

FTB legal ruling on repatriated earnings

The Franchise Tax Board issued Legal Ruling 2005-02, Business or Nonbusiness Characterization of Income Earned with Respect to Cash Dividends, Pending Their Domestic Reinvestment under Section 965 of the Internal Revenue Code, on July 8, 2005.

It affects multinational corporations planning to bring home billions of dollars of foreign earnings this year under a one-year federal rule intended to encourage the repatriation of dividends from foreign subsidiaries for investment in domestic operations. Legal Ruling 2005-02 provides certainty with respect to the classification of income earned from holding such dividends pending investment. These companies can now go forward with repatriation knowing the tax consequences under California law.

The Federal American Jobs Creation Act of 2004 encouraged companies to take money kept in overseas accounts to avoid high taxes at home and spend it on plants, equipment, and jobs -- in the United States. Under this new federal law, U.S.-based companies have one year in which they can repatriate the earnings of their foreign operations at a special tax rate of just 5.25 percent instead of the usual 35 percent. California has not conformed to this federal legislation. However, California already allows either complete elimination of such dividends from income or allows a 75 percent deduction with respect to them depending on the circumstances.

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Installment agreement pilot program – personal income tax

Effective September 1, 2005, through December 31, 2005, we will conduct a four-month pilot program for installment agreements for individual taxpayers. The program will modify the current installment agreement conditions from \$10,000 within 36 months to \$25,000 within 60 months. Applicants will qualify if they:

- Owe a balance of \$25,000 or less.
- Agree to pay in full within 60 months or less.
- **Have filed** all required personal income tax returns.

No financial statement will be required to establish the installment agreement. We reserve the right to file a lien as a condition of the installment agreement depending on compliance history. For further information, please contact the *FTB Collection Resolution Unit* at (800) 689-4776.

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www.ftb.ca.gov

Tax News is a bimonthly publication of the Communications Services Bureau of the California Franchise Tax Board. Our primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

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Tax Practitioner Services

Our Tax Practitioner Support Unit is available from 8 a.m. to 5 p.m., Monday through Friday. Our telephone number is (916) 845-7057. You can send us a fax 24 hours a day, seven days a week. Our fax number is (916) 845-6377.

Hearing Impaired
TDD (800) 822-6268

Report real estate commissions on Form 1099-MISC

Real estate brokers are required to report to the Internal Revenue Service and the Franchise Tax Board all real estate commission payments of \$600 or more that they make to brokers and agents in the course of doing business.

For real estate transactions:

- Listing brokers must report commission payments they make to buyers' brokers.
- Listing brokers must report commission payments they make to their listing agents.
- Buyer brokers must report commission payments they make to their agents.

If you have clients who need to report these types of payments, be sure to use Form 1099-MISC, *Box 7 – Nonemployee Compensation*.

Payers are required to furnish statements to payment recipient by January 31, and information returns to the IRS and the FTB by February 28, following the year of payment. If your clients file the information returns electronically, the due date is March 31.

If your clients need more time, an extension to file may be submitted to the IRS and FTB by the filing due date. For FTB, use form FTB 6274A, *Request for Extension to File for Information Returns*.

There are several ways to file Forms 1099-MISC:

- Combined federal/state filing method.
- Electronic filing.
- Magnetic media.
- Paper.

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Repatriated earnings

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California law and regulations govern business/nonbusiness characterization of income. Investments permitted under Internal Revenue Code 965 may or may not serve an operational business function in the taxpayer's unitary trade or business. The taxpayer's investment plan will determine whether the money is intended to be used for an operational business function and the characterization of the interest earned pending investment. If the investment plan contemplates a business use, the earnings will constitute apportionable California business income for corporation franchise and income tax purposes and only a portion of the income will be taxed by California. The portion taxed is related to the taxpayer's relative presence in California as compared to its presence everywhere. On the other hand, income from the interim investment of those funds will not be apportionable business income if the repatriated dividends are designated for a nonbusiness function or are earmarked for a line of business separate from the taxpayer's unitary trade or business. If the earnings are characterized as nonbusiness income, generally all of the earnings will be treated as California income if the taxpayer is based in California or will be treated as income assigned to another state if the taxpayer is not based in California.

To read the entire ruling, visit our FTB Laws and Legislation Webpage at www.ftb.ca.gov.

Are you ready for bankruptcy reform?

In April 2005, President George W. Bush signed into law the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*. Most of the provisions in this new law, more commonly known as the *Bankruptcy Reform Act of 2005*, go into effect October 17, 2005, 180 days after enactment. The new law affects individual and business bankruptcies, and, more than 20 of its provisions involve taxes.

Bankruptcy is already one of the most misunderstood subjects in our country's legal system. When tax debt is involved, all the related laws, processes, and procedures can make it seem even murkier.

We have a unit devoted entirely to helping you and your clients understand how the federal bankruptcy laws impact your clients' California tax liabilities.

Whenever possible, contact us *before* your clients file for bankruptcy. Your knowledge of our bankruptcy procedures can influence whether your clients have a smooth journey back to solvency or a bumpy ride through the bankruptcy process.

Our bankruptcy unit is organized by type of taxpayer and bankruptcy. Contact us during normal business hours at these telephone numbers:

- Bankruptcy (916) 845-4750
- Bankruptcy Fax (916) 845-6786
- Corporations Chapter 7, 11 (916) 845-4375
- Individuals Chapter 7, 11, 12 (916) 845-7584
- Individuals Chapter 13 (916) 845-7050

What you need to know before your clients file a bankruptcy petition.

You may request information regarding your clients' tax obligations, such as their balance due and what tax returns have or have not been filed, before filing a bankruptcy petition.

- We will need a power of attorney declaration from your clients authorizing the disclosure before we can release their tax information to you.
- Fax the power of attorney declaration with your request to our bankruptcy staff at the fax number given above. For more information on obtaining and submitting power of attorney declarations, read our *Power of Attorney Booklet*, FTB 3520, available on the *Forms and Publications* page of our Website at www.ftb.ca.gov.

Why do you continue to send tax notices to my clients, even when they are in bankruptcy?

For bankruptcies filed on or after October 22, 1994, governmental units can issue and finalize audit assessments, send notices of tax deficiency, and demand returns.

The California Taxpayers' Bill of Rights also requires us to notify your clients anytime we assess a new liability. Generally, we must also advise delinquent taxpayers of the status of their account annually.

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Report real estate commissions on Form 1099-MISC

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We encourage filers to participate in the *IRS Combined Federal/State Filing Program* for electronic and magnetic media filers. Under this program, payers report directly to the IRS and the IRS selects and forwards the state's returns. It saves the payer the cost and effort of having to produce a separate file for the state. **Note:** If your clients choose the combined filing method, do not send a file to us.

Both the IRS and FTB offer electronic filing for sending information returns. File formats follow the IRS Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically*.

If your clients are required to file 250 or more information returns, they must file electronically or magnetically. The 250-or-more return requirement applies separately to each type of form. We encourage you to file electronically or magnetically even when you are filing fewer than 250 returns.

If you do not file electronically or magnetically, you must file your paper Forms 1099 with the IRS along with Transmittal Form 1096. When you file paper returns, the IRS will forward the California information to us. Do not send the state copy of the paper form to IRS. You may keep it in your records.

For more information on reporting real estate commission payments, contact our Information reporting Help desk at (916) 845-6304.

Are you ready for bankruptcy reform?

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How are tax refunds processed when there is a bankruptcy involved?

If your clients file Chapter 7 bankruptcy and only have post-petition liabilities, FTB will offset the *post-petition refund* automatically to any outstanding post-petition debt. If your clients expect a refund on a post-petition tax year, allow six to eight weeks after filing the tax return before inquiring about its status.

If your client expects a refund on a pre-petition tax year, please call us to determine its status.

What about dissolving a corporation? How can my client receive a tax clearance certificate?

California corporations and qualified foreign corporations must obtain a tax clearance certificate from us to complete their dissolution or surrender with the California Secretary of State. To obtain a tax clearance certificate, file a *Request for Tax Clearance Certificate — Corporation*, form FTB 3555. The instructions are on the form. Your clients must also file all required returns, pay any outstanding taxes, penalties, interest and fees, *and* do one of the following:

- File an assumption of tax liability.
- Post a surety bond.
- Post a cash bond.
- Request a tax clearance certificate based on the taxes paid (final return).

Upon approval, we will send the tax clearance certificate to the corporation and to the Secretary of State. You can contact our *Tax Clearance Unit* at (916) 845-4124 for additional information.

What about estates?

When there is a requirement to file an estate fiduciary return and the estate is a corporation, file Form 100, *California Corporation Income Tax Booklet*.

If the estate is an individual, file Form 541, *California Fiduciary Income Tax Return*.

Please mail the original return with payment of the tax to the address we specify on the tax form. To request a prompt determination of the tax, send a copy of the return, along with a letter requesting the determination to:

Franchise Tax Board
PO Box 1673
Sacramento CA 95812-1673

Note: Contact us to determine any amounts due to us before you distribute the estate. Also, contact us if we sent your clients a bill on an estate account that they already paid.

My clients want to file a lawsuit against you.

In bankruptcies involving tax debt, sometimes there are situations, i.e., discharge disputes, claims issues, etc., where we disagree with your clients. If your clients are considering legal action, please call us before filing with the court. We will do everything reasonable to resolve the issue(s) without court intervention. If we cannot and service is necessary and allowed by mail, send it to:

Chief Counsel
Franchise Tax Board
PO Box 2229
Sacramento CA 95812-2229

Note: If personal service is necessary, your clients must serve a designated employee at our central office located at 9646 Butterfield Way, Sacramento CA 95827. In addition, please fax a copy directly to the bankruptcy group at (916) 845-6786 or mail it to:

Franchise Tax Board MS A-340
PO Box 2952
Sacramento CA 95812-2952

What are some alternatives to filing bankruptcy?

Installment agreements

Installment agreements can be an alternative to filing bankruptcy. With court approval, your clients may also make payments during the bankruptcy on debts that will not be discharged. For more information, get our *Installment Agreement Request Booklet*, FTB 3567BK or contact our *Installment Agreement Unit* at (800) 689-4776.

Offer in compromise

Your clients may submit an offer to pay a lesser amount than what is actually due to satisfy non-disputed final tax liabilities. They may wish to consider this option prior to filing bankruptcy, in conjunction with the filing, or to pay non-dischargeable debts after bankruptcy. We outline the requirements in our booklets, FTB 4905PIT, *Offer in Compromise for Individuals*, and FTB 4905BE, *Offer in Compromise for Business Entities*. Call our *Offer in Compromise Unit* at (916) 845-4787 for more information.

How can I learn more?

If you are interested in having a member of our *Bankruptcy Unit* speak to your organization, contact our *FTB Speakers' Bureau* at (916) 845-7565 or email them at speakersbureau@ftb.ca.gov.

Tips for the October 17 deadline

The October 17 deadline to file a 2004 state tax return is approaching. Here are some things to keep in mind during these final days:

The October 17 extended due date is for the filing of tax returns only. Any tax due needed to be postmarked or submitted electronically no later than April 15, 2005, in order to be considered timely and avoid penalties and interest.

You can still e-file your clients' California tax returns! We accept both refund and balance due returns through October 17, 2005. If you are not yet an approved Electronic Return Originator and want to e-file your clients' tax returns, you must first enroll with the Internal Revenue Service. Once you have your electronic filer identification number, complete and submit the *California e-file Program Enrollment Form* (FTB 8633) online at www.ftb.ca.gov, keyword: *e-file*.

When your clients are experiencing financial hardships and cannot pay their taxes in full, encourage them to file their returns by the extended due date and to arrange to make monthly installment payments. We not only streamlined the application and approval process, we also put it online so that taxpayers could apply at any time. If we approve your clients' request, we agree to let them pay the tax they owe in monthly installments instead of immediately paying the amount in full. Once we accept their online installment agreement application, they will receive a written notice within 30 days. To qualify for payment arrangement taxpayers must:

- Owe a balance of \$10,000 or less.
- Agree to pay your account in 36 months or less.
- Have filed all required personal income tax returns.

To receive an online installment agreement taxpayers must agree to:

- Pay by electronic funds transfer.
- Make monthly payments of \$25 or more.
- File all future tax returns on time.
- Pay all future tax balances when they are due.
- Pay a \$20 fee for establishing the installment agreement. (The fee amount is added to the balance.)

To apply for an installment payment agreement, go to our Website at www.ftb.ca.gov and click on the *payment options* link.

In general, taxpayers must pay California use tax on purchases made from out-of-state if the seller does not collect California sales or use tax, and the taxpayer uses, gives away, stores, or consumes the item in this state. State legislation passed in 2003 required a use tax line to be added to California's income tax returns, making it easier for consumers to report and pay use tax on their purchases.

Please advise your clients about the possibility of having a use tax liability. For many taxpayers this new line added to our income tax returns is their first introduction to the idea of a use tax. If your clients have a use tax liability, advise them to report it on their California income tax return. It is easier and more convenient to report it to us than reporting it separately to the Board of Equalization.

Use the Internet to file information returns

By using our Internet filing option to send us your clients' information returns (1098s, 1099s, 5498s, and W-2Gs), you are helping us reduce the tax gap and increasing your productivity at the same time.

We received more than 4 million information returns via the Internet last year. These files contained far fewer formatting errors and were easier to process than information returns submitted by other means. Bottom line – the more timely and accurate the data we receive from you, the more efficient we can be in identifying true noncompliance issues that are contributing to the tax gap.

Internet filing is safe and easy to use. You send us text or zip files using the same file format as that for magnetic media filing (see the IRS Publication 1220, *Specifications for Filing Forms 1998, 1099, 5498, and W-2G, Electronically or Magnetically*). And, you also get an immediate confirmation when we receive your file. A week later, simply access the secure Website to view the edit results for your file.

TestWare, our free software, lets you to test your data files before you submit them. When you use *TestWare*, you help ensure that your files pass our edit program successfully on the first try.

We extended the Internet reporting due date from February 28 to March 31. It's convenient, and it gives you more time for making changes or corrections before submitting your file. If you are not currently using the Internet filing option, now is a good time to go on our Website and try it out. To join, go to our Website at www.ftb.ca.gov, and type keywords: *1099 Internet filing*, into our search engine. Download form FTB 4092A, *Internet Filing Application - Information Returns*, and mail or fax it to the address provided. Get familiar with Internet filing now so in 2006 you can join thousands of tax professionals in helping us close the tax gap.

Tax forms news and previews

When lawmakers chaptered AB 263 into law on September 29, 2004, they amended the tax statute that allows a deduction for dividends received by a parent corporation from an insurance company subsidiary because the statute was previously found to be unconstitutional. The law also provides disincentives for corporations subject to tax under the Corporation Tax Law to overcapitalize insurance subsidiaries that are subject to the insurance gross premiums tax instead of the corporate income tax. We may develop a new form to track the transactions between the insurance companies and the corporations for deferred income.

Simply checking the final return box on the next tax return will not officially dissolve a corporation. Corporations seeking to dissolve must adhere strictly to the Secretary of State's dissolution procedures. When they do not, they often experience delays that result in additional tax owed. To help these corporations easily locate dissolution procedures, we are adding a link to the Secretary of State's *Dissolution Forms Webpage* to our own *Tax Forms and Publications Webpage*, as well as in the instructions section of our paper tax products.

Here are some of the changes we are considering making to the tax forms and instructions for individuals:

- Adding a line to the 540 2EZ for capital gains from mutual funds.

- Increasing the *Resident Income Tax Return and Nonresident Income Tax Return* booklets by eight pages, and the 540 2EZ booklet by four pages, in order to include:
 1. Tax tables up to \$100,000.
 2. W-2 forms.
 3. More instructions for reporting use tax.
- Removing the word *Step* on all individual taxpayer tax forms and instructions, except the 540X.
- Adding a *prior name* box on the main individual taxpayer tax forms.
- Adding lines for interest, dividends, pensions, and capital gains from mutual funds.

We often update our tax forms after we initially release them. It is now easier than ever to review the most recent updates, online, using our *Forms and Publication Webpage*. Go to our Website at www.ftb.ca.gov and click on *Forms and Publications*.

We have added pull-down menus that allow you to view the list of forms and publications we have revised since we released the initial paper version. To view the revisions, first select the form using the pull-down menu. Then click the *View Updates* button. You will get a description of the change(s), and information about where you can locate the revision on the form.

Note: In most cases, when we revise a form we will not create a paper version.

Tax News is going electronic – totally

The tax industry is moving at a dizzying pace right now. We have to keep up and so do you. That is why we are discontinuing the paper version of *Tax News* and expanding our electronic information services — *Tax e-News* and *Tax News Online*.

You get more news and information — faster — with our electronic *Tax News*. The newly designed *Tax News Webpage* will place many of our tax resources and services at your fingertips.

By shifting to an electronic platform, *Tax News* will become more of an *on-demand* information service, one where you can get the news when you

want it. And with the electronic *Tax News*, you decide how much or how little news you want.

Best of all, you get it all free of charge.

We plan to make the change in the spring of 2006, but don't wait until then to start getting your Franchise Tax Board news online. Go to www.ftb.ca.gov and click on the link titled *Tax News Online*. Locate the *Subscriptions* link and follow the instructions for subscribing to *Tax e-News*.

Tax e-News subscribers receive the electronic version of *Tax News* as well as any other important late-breaking news

we have. *Note:* Make sure you add our *from address (CSBEmailServices)* and our title (*FTBTaxNews*) to your email address book (and to your safe senders list if you have one). This will prevent overly aggressive spam filters from sweeping up our *Tax e-News* before you get to see it.

Subscribers who prepaid for *Tax News* beyond the March/April 2006 issue will receive a prorated refund amount equivalent to \$2 per each issue.

For more information, email us at taxnews@ftb.ca.gov. Or call our *Tax News Hotline* at (916) 845-7070.

e-file news

Business e-file Arrives January 2006

The Franchise Tax Board will roll out the California **Business** e-file Program January 2006. This program is in addition to the e-file program for individual taxpayers. To participate in the California Business e-file Program you will need to:

- Be accepted in the IRS e-file program.
- Enroll in the California program.

If you are already enrolled in the California e-file program, you **do not** need to enroll again for Business e-file. If your office will have different contact information for Business e-file, please update your information using our online enrollment form at www.ftb.ca.gov (search for *Join e-file*).

The first rollout in January will include the following California forms and schedules:

- Form 100 (including all attached schedules)
- Form 3523 – *Research Credit*
- Form 3535 – *Manufacturers' Investment Credit*
- Form 3540 – *Credit Carryover Summary*
- Form 3548 – *Disabled Access Credit for Eligible Small Businesses*
- Form 3805E – *Installment Sale Income*
- Form 3805Q – *Net Operating Loss (NOL) Computing and NOL and Disaster Loss Limitation – Corporation*
- Form 3805Z – *Enterprise Zone Hiring and Sales or Use Tax*
- Form 3806 – *LARZ Credit*
- Form 3807 – *LAMBRA Credit*
- Form 3809 – *Targeted Tax Area Deduction and Credit Summary*
- Form 3834 – *Interest Computation Under the Look Back Method for Completed Long-Term Contracts*
- Form 3885 – *Corporation Depreciation and Amortization*



- Form 5806 – *Underpayment of Estimated Tax by Corporations*
- Schedule D-1 – *Sales of Business Property*
- Schedule H (100) – *Dividend Income Deduction*
- Schedule P (100) – *Credit for Prior Year AMT*
- Schedule R – *Apportionment and Allocation of Income*

We will accept all corresponding IRS forms and schedules. Please check with your software provider for a specific list of forms and schedules it supports. All the information you will need for Business e-file, including the list of approved software providers, will be available on our Website at www.ftb.ca.gov (Key word: *e-file*). For California Business e-file questions, please contact us at:

e-Programs Customer Service

Phone: (916) 845-0353

Email: e-file@ftb.ca.gov

e-file through October 17

You can still e-file your clients' California tax returns during

the six-month extension period following the April 15, 2005, deadline. We accept both refund and balance due returns through October 17, 2005. Please remember that your clients must have paid any taxes owed on or before April 15, 2005, to avoid penalties and interest. If you are not yet an approved Electronic Return Originator and want to e-file your clients' tax returns, you must first enroll with the Internal Revenue Service. Once you have your Electronic Filer Identification Number, complete and submit the *California e-file Program Enrollment* form (FTB 8633) online at www.ftb.ca.gov, keyword: *e-file*.

There is nothing to mail. You will be enrolled within 48 hours and generally can begin submitting e-file returns at that time. You will receive confirmation from us by mail within seven days.

Interest rates change in 2006

For the period of January 1, 2006 through June 30, 2006, the adjusted interest rate on underpayments of California personal income tax, and, corporate income and franchise taxes will be six percent. The interest rate on corporation overpayments for the same period will be three percent. For past interest rate information, visit our Website at www.ftb.ca.gov, keyword: *interest rate*.

Amnesty update: the bills are in the mail

New billing information

The amnesty program application period ran from February 1, 2005 through March 31, 2005. Taxpayers who did not participate in amnesty and have a current balance due will receive a *Notice of State Income Tax Due* bill. This bill will include the 50 percent interest-based penalty.

Since July 27, 2005, we have mailed approximately 500,000 *Notice of State Income Tax Due* bills to individuals and business entities. Taxpayers can call the number on their notice for additional information, or visit our Website at www.ftb.ca.gov for a listing of frequently asked questions about the notices.

Military personnel on active duty status

Our amnesty program is still an option for military members:

- Serving in a combat zone or qualified hazardous duty area.
- Assigned outside the United States, away from their normal duty station, in connection with a contingency operation.

This also includes civilians serving in support of military personnel in those areas or operations and personnel hospitalized as a result of injury received while serving in those areas or operations. We have taken additional measures to protect our military personnel from receiving notices during this amnesty period. If any of your military clients receive a bill, contact the Tax Practitioner Hotline at (916) 845-7057.

Penalty waiver/claim for refund

There is no provision in the law to waive the 50 percent interest-based penalty. If you feel your clients received the penalty in error or you want to discuss payment of the tax, please call the number on their billing.

Mandatory electronic payments

Your business entity clients can check the status of their mandatory electronic fund transfer payment by calling (800) 852-5711. To set up an electronic fund transfer account, please call (916) 845-4025.

Payment options

For those clients who are not required to pay electronically and choose to use check or money order, be sure to:

- Make the check payable to the Franchise Tax Board.
- Write the account number and tax years on the payment.
- Attach a copy of the notice to the payment and send it to:

Franchise Tax Board
PO Box 942867
Sacramento CA 94267-1111

New ID number mandated for taxpayers

Starting January 1, 2006, many of the notices and bills we send to your clients will have a unique identification number instead of their social security number. The change is the result of a new California law aimed at further protecting taxpayers' social security numbers from unauthorized use.

Senate Bill 25, chaptered on October 12, 2003, makes it illegal for us to print social security numbers on materials we intend to mail to taxpayers. State and federal income tax agencies rely heavily on social security numbers and this law does not prevent us from using social security numbers internally, nor does it

prohibit us from using social security numbers on documents mailed to authorized third parties (e.g. garnishments and levies.). SB 25 does not prohibit taxpayers from using social security numbers on their tax returns.

All the information we receive from taxpayers is confidential, according to California law. We only share it with federal or state agencies and only for purposes specifically stated in the law. We have stringent policies and procedures regarding privacy and disclosure. All our employees receive training annually about ensuring the confidentiality of taxpayer information and are given updated procedures on a

regular basis. Employees who violate these policies and procedures are subject to disciplinary action and/or are punishable by law.

State announces 2005 income tax rate change

The inflation rate, as measured by the California Consumer Price Index (CCPI), for all urban consumers from June 2004 to June 2005, was 2.8 percent. The tax threshold has risen to an adjusted gross income (AGI) of \$10,764 for single or separate taxpayers and to \$21,527 for joint, surviving spouse, and unmarried head of household taxpayers.

The indexed values for tax year 2005 are as follows:

STANDARD DEDUCTIONS

(Revenue and Taxation Code Section 17073.5)

The standard deduction amount for single or separate taxpayers will increase from \$3,165 to \$3,254 for tax year 2005. For joint, surviving spouse, or head of household taxpayers, the standard deduction increases from \$6,330 to \$6,508 for tax year 2005.

PERSONAL EXEMPTIONS

(Revenue and Taxation Code Section 17054 (a)(b)(c))

The personal exemption credit for single, separate, and head of household taxpayers will increase from \$85 to \$87 for the tax year 2005. For joint or surviving spouse taxpayers, the personal exemption credit will increase from \$170 to \$174 for tax year 2005.

DEPENDENT EXEMPTIONS

(Revenue and Taxation Code Section 17054 (d)(1))

The dependent exemption credit will increase from \$265 per dependent claimed in 2004 to \$272 each for tax year 2005.

JOINT CUSTODY HEAD OF HOUSEHOLD/ DEPENDENT PARENT CREDIT

(Revenue and Taxation Code Section 17054.5)

Joint custody head of household was a filing status for pre-1987 tax years. It has been replaced as a tax credit for post-1986 tax years. This provision was further amended to add the dependent parent credit for tax years beginning on or after January 1, 1988. The original 1987 taxable year credit was \$200 or less, computed by multiplying the net tax by 30 percent. Indexing last year's credit of \$337 yields a 2005 credit of the lesser of \$346 or 30 percent of net tax.

QUALIFIED SENIOR HEAD OF HOUSEHOLD CREDIT

(Revenue and Taxation Code Section 17054.7)

Senate Bill 389 (Chap. 90-1154) created a tax credit, beginning with 1990 taxable year, equal to an amount of 2 percent of taxable income; not to exceed \$750. Due to legislation SB 673 (Chap. 93-877) the stated dollar amount and the related indexing provision were eliminated. Indexing was restarted for the 1993 taxable year. For the 2005 taxable year, the new maximum credit will be \$1,060. The new 2005 maximum AGI ceiling amount allowed for this credit is \$56,262.

QUALIFIED PARENT CREDIT/YOUNG INFANT CREDIT

(Revenue and Taxation Code Section 17052.20)

This tax credit was in effect for tax years 1991-1993. This credit has sunset and will not appear in the 2004 Personal Income Tax booklets. However, the credit still has carryover provisions. It is included on the 2005 form FTB 3540, *Credit Carryover Summary*.

RENTER'S TAX CREDIT

(Revenue and Taxation Code Section 17053.5)

Senate Bill 169 (Chap. 91-117) reduced the tax credit for renters. The credits were phased out based on a sliding AGI (Adjusted Gross Income) scale for tax year 1991. In 1992, these AGI amounts were subject to indexing. For tax years 1993 and 1994 the credit was suspended due to passage of AB 760 (Chap. 93-62). The credit was suspended for tax year 1995 due to AB 2389 (Chap. 94-144), for tax year 1996 due to SB 1794 (Chap. 96-192), and for tax year 1997 due to AB 1592 (Chap. 97-292). The credit was reinstated for tax year 1998 by SB 94 (Chap. 98-931) as a nonrefundable \$60 credit for single filers with an AGI under \$25,000 and a \$120 credit for joint filers with an AGI of \$50,000 or less. Indexing was restarted for taxable year 1999. The new 2005 indexed year AGI amounts are under \$30,794 for single filers and under \$61,588 for joint filers.

REDUCTION OF EXEMPTION CREDITS

(Revenue and Taxation Code Section 17054.1)

Senate Bill 169 (Chap. 91-117) activated the reduction of California personal exemption credits in conjunction to federal adjusted gross income levels. For each \$2,500 (\$1,250 if married filing separate) of AGI or fraction thereof which exceeds the threshold value, a reduction of \$6 (\$12 joint) will apply. The new indexed threshold values for the 2005 tax year are as follows:

Single, Married Filing Separate . . .	\$143,839
Head of Household	\$215,762
Joint, Surviving Spouse	\$287,682

CONTINUED ON PAGE 10

Tax rate change

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REDUCTION OF ITEMIZED DEDUCTIONS

(Revenue and Taxation Code Section 17077)

Senate Bill 169 (Chap. 91-117) also activated the reduction of California itemized deductions based on AGI similar to the federal reduction. The amount of the itemized deductions otherwise allowable shall be reduced by the lesser of (1) 6 percent of excess of AGI over the threshold amount or (2) 80 percent of itemized deductions otherwise allowed for the tax year. The new indexed threshold amounts for tax year 2005 are as follows:

Single, Married Filing Separate . . .	\$143,839
Head of Household	\$215,762
Joint, Surviving Spouse	\$287,682

RETURN FILING REQUIREMENTS

(Revenue and Taxation Code Section 18501)

Senate Bill 721 (Chap. 95-65) authorized the increase in the filing requirement thresholds and indexing of the thresholds in subsequent years. Starting with tax year 1995, the filing requirement thresholds for AGI amounts from all sources were: \$8,000 for an individual and \$16,000 for married filers. The threshold amounts for gross income from all sources were: \$10,000 for an individual and \$20,000 for married filers.

Assembly Bill 1140 (Chap.99-196) also changes certain minimum filing threshold amounts. They will be adjusted to account for the inclusion of the additional senior exemption credit(s) and the dependent exemption credit(s) allowed under previously referenced legislation. The chart on the next page reflects the indexed amounts for taxable year 2005.

Gross income more than:

Filing Status on 12/31/05	Age on 12/31/05	No Dependents	1 Dependent	2 Dependents
Single or Head of household	Under 65	13,085	22,152	28,952
	65 or older	17,435	24,235	29,675
Married filing jointly or Married filing separately	Under 65 (both spouses)	26,170	35,237	42,037
	65 or older (one spouse)	30,520	37,320	42,760
Qualifying widow(er)	65 or older (both spouses)	34,870	41,670	47,110
	Under 65		22,152	28,952
	65 or older		24,235	29,675

Adjusted gross income more than:

Filing Status on 12/31/05	Age on 12/31/05	No Dependents	1 Dependent	2 Dependents
Single or Head of household	Under 65	10,468	19,535	26,335
	65 or older	14,818	21,618	27,058
Married filing jointly or Married filing separately	Under 65 (both spouses)	20,935	30,002	36,802
	65 or older (one spouse)	25,285	32,085	37,525
Qualifying widow(er)	65 or older (both spouses)	29,635	36,435	41,875
	Under 65		19,535	26,335
	65 or older		21,618	27,058

Tax rate change

CONTINUED FROM PAGE 10

ALTERNATIVE MINIMUM TAX (AMT) EXEMPTION

(Revenue and Taxation Code Sections 17062(5)(A-C) and (6)(A-C))

Senate Bill 519 (Chap. 98-7) authorizes the start of new base exemption amounts for the AMT and their exemption phase outs. It also provides for the indexing of these amounts for subsequent years, commencing with tax year 1998. The exemption amounts for taxable year 2005 are:

Single or Unmarried:	\$52,898
Joint or Surviving Spouse:	\$70,531
Separate or an Estate or Trust	\$35,263

Starting initial amounts for AMT exemption phaseouts are:

Single or Unmarried	\$198,366
Joint or Surviving Spouse	\$264,488
Separate or an Estate or Trust	\$132,243

2005 TAX RATE SCHEDULES (Revenue and Taxation Code Section 17041)

	IF THE TAXABLE INCOME IS:			OF THE
	OVER	BUT NOT		AMOUNT
		OVER		OVER
Schedule X - Use if your filing status is Single or Married Filing Separate and Fiduciary Taxpayers	\$ 0	\$ 6,319	\$ 0.00 + 1.0%	\$ 0.00
	6,319	14,979	63.19 + 2.0%	6,319
	14,979	23,641	236.39 + 4.0%	14,979
	23,641	32,819	582.87 + 6.0%	23,641
	32,819	41,476	1,133.55 + 8.0%	32,819
	41,476	AND OVER	1,826.11 + 9.3%	41,476
Schedule Y - Use if your filing status is Married Filing Joint or Qualifying Widow(er) with Dependent Child	\$ 0	\$ 12,638	\$ 0.00 + 1.0%	\$ 0.00
	12,638	29,958	126.38 + 2.0%	12,638
	29,958	47,282	472.78 + 4.0%	29,958
	47,282	65,638	1,165.74 + 6.0%	47,282
	65,638	82,952	2,267.10 + 8.0%	65,638
	82,952	AND OVER	3,652.22 + 9.3%	82,952
Schedule Z - Use if your filing status is Head of Household	\$ 0	\$ 12,644	\$ 0.00 + 1.0%	\$ 0.00
	12,644	29,959	126.44 + 2.0%	12,644
	29,959	38,619	472.74 + 4.0%	29,959
	38,619	47,796	819.14 + 6.0%	38,619
	47,796	56,456	1,369.76 + 8.0%	47,796
	56,456	AND OVER	2,062.56 + 9.3%	56,456

SUMMARY

Indexed amounts for tax year 2005 are as follows:

Personal Exemption Credit:

Single, Separate, or Head of Household	\$87
Joint	\$174
Blind	\$87
Age 65 and over	\$87
Dependent Exemption Credit	\$272

Standard Deductions:

Single or Separate	\$3,254
Joint, Surviving Spouse or Head of Household	\$6,508

Credit for Qualified Senior Head of Household:

New maximum is	\$1,060 *
New AGI ceiling is	\$56,262

Credit for Joint Custody Head of Household:

Lesser of \$346 or 30 percent of net tax *

* Nonresident filers receive a prorated amount based on the percent of total AGI attributable to California sources.

Hurricane Katrina victims granted state tax relief

On September 8, the IRS extended the due dates for filing tax returns and paying taxes until January 3, 2006, for victims of Hurricane Katrina. The IRS will cancel interest and any late filing or late payment penalties that would otherwise apply. This tax relief applies to 64 Louisiana parishes, 52 Mississippi counties, 6 Alabama counties and 3 Florida counties. Refer to IRS press release IR-2005-91 dated Sept. 2, 2005 for the specific counties covered under this relief measure. The Franchise Tax Board will follow the federal treatment, extending the due date to January 3, 2006, and canceling interest and late filing or late payment penalties that would otherwise apply.

Taxpayers can claim the disaster loss in one of two ways: 1) in the year the disaster occurred, when they file their 2005 tax return next spring; or 2) taxpayers can claim the loss in the tax year before the disaster occurred by filing either an amended or original 2004 tax return. The advantage of claiming the disaster loss in the prior year is that the FTB can quickly issue a refund.

Taxpayers claiming the disaster loss should write "Hurricane Katrina" in red ink at the top of the tax return to alert the FTB to expedite the refund. If taxpayers are e-filing, they should follow the software instructions to enter the disaster information.

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