance Claim Booklet" and the FTB 9000R, "Renter Assistance Claim Booklet," in large print and on audiocassette. To order a booklet or audiocassette, call FTB at (800)-822-5711. TDD users call 800-822-6268.

FTB also provides fillable forms on its Web site so eligible individuals who prefer to use the Internet can complete a form on-line. The Internet Web site address is www.ftb.ca.gov.

Free assistance is also available from the Homeowner and Renter Assistance Volunteer Program. For information on program sites, call FTB at (800) 852-5711, contact a local Senior Citizen Information and Referral Service or visit an FTB district office.

FTB Calendar

(Continued from page 5)

- Requests for Tax Return are mailed to corporations who have not filed their 1997 corporate tax return.
- Demands to file 1997 corporate tax returns are mailed to nonqualified and qualified corporations

15 Second quarter 1999 personal income tax estimate payments are due.

20 See May 20.

Filing Tips for QSubs

Will your Form 100S include one or more QSubs? If so, here are some tips for completing Form 100S.

Tip #1

Form 100S (Side 1), Question D, should be checked "Yes" to indicate that the return includes one or more QSubs.

Tip #2

Per Form 100S, Section DD instructions, California requires that the parent S corporation attach a copy of the federal Form 966 for each QSub doing business or qualified to do business in California to the return for the income year during which the QSub election was made.

Tip # 3

Form 966 should also be attached to Form 100S for any subsequent year that there is any QSub addition or termination

Tip #4

The S corporation parent should include Schedule QS (Qualified Subchapter S Subsidiary Information Worksheet) with Form 100S each year that a QSub election is in effect.

QSub: A New Tax Planning Vehicle

The passage of the Small Business Job Protection Act provides for the tax treatment of a Qualified Subchapter S Subsidiary (QSub, a.k.a. QSSS) for taxable years beginning after 1996. The House Ways and Means Committee understood that there are situations where taxpayers may wish to separate different trades or businesses in different corporate entities. The Committee believes that, in such situations, shareholders should be allowed to arrange these separate corporate entities under parent-subsidiary arrangements as well as brother-sister arrangements.

Under the proposed regulations, the QSub election's effect is that the existing subsidiary is not to be treated as a separate corporation. The QSub is deemed to have liquidated under IRC Sections 332 and 337. All assets, liabilities, and items of income, deduction, and credit of a QSub are to be treated as those of the parent S corporation. Items of the QSub that become attributable to the parent S corporation include accumulated earnings and profits, passive investment income and built-in gains. Transactions between the parent S corporation and the QSub are not taken into account. The tax treatment of the liquidation or of a larger transaction that includes the liquidation will be determined under the IRC and general principles of tax law, including the step transaction doctrine.

For a valid QSub election, the parent must be a qualified S corporation (IRC Section 1362(a)), the QSub must meet the standards for qualification under IRC Section 1361(b), and the S corporation must make the QSub election for federal purposes. Note: an election made by the S corporation to treat its subsidiary corporation as a QSub for federal purposes is a binding election for California. An election different from the federal QSub election may not be filed for California. California follows the federal transitional relief procedures for perfecting a QSub election.

How Much Tax Should S Corporations Pay?

The S corporation parent is required to pay an $800 annual tax for each QSub it owns. If the S corporation parent is not doing business in California and is not a qualified corporation in California, but the QSub is, then the S corporation parent is deemed to be qualified and/or doing business in California as well. This situation then subjects the S corporation parent to the minimum franchise tax, as well as the commencing tax due to the Franchise Tax Board.

Example:

Scoop, an S corporation parent, owns three QSubs (Vanilla, Chocolate and Strawberry). Scoop began business as an S corporation in 1997. It made valid QSub elections for Vanilla, Chocolate and Strawberry in 1998. Vanilla and Chocolate are qualified and doing business in California, Scoop and Strawberry are not.

For income year 1998, Scoop is deemed to be doing business in California because of Vanilla's and Chocolate's business activities in California and is subject to California franchise tax, in an amount at least equal to the minimum franchise tax. For income year 1998, Scoop is responsible for its own franchise tax (the greater of the minimum franchise tax or 1.5 percent of net income for tax purposes) plus two annual taxes for the QSubs Vanilla and Chocolate.

The QSub annual tax is due and payable when the S corporation's first estimated tax payment is due. If a QSub election is made during the income year, the QSub annual tax is due with the S corporation's next estimated tax installment. The QSub annual tax is subject to estimated tax rules and penalties, and is the liability of the parent S corporation.

An amount equal to the greater of the minimum franchise tax or 1.5 percent of net income for tax purposes for the parent S corporation **plus** the QSub(s) annual tax(es) is to be reflected on Form 100S, line 22, Tax.

FTB to Contact Nonfiler Corporations

In June, the Franchise Tax Board will mail notices to corporations that have yet to file their 1997 California corporate tax return.

If you have clients who fall into this category, file the delinquent returns as soon as possible.

All of the corporation accounts go through a rigorous review process prior to the issuance of notices, however, some notices are sent to corporations that do not have a filing requirement with us because they were dissolved by shareholders and are still in business as sole proprietors or partnerships.

If you have clients that fall into this category, they can avoid receiving these notices by ensuring that the dissolving corporations contact the Employment Development Department and the State Board of Equalization to update their entity status and change their classification.

Once the corporation's classification is changed, FTB will no longer send out notices requesting that a corporate tax return be filed.

Notices to Nonfilers Mailed in May

Phone Service Can Assist Individuals Seeking to File Delinquent Returns

Now that you've finished preparing your clients' 1998 personal income tax returns, you may want to make sure they've filed their 1997 returns.

The Franchise Tax Board has been sending notices to nonfilers over the last few months, reminding them of their requirement to file a return.

During the month of May, approximately 70,000 of those individuals will receive a Notice of Proposed Assessment from FTB.

More proposed assessments will be mailed during the coming months, as well as more requests for tax returns, and it's always best to file the return before the reminders come.

Even if you've dealt with these issues in the past, there are some new aspects to FTB's Nonfiler Program that you may encounter. For example, this year:

- Individuals were contacted who had paid a substantial amount of mortgage interest during the 1997 tax year (which would imply that they had income), but who had gone undetected by the current Nonfiler Program. Approximately 24,000 individuals meeting this criteria were contacted during the months of January and February of this year, and in the first 30 days after the notices were mailed, more than 1,000 tax returns were received.
- A new FTB form was developed and mailed out with every nonfiler Notice of Proposed Assessment. This "Quick Resolution/Protest Worksheet" is a check-the-box type form and covers the most common responses to FTB's Notice of Proposed Assessment.

The Nonfiler Program's Interactive Voice Response applications are available 24 hours a day, seven days a week. This means that an individual can, at their own convenience:

1) order forms,
2) get answers to commonly asked questions, and
3) resolve their own account (in cases where they had already filed the required return under a social security number other than the one shown on FTB's notice).

The IVR telephone numbers for the Nonfiler Program are shown below. When responding to a:

- Request for tax return, call (800) 545-5009.
- Notice of proposed assessment, call (800) 895-5440.

Collection Queries? Send Us a Fax

You can send a fax with your questions about personal income tax collection to the Franchise Tax Board.

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

Watch Out for California Nonconformity with Internal Revenue Code Section 469

California conforms to Internal Revenue Code (IRC) Section 469 with certain exceptions (California Revenue and Taxation Code Sections 17551, 17561 and 24642).

But, California has never conformed to the special rules for qualified real estate professionals provided under IRC Section 469(c)(7).

Additionally, for purposes of the S corporation franchise or income tax, California law applies the rules for limitations and material participation differently for California S corporation taxpayers (CRTC Section 23802(f)(3)(A)).

Rental Real Estate

IRC Section 469(c)(7) provides special rules for qualified real estate professionals. For federal purposes, these special rules provide that rental real estate activities of a qualified real estate professional are not presumed passive. To apply these special rules, more than half the taxpayer's personal services in all businesses must be in real property businesses in which the taxpayer materially participates and the taxpayer must spend more than 750 hours in such real property trades and businesses. If a taxpayer satisfies both of these requirements, each rental real estate activity in which the taxpayer materially participates is treated as nonpassive. California, however, has never conformed to these special rules; therefore, for California purposes, any rental activity is a passive activity.

S Corporation and Passive Activity

For purposes of the California S corporation franchise or income tax, the passive loss limitation rules apply to S corporations as if the S corporation were an individual. Material participation of an S corporation in its activities is determined as if the S corporation was a closely held C corporation (CRTC Section 23802(f)(3)(A)). These passive loss limitation rules apply only for purposes of the S corporation franchise or income tax. The passive loss limitation rules do not affect the amounts passed through to shareholders.

The Internal Revenue Service does not apply the passive loss limitation rules to S corporations because an S corporation is generally exempt from federal income taxes (IRC Section 1363(a)).

Basic Steps for Applying IRC 469 Rules

Here are the basic steps for applying the passive activity loss limitation rules:

Step 1

Identify the activities. See Treasury Regulation 1.469-4 for the definition of activity. Treasury Regulation Section 469-4(c) provides the general rules for grouping activities. Treas. Reg. §1.469-4(d) explains the limitation on grouping rental activities with trade or business activities.

Step 2

Separate activities into rental activities and trade/business activities. See Internal Revenue Code §469(j)(8) and Treas. Reg. §1.469-1T(e)(3) for the definition of rental activities and Treas. Reg. §1.469-4(b) for the definition of trade or business activities.

Step 3

For each rental activity, determine whether the activity meets one of the six exceptions to rental activity. If the rental activity does not meet an exception, the activity is a passive rental activity. If the activity meets one of the six exceptions, then treat as a trade/business activity or as part of a trade/business activity. See Treas. Reg. 1.469-1T(e)(3)(ii) for the six exceptions to rental activity.

(Continued on page 11)

Interest Rates

For the period of July 1, 1999, through December 31, 1999, the interest rate on underpayments and overpayments of California income taxes will be **seven percent.** The following table lists interest rates since 1988.

Effective Date	Rate
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%
1 Jan. 1999 - 30 June 1999	8%
1 July 1999 - 31 Dec. 1999	**7%**

State Reduces Prepaid Minimum Tax

AB 2798 Also Shrinks 2nd Year Minimum Tax for Eligible Entities

Beginning this year, eligible foreign and domestic corporations will pay less prepaid minimum taxes. Some corporations may be eligible for a reduced second year minimum franchise tax as well.

Enacted in August 1998, Assembly Bill 2798 (Machado), reduced the prepaid minimum tax amount from $600 to $300 for an income year that begins during 1999 or later. Before AB 2798, certain corporations were already eligible for a reduced prepaid minimum tax of $600 for income years beginning on or after January 1, 1997.

The prepaid minimum tax is payment for the corporation's first taxable year and is due on the day that the corporation registers or qualifies with the Secretary of State or begins to do business in California.

The corporation must meet two conditions to qualify for the reduced payment. First, 50 percent or more of the corporation's stock cannot or will not be owned by another corporation. Secondly, the corporation must meet the definition of a qualified new corporation.

If a corporation's income year began during 1999 or later and it:

- Began operations at or after the time of incorporation,
- Estimates its gross receipts (less returns and allowances) to be $1,000,000 or less on its first Form 100 tax return,
- Estimates its tax liability to be $800 or less on its first Form 100 tax return, and
- Did not begin business operations as a single proprietorship, partnership or other business entity prior to incorporation,

then it meets the definition of a qualified new corporation and should pay the reduced prepaid minimum tax of $300.

(Continued on page 12)

Tips for Paying, Reporting Reduced Minimum Tax

Here are three scenarios (each involving the fictitious Alpha Corporation) that describe how to pay and report the reduced minimum tax and the second taxable year minimum franchise tax. For each of the scenarios, assume that:

- The Alpha Corporation incorporated with the California Secretary of State on January 12, 1999, and paid a reduced prepaid minimum tax of $300.
- On April 15, 1999, the Alpha Corporation made its first and only estimate payment of $500 for income year ending December 1999.
- The corporation filed a return for income year ending December 1999 on March 15, 2000.

Example 1

The Alpha Corporation filed its first Form 100 tax return timely and reported gross receipts (less returns and allowances) of $945,000.

The corporation reported a loss of $8,500 on the "net income for tax purposes" line and the reduced minimum franchise tax of $500 on the next line of the Form 100. The Alpha Corporation does not enter any amount on the "Additional SOS prepayment tax" line of its Form 100.

Since the Alpha Corporation did not have any credits or Alternative Minimum Tax, it reported $500 on the "Adjusted Total Tax" line of Form 100. The corporation entered $500 on the "1999 estimated tax payments…" line, and no amount on the "Tax due" line.

(Continued on page 12)

Basic Steps for Applying IRC 469 Rules

(Continued from page 10)

Step 4

For each trade/business activity for which income is not specifically excluded from passive activity, determine whether the taxpayer's participation meets one of the seven tests for material participation. If the taxpayer meets any one of the seven tests, the activity is nonpassive. If the taxpayer does not meet any one of the seven tests, the activity is passive. See Treas. Reg. §1.469-5T(a) and (b) for the seven tests to determine material participation in trade or business activity.
[Note: For items of income specifically excluded from passive activity, see IRC Section 469(e); Treas. Reg. 1.469-1T(e)(4), (5) and (6); and Treas. Reg. §1.469-2T(c)(3), (4), (5), (6) and (7).]

Step 5

For each passive activity that has net income, determine whether the income is subject to recharacterization. See Treas. Reg. §§1.469-2(f) and 1.469-2T(f) for six situations in which income (but not loss) is subject to recharacterization.

Prepaid Minimum Tax Drops to $300

(Continued from page 11)
If a corporation's income year began during 1997 or 1998 and:

- It estimates its gross receipts (less returns and allowances) to be $1,000,000 or less on its first Form 100 tax return, and
- It estimates its tax liability to be $800 or less on its first Form 100 tax return,

then it meets the definition of a qualified new corporation and should pay the reduced prepaid minimum tax of $600.

If a qualified new corporation pays a reduced prepaid minimum tax and afterwards it exceeds the allowable gross receipts (less returns and allowances) of $1 million or the allowable tax amount of $800 on its first Form 100 tax return, it must pay an additional tax of:

- $200 for an income year that began in 1997 or 1998, or
- $500 for an income year that began in 1999 or later.

This additional tax must be paid by the due date of the corporation's first Form 100 tax return (without regard to extension).

AB 2798 also reduced the second taxable year minimum franchise tax to $500 for eligible corporations. This provision is also effective for income years beginning on or after January 1, 1999.

In order to pay the reduced second taxable year minimum franchise tax, a corporation must meet the following criteria:

1 It must be a qualified new corporation. To be considered a qualified new corporation, the corporation must:

(a) Begin operations at or after the time of incorporation,

(b) Estimate its gross receipts (less returns and allowances) to be $1,000,000 or less on its first Form 100 tax return, and

(Continued on page 20)

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Tips for Paying, Reporting Reduced Minimum Tax

(Continued from page 11)

Example 2

The Alpha Corporation filed its first Form 100 tax return timely and reported gross receipts (less returns and allowances) of $945,000. The corporation reported $6,300 on the "Net income for tax purposes" line and measured tax of $557 on the next line of the Form 100. The corporation does not enter any amount on the "Additional SOS prepayment tax" line of its Form 100.

Since the corporation had no credits or Alternative Minimum Tax, it reports $557 on the "Adjusted Total Tax" line of Form 100. The corporation enters $500 on the "1999 estimated tax payments…" line, and $57 on the "Tax due" line.

Example 3

The corporation's first Form 100 tax return reports gross receipts (less returns and allowances) of $1,100,000. The corporation reports $6,300 on the "Net income for tax purposes" line and the minimum franchise tax of $800 (on the next line) of Form 100. The corporation enters $500 on the "Additional SOS prepayment tax" line of the Form 100 because it did not meet the gross receipts requirements.

Since the corporation had no credits or Alternative Minimum Tax, it reports $1,300 on the "Adjusted Total Tax" line of Form 100. The corporation enters $500 on the "1999 estimated tax payments…" line, and $800 on the "Tax due" line.

PROPOSED BILLS

Capital Gains

Among the measures being considered by the California Legislature are several that would affect capital gain taxes.

AB 7 (Campbell) and SB 34 (Brulte) would exclude from gross income any gain from the sale or exchange of a capital asset held by the taxpayer for five or more years.

SB 30 (Peace) would extend, and in certain cases, increase the exclusion percentage for gain from the sale or exchange of small business stock.

Conformity

Among the measures being considered by the California Legislature are some that involve conformity with the Internal Revenue Code or the Internal Revenue Service Reform Act.

SB 94 (Chesbro) would make a number of conformity and other tax changes. This bill would conform to the Internal Revenue Service Restructuring and Reform Act of 1998 technical changes relating to the exclusion of capital gains on the sale of a principal residence. It would expand innocent spouse protections by conforming to the IRS Reform Act provisions relating to innocent spouses and conform to the IRS Reform Act provision to suspend the statute of limitations for certain refund claims for periods during which the taxpayer is “financially disabled.” This bill would provide FTB administrative authority to compromise a tax debt similar to the IRS’s current offers in compromise authority.

This bill also would eliminate the tentative minimum tax limitation on personal exemption credits by allowing the personal exemption credits to reduce regular tax below tentative minimum tax.

It would delete obsolete refund provisions relating to the renter’s credit that are no longer necessary because the reinstated renter’s credit is not refundable. This bill would provide relief to an employee whose employer withheld delinquent taxes from the employee’s pay, pursuant to an earnings withholding order from the Franchise Tax Board (FTB), but failed to remit the amounts to FTB.

Tax Credits

Among the measures being considered by the Legislature are some that would either create new tax credits or modify existing ones. They include bills dealing with these subjects:

Agriculture.

AB 287 (Strickland) would allow a credit equal to the fair market value at wholesale of agricultural products donated by a taxpayer during the taxable or income year to a nonprofit charitable organization or food bank.

At-risk youths.

AB 203 (Washington) would establish the Second Chance Youth Employment Act of 1999 and would create credits equal to:

One-third of the amount paid or incurred by a qualified employer as wages to a qualified at-risk youth during the first year of employment, and the amount paid or incurred for the county probation officer fee, not to exceed $300, for each qualified at-risk youth.

Child care.

AB 149 (Leach) would create the Family Choice Child Care Act of 1999. The bill would allow a credit equal to 30 percent of the federal credit for household and dependent care services necessary for gainful employment or $150 per qualifying individual.

AB 401 (Strickland) would remove the January 1, 2003, sunset date for the Employer Child Care Contribution Credit. In addition, this bill would allow a credit

(Continued on page 14)

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 *www.leginfo.ca.gov*, which is the Official California Legislation Information Web site address.

PROPOSED BILLS

Tax Credits

(Continued from page 13)

equal to the amount paid or incurred for child care for any child of the taxpayer who is under 13 years of age. The credit could not exceed $300 per child per taxable year.

AB 763 (Bates) which would allow a 50 percent credit for certain costs paid or incurred during the taxable year for the adoption of any minor child.

SB 549 (Ortiz) would permit the Employer Child Care Program Credit to reduce tax below the tentative minimum tax for purposes of alternative minimum tax. The bill also would increase from 30 percent to 70 percent the percentage of costs eligible for the credit for facilities serving low-income children. This bill also would create a new credit for loans made by a bank or financial corporation to purchase, construct, expand or rehabilitate a qualified child care facility.

Corporate headquarters.

AB 490 (Ducheny) would create a new headquarters credit equal to six percent of the eligible costs paid or incurred by a qualified taxpayer that either locates a new corporate headquarters in this state or maintains or expands an existing corporate headquarters in this state.

Custodial/Noncustodial parents.

AB 53 (Pacheco) would allow a noncustodial parent of a child to deduct from gross income all child support payments, provided the parent pays all court-ordered child support by December 31 of the year for which the child support is owed.

Education.

AB 49 (House) would establish a credit equal to $500 for each child of the taxpayer that attends a California private school.

AB 81 (Cunneen) would establish two credits. The first credit would equal 50 percent of the amount paid or incurred during the taxable or income year for qualified expenses in connection with lending a qualified employee to a California public school or vocational institution for teaching math or science.

The second credit would be equal to 50 percent of the amount paid or incurred during the taxable or income year for qualified expenses in connection with allowing a public school teacher to attend an employer-sponsored education class.

AB 122 (Kaloogian) would allow a credit equal to any fees, not to exceed $500 per taxpayer, paid to a public school in California for the support of a school-sponsored activity.

ABX 34 (Kaloogian) would provide a credit equal to a qualified fee paid by the taxpayer to a qualified school for a school-sponsored activity. The credit could not exceed $500 per taxable or income year. For a husband and wife who file separately, the credit would be equally divided between them.

Enterprise zone.

SB 403 (Kelley) would amend the existing enterprise zone sales and use tax credit for the purchase of qualified property to include agricultural drain water treatment facilities in the definition of qualifying water pollution control mechanisms.

Exploration.

SB 85 (Knight) would establish a credit equal to 10 percent of wages paid by the taxpayer to employees performing services related to a resuable launch vehicle.

Family member care.

AB 408 (Correa) would allow a credit to a taxpayer who maintains a home for an immediate elderly family member. The amount of the credit in any one taxable year would be limited to $250 for each taxpayer.

Firearms.

AB 9 (Cardoza) would establish a credit of $150 each for the purchase of up to two gun safes during the taxable year.

AB 156 (Strickland) would create a credit equal to the amount paid or incurred, not to exceed $75, for the purchase of each locking device on a firearm. The amount of the credit allowed in any one taxable year could not exceed $225.

(Continued on page 15)

Moving? Take Tax News With You

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,
PO 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.

PROPOSED BILLS

Tax Credits

(Continued from page 14)

Inventory storage expenses.

AB 462 (Briggs) would establish a six percent credit similar to the Manufacturers' Investment Credit for the construction, reconstruction or acquisition of qualified property that is primarily used for the handling, movement and storage of inventory in a qualified facility (warehouse).

Low-income housing.

AB 97 (Torlakson) would provide that the credit for the costs of constructing or rehabilitating low-income housing shall be in effect so long as the federal low-income housing credit is in effect; and it would permanently increase the maximum aggregate housing credit dollar amount allocated annually by the California Tax Credit Allocation Committee from $35 million to $50 million for years beginning in the year 2000 or later.

Manufacturers' Investment Credit.

AB 473 (Hertzberg) would remove the January 1, 2001, sunset date and the related job creation requirement for the Manufacturers' Investment Credit. The MIC would become a permanent credit.

Motion picture and television program expenses.

AB 358 (Wildman) would allow a credit equal to 10 percent of the amount paid or incurred for qualified wages and salaries to employees and contractors in connection with the production of a qualified television program or qualified motion picture.

AB 484 (Kuehl) would allow taxpayers engaged in the production, development or distribution of motion picture and television production to claim a refundable credit equal to 6% of specified production labor contract costs of qualified property.

Public transit passes.

SB 17 (Figueroa) would reinstate the credit for employer provided public transit passes. The credit would equal 40 percent of the cost paid or incurred by an employer for providing subsidized public transit passes to an employee.

Research expenses.

AB 68 (Cunneen) would increase from 11 percent to 15 percent the California credit percentage for qualified research. In addition, this bill would decrease the minimum threshold for the taxpayer's base amount in computing the research expenses credit from not less than 50 percent to not less than 35 percent of the taxpayer's current year qualified research expenditures.

AB 465 (Nakano) would increase the California alternative incremental credit (research and development credit) by fully conforming to the federal credit percentages for the alternative incremental credit.

SB 495 (Figueroa) would allow a credit equal to $1,000 for each qualified employee who is engaged in activities related to space vehicles and parts and has been employed by the taxpayer for more than six months but less than three years during the taxable or income year.

Seed and venture capital investments.

AB 482 (Davis) would establish the California Seed Capital and Early Stage Corporation (the Corporation) to generate investment in private seed and venture capital partnerships or entities through a single designated for-profit investment fund.

Unemployment insurance / Employment training.

AB 489 (Ducheny) would create a credit equal to the costs paid or incurred during the taxable or income year for unemployment insurance and employment training taxes on tips reported by the taxpayer's employees pursuant to the Unemployment Insurance Code.

(Continued on page 16)

Package X Still Available

The 1998 Package X is still available.

There are three versions to choose from. The bound and loose-leaf paper versions cost $12 plus sales tax.

The best value, however, is the CD-ROM for Windows version. It costs $19, plus sales tax and comes with:

- 1998 California Package X forms;
- 1998 Internal Revenue Service Package X forms;
- Several fillable forms;
- California Package X forms for the four previous years; and
- Information on electronic filing (e-file).

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.

PROPOSED BILLS

Tax Deductions

(Continued from page 15)

The California Legislature is considering a variety of tax deduction measures and proposals on topics ranging from adoption to Year 2000.

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

AB 130 (Kaloogian) which would conform the deduction allowed for medical insurance for a self-employed individual to the percentages allowed under federal law.

AB 579 (Honda) which would allow a taxpayer to claim a section 179 deduction for the cost of items placed in service during 1998 or 1999 for modifying or purchasing computer software that is year 2000 compliant.

SB 109 (Knight) which would allow as a deduction an amount equal to the amount paid or incurred during the taxable year for private mortgage insurance for the first five years that the home is owned by a first-time home buyer.

SB 493 (Figueroa) which would create and place the California Birth Defects Research Fund on the individual income tax return and permit taxpayers to designate contributions to the fund for taxable years beginning on or after January 1, 2000, and before January 1, 2005. A deduction would be allowed for any contribution made to the fund. For taxable years beginning in 2000, the fund would be required to receive contributions of $250,000 (or the indexed amount) to remain on the tax return.

Economic Areas

There are also measures being considered by the California Legislature that would affect economic development areas:

AB 51 (Briggs) would allow the governing body of a city, county, or city and county to apply to the Trade and Commerce Agency to reconfigure the geographic boundaries of an existing enterprise zone within its jurisdiction.

AB 356 (Washington) would require the Trade and Commerce Agency to designate one city within the Los Angeles County as a new enterprise zone based on a ranking of applicant cities. The new zone would be required to meet specified criteria related to the city unemployment, median annual household income, and population. Businesses operating within the new zone would receive the same tax incentives as those received by businesses operating in existing enterprise zones.

SB 84 (Costa) would modify the rules regarding expansion of enterprise zones. It would:

- Delete the requirement that the proposed expansion area meet the general enterprise zone designation criteria that currently requires that the designation application propose effective, innovative and comprehensive regulatory, tax, program and other incentives in attracting private sector investment in the enterprise zone.
- Allow expansion into adjacent unincorporated areas of the county as well as into an adjacent city or cities.
- Allow expansion into noncommercial or nonindustrial land if that land is needed as a right-of-way and is needed for contiguous expansion.
- Specify that expansion into an adjacent city or cities, or unincorporated area of the county, must be into an area contiguous to the existing enterprise zone.

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Sign up For Tax e-News

The Franchise Tax Board has an electronic information service exclusively for tax practitioners. The service is called Tax e-News and it is designed to provide current news and information affecting tax professionals.

To sign up for the service, simply send an e-mail message to

Tax_e-News@ftb.ca.gov.
If you have questions about the service, call: (916) 845-7070.

PROPOSED BILLS

Economic Areas

(Continued from page 16)
Under this bill, any businesses located in or that move to areas in which an enterprise zone is expanded would be eligible for the enterprise zone tax incentives.

SB 511 (Alarcon) would permit an enterprise zone to also expand into an adjacent unincorporated area of the county.

FTB - Sponsored Bills

Among the measures being considered by the legislature are several Franchise Tax Board sponsored bills. They include bills dealing with these subjects:

Appeals.

AB 1636 (Assembly Revenue & Taxation Committee) would specify that the 90-day period for filing an action in court begins on the date the State Board of Equalization determination becomes final, clarifying that the taxpayer would have 120 days to file an action.

Corporation elections.

SB 184 (Kelley) would allow a top tier corporation to elect, on the behalf of all qualified extractive apportioning trades or businesses within the commonly controlled group, whether the members of its group would apportion using the single- or double-weighted sales factor.

Credit cards/Interest abatement.

SB 603 (Speier) would allow the Government Code provisions to control FTB's credit card program by removing the current Revenue and Taxation Code references. This bill would require FTB and any other state agency accepting credit cards for payment to notify each eligible payer and to provide the payer either a space on the billing statement or complete instructions on how to pay the agency by credit card.

This bill would allow FTB to abate interest for the same period as the Internal Revenue Service for delays resulting from an error or delay in the performance of a ministerial or managerial act by an IRS officer or employee that occurred on or before the final federal determination was made.

Filing status.

AB 1635 (Assembly Revenue & Taxation Committee) would make the following changes:

Allow FTB to revise the California return to reflect the proper filing status (even if different from federal) when the filing status used on the taxpayer's federal income tax return is determined to be incorrect.

Allow taxpayers who are not required to file a federal income tax return to select any filing status that could have been claimed on the federal return.

Permit taxpayers who file a joint return for federal purposes and are allowed to file either married filing single or joint for California purposes to change their filing status to married filing single after the due date for filing the return has passed.

Limited Liability Corporations.

AB 189 (Ackerman) would clarify the Franchise Tax Board's authority to suspend a disregarded limited liability corporation by eliminating an erroneous reference to LLCs classified as a partnership.

AB 190 (Ackerman) would make the annual tax of an LLC (whether classified as a partnership or disregarded) due and payable on the due date of the LLC return, rather than by the 15th day of the fourth month after the beginning of the taxable year. This change would be consistent with the annual tax due date for limited partnerships and limited liability partnerships.

Multistate tax compact.

AB 753 (Kaloogian) would repeal all provisions related to the Multistate Tax Compact.

(Continued on page 18)

Request a Head of Household Presentation

Franchise Tax Board conducts informative presentations on the head of household filing status at locations throughout the state.

The presentations are geared towards helping practitioners better understand the head of household filing status. A typical presentation includes a head of household program overview, an explanation of the qualification criteria for using the head of household filing status and a discussion about important questions that practitioners should ask their clients who file head of household.

For information on how to get a head of household presentation conducted in your area, contact FTB's Head of Household Unit at (916) 845-6265.

Tax Agencies Offer Educational Opportunities

The Franchise Tax Board, along with the State Board of Equalization, Internal Revenue Service, Employment Development Department and a host of state, local and federal organizations, routinely offer free seminars for business owners and individual taxpayers.

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

Also visit the BOE Web site at www.boe.ca.gov and click on "Taxpayer Education."

PROPOSED BILLS

FTB - Sponsored Bills

(CONTINUED FROM PAGE 17)

Penalties.

AB 296 (Strickland) would amend the demand penalty when an individual fails or refuses to make and file a return (and the failure is not due to reasonable cause), so that the 25 percent penalty would be calculated after allowing for credits and withholding. Thus, a taxpayer who would have been entitled to a refund would not owe a penalty.

Tax Brackets.

AB 1140 (Villaraigosa) would increase the income filing thresholds for taxpayers eligible to claim the senior exemption credit or the dependent exemption credit, eliminating the need for certain taxpayers to file an income tax return.

Tax credits and/or refunds.

AB 463 (Maldonado) would provide that the statute of limitations for claims for refunds or credits is the four-year period that begins on the date the return was actually filed, if the return was timely filed by the extended due date. Thus, for timely filed returns, this bill would eliminate the difference in the SOL applicable to proposed deficiency assessments and overpayments.

Wage Reporting.

AB 1634 (Assembly Revenue & Taxation Committee) would change the definition of wages for the purpose of the quarterly report to include all renumeration includible in gross income for services paid by an employer engaged in a trade or business "to all employees," while maintaining the current definition of wages for withholding purposes to preserve the current exception to withholding.

In addition, here are the highlights of some other FTB-sponsored proposals:

SB 1229 (Senate Revenue & Taxation Committee) would make the following changes:

- Clarify that substandard housing could be housing that is either occupied or abandoned.
- Eliminate obsolete language regarding pending litigation on intercompany dividends from the provisions regarding dividends paid between members of a unitary group.
- Specify that for purposes of determining the correct amount of tax for water's-edge electors, the presumption of correctness attaches to all federal audit determinations including determinations made by the audit, appeals and/or Competent Authority Levels.

SB 1230 (Senate Revenue & Taxation Committee) would:

- Delete language that would require the payment of estimated tax as a prerequisite for receiving an extension of time to file a return.
- Delete the separate exempt organization provision for the automatic extension of time to file.
- Eliminate the $10 fee for the revivor of an exempt organization; and
- Permit FTB to require, as a condition of revivor, an exempt organization to submit a new exempt application, if requested by FTB.

Minimum Taxes

Among the measures being considered by the California Legislature are several that would either change or eliminate the minimum franchise tax for some corporations.

AB 10 (Correa) would provide that for income years beginning on or after January 1, 2000, and before January 1, 2003, a qualified new corporation would not be subject to the prepayment of minimum franchise tax to the Secretary of State. For income years beginning on or after January 1, 2003, the prepayment to the SOS for qualified new corporations would return to $300.

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PROPOSED BILLS

Minimum Taxes

(Continued from page 18)
AB 19 (Leach) would exempt from the minimum franchise tax every corporation that has been incorporated for less than five years.

SB 40 (Brulte) would eliminate the minimum franchise tax and the related prepayment of the minimum franchise tax to the Secretary of State.

Miscellaneous

In addition, here are the highlights of some miscellaneous measures being considered:

Education.

AB 2 (Alquist) would expand the current gross income exclusion for amounts paid or incurred by the employer for "educational assistance" to include graduate level courses beginning after June 30, 1999 and before July 1, 2007.

Payment methods.

AB 41 (Wesson) would allow a taxpayer to make a payment of taxes with a "deposit in the nature of a cash bond" to stop the running of interest and still preserve the taxpayer's right to file a subsequent claim for refund.

Disasters.

AB 114 (Florez) would allow special disaster treatment of losses sustained as a result of a freeze or any related casualty that occurred during the winter of 1998-99 in any county of California that was declared a disaster.

Voter Registration.

SB 86 (Murray) would require the Secretary of State to provide voter registration information to the FTB for inclusion in the income tax instructions pamphlet.

Tax Form Corrections

(Continued from page 3)
Schedule CA (540NR), California Adjustments - Nonresidents or Part-Year Residents, Instructions, for Column E, line 7, Wages, Salaries, Tips, Etc. reads:

"Enter all wages, salaries, tips and other compensation you earned while you were a California resident. And, if you performed work in California while you were a nonresident, include the portion of wages or other compensation earned in California. *Include moving expense reimbursement for moves into California*. Airline employees and Interstate Rail and Motor Carrier employees, get FTB Pub. 1031, for more information."

Delete this sentence: *"Include moving expense reimbursement for moves into California."*

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2), Form 540NR Booklet and single copy are incorrect.

Schedule K-1 (541), Beneficiary's Share of Income, Deductions, Credit, etc. Beneficiary's instructions, line 10a reads: "Report any amount in column (c). Then enter the adjustment on Schedule CA (540 or 540NR), line 37, as…appropriate."

It should read: "Report any adjustment on line 10a, column(c). Then enter the adjustment on Schedule CA (540 or 540NR), line 38, as…appropriate."

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2), Form 541 Booklet and single copy are incorrect.

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

Delete the Credit Code 170, Joint Custody Head of Household; and Credit Code 163, Senior Head of Household from the Credit Table.

Note: The instructions were revised because a trust cannot meet the definition

(Continued on page 20)

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State Also Shrinks 2nd Year Minimum Tax

(Continued from page 12)

(c) Not begin business operations as a single proprietorship, partnership or other business entity prior to incorporation.

2 It must have incorporated on or after January 1, 1999,

3 It cannot be a corporation that reorganized solely for the purpose of reducing the minimum franchise tax; and

4 It cannot be a limited partnership, limited liability company, limited liability partnership, charitable organization, RIC, REIT, REMIC, FASIT, qualified Subchapter S subsidiary or any other subsidiary corporation.

For additional information regarding the reduced prepaid minimum tax refer to Revenue and Taxation Code (R&TC) Section 23221.

Tax Form Corrections

(Continued from page 19)

of qualified taxpayer under these credits, nor can these credits be carried over (they would be applicable only up to the date of a taxpayer's death).

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2) and single copy are incorrect.

FTB 5806, Underpayment of Estimated Tax by Corporations, Instructions, Page 1, General Information, 4th paragraph reads: "No addition to tax…increased by the provisions of Assembly Bill 2797 (Ch. 98-322)."

It should read: "No addition to tax…increased by the provisions of Senate Bill 519 (Ch. 7, Stats. 1998) or Assembly Bill 2797 (Ch. 322, Stats. 1998)."

The Internet version is correct. Package X, paper and CD-ROM (release 98.1 and 98.2) and single copy version are incorrect.

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