



chair **John Chiang**
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State of California
Franchise Tax Board

06.23.09

Gina Rodriquez
Spidell Publishing, Inc
PO Box 61044
Anaheim, CA 92803-6144

Dear Ms. Rodriquez,

Thank you for presenting at the Taxpayers' Bill of Rights Hearing held December 4, 2008. The following responses are for the three issues sent to us in your letter dated December 3, 2008, that we did not respond to originally, and follow-up responses to our letter dated June 2, 2009.

Double Withholding

The issue that Spidell is asking FTB to address is double withholding on non-California partnerships. FTB does not see this issue as double withholding. FTB recognizes this issue as a tax gap. California residents and nonresidents are subject to real estate withholding tax when California real property is sold. Before January 1, 2009, all partnerships were exempt from real estate withholding. When California real property was sold belonging to a partnership, there was no withholding. FTB recognized the exemption as a tax gap for non-California partnerships.

Although the law technically requires withholding at source from distributions of California source income by out-of-state partnerships, in reality the state has no practical means of enforcing withholding on non-California partnerships.

In Spidell's example dated December 3, 2008, the Nevada partnership, Lotsa Properties, withholds on a distribution. In reality, the non-California Lotsa Properties, will probably not withhold and remit to FTB when they make a distribution to any of the partners. So in practice, there is no double withholding.

In some, but not all cases, such as in the example provided, the same income is being distributed that has already been withheld upon as part of the real estate transaction. That is why FTB has procedures in place to allow a waiver or reduced withholding if the combination of the partner's share of the real estate withholding and the withholding on the distribution would result in double withholding. CCR section 18662-3 (b) allows FTB to consider documentation to the effect that the 7 percent rate will result in double (over)withholding.

The example provided by Spidell assumes the distribution is the same or only income of the partnership. It appears there's double (over)withholding. However, on the other side, what if income on the K-1 is considerably more than what is distributed? Or the distribution is

return of capital or previously reported income where there is no withholding? The distribution and income from the K-1 are very different items. A distribution is not always withheld upon and K-1 income is what's taxable on the income tax return. K-1 income amounts are reported on lines 1-11 of the 2008 Form 565 K-1. What is distributed to pass-through owners is what may require nonresident withholding. The amounts distributed are reported on line 19 (a) and (b) of the 2008 Form 565 K-1. Please note that the gain on sale of property, depending on the type of property, would be reported on line 8, 9, or 10 of the 2008 Form 565 K-1. In other words, the gain is only one line item of the eleven income items on a K-1.

Nonresident withholding is a prepayment and 7 percent is the average. Our records show that 70 percent of nonresidents receiving California source income are nonfilers.

We continuously work on California partnerships and partnerships qualified to do business in California to withhold on distributions. Our only means of assuring the property sale is reported on a California tax return is to withhold at the source.

Estimated Tax Payments Held in Suspense

Last August, FTB sent the new "two-year" notification to taxpayers who had made estimate payments but had not filed a tax return. We mailed 24,000 notices to taxpayers who had made a total of \$117 million estimate payments. These notices were for tax year 2005. If returns are not filed, the statute of limitations will expire in April 2010. We do not yet know how many of these 24,000 taxpayers have since filed a return. We plan to begin gathering that information soon, but we are intentionally waiting until most of the returns from this filing season have been processed. However, we will not be able to measure the full impact of this additional notification until the end of the statute of limitations.

We would like to determine the impact of this new notification before considering an earlier, third notification. Many taxpayers already file their returns 8-20 months late. Almost half a million taxpayers filed their 2006 tax return, due in 2007, in 2008. Sending notification letters to the estimate payers in this group immediately after the extended due date would have been unnecessary.

Small Refunds Checks

Revenue & Taxation Code (R&TC) §19301 requires FTB to refund any overpayment to the taxpayer. Exceptions exist to offset tax liabilities on other years and other specified liabilities. Taxpayers may also request overpayments of estimated taxes be transferred to the next year. Per R&TC §19307, a return shall be considered a claim for refund if certain credits exceed tax due by more than one dollar. A legislative change would be required for FTB to begin rolling over all overpayments that are more than \$1.

In 2007, FTB considered the possibility of adding a line to tax returns to allow taxpayers to voluntarily request overpayments of \$5 or less be transferred to the next year. With the increased costs for programming system changes, tax form changes, processing returns where taxpayers forget about the transfer or forget that the requested transfer was used to offset other liabilities or adjustments, processing the resulting Return Information Notices, and responding to the increased phone calls and correspondence, it was determined that it

would be cost prohibitive to encourage taxpayers to roll over low dollar overpayments to the next year.

Revised Texas Franchise Tax

The Legal Division has completed the Draft Legal Ruling concerning the treatment of the Revised Texas Franchise Tax for California purposes. The ruling is expected to be released to the public in mid July.

Accelerated Estimated Tax Payments Follow-up

As the result of legislation enacted last year, new California estimate payment requirements began January 1, 2009. You recommended we address this issue administratively and/or legislatively.

On March 26, 2009, AB 1580 was introduced to clean up the Accelerated Estimated Tax Payment issue by correcting the wage-withholding problem.

Claiming Refunds of Estimated Tax Payments Follow-up

You recommended we implement the procedures used by the IRS to allow taxpayers to designate a refund from an amended return to the next year's estimated tax.

Our Tax Forms and Notices Action Team (TFNAT) formed a sub-team to study this suggestion. We feel this is feasible, and could be treated as an informal process not requiring legislation. We don't anticipate working through implementation issues surrounding this in time for the 2010 process year due to the already tight constraints on resources. Several issues need to be addressed before implementation such as system changes, internal procedures, and training. Legal has identified several issues as well relating to interest and effective dates of payments that need to be worked through. The sub-team will work with Legal, Processing, and Audit to fully develop an implementation plan.

Suspend Collection Action When Claim Pending Follow-up

You recommended we implement the procedures used by the IRS, which generally stops collection action on a taxpayer that has a pending refund claim.

FTB's existing procedures appear to coincide with the methods used by the IRS to manage cases with these issues. A copy of our current Collection Procedures Manual can be found on our website. Our current policy follows the IRS's policy to give reasonable consideration to suspend collection activities on a tax year until a taxpayer's claim for refund can be processed. We also agree that specific facts and circumstances of any given case may warrant continued collection activity on these cases. With that in mind, if a collection account were assigned to a collector, the collector would analyze the account and place a system hold on the tax year at issue, if appropriate. When an amended return has been filed by the taxpayer that will fully pay the existing liability or result in a refund, the taxpayer should provide a copy of that return to the collector and FTB will stop collection activities for that particular original tax return and tax period until the amended return is processed.

The current processing timeframe for amended returns is approximately three months, although timeframes may be extended depending on the complexity of the case and/or other issues. In addition, if necessary, FTB may consider expediting the processing of an amended return claim for refund depending on the circumstances of the case.

I appreciate your continued input and recommendations to improve tax law and our policies.

Sincerely,

Steve Sims, EA
Taxpayers' Rights Advocate

cc: Hon. John Chiang, Chair
Hon. Betty T. Yee, Member
Hon. Michael C. Genest, Member