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Date: November 1, 2007
To: Interested Parties
From: Anne Miller
Subject: RDP Draft Instructions and Worksheet – Questions and Responses to draft FTB Pub. 737, Tax Information for Registered Domestic Partners

Hello,

Attached is our response regarding your questions and comments relative to the 9/14/07 preliminary draft of FTB Pub. 737, Tax Information for Registered Domestic Partners. FTB is preparing to release an updated draft FTB Pub. 737, which will include many of your suggestions. We expect to release the revised FTB Pub. 737 to you by 11/5.

The Questions and Responses document was sent to you as reference material for your review of the updated draft FTB Pub. 737. Upon release of our revised draft publication, we will be requesting your comments by 11/30/07. You can submit your comments to us at RDP@ftb.ca.gov. We plan to release the official FTB Pub. 737 on 12/17/2007.

Best regards,

Anne Miller, Chief
Filing Division
Franchise Tax Board
(916) 845-4905

RDP Draft Instructions and Worksheet - Questions and Responses

Subject	Question	Responses	Action Item
Question 1 - History	<p>1a. Why does the FTB think 2002 is the first year that there is any income tax effect for RDP's? If able to acquire CP since 2000 (first year Secty of State allowed registration) there may be community assets from then now generating CP income for state income tax purposes I would think.</p> <p>1b. I noticed in the attached draft regulations for SB 105 that 2002 is used as the operative date for when registered domestic partners were first recognized in California. However, the first domestic partner law went into effect on January 1, 2000. Is there a reason that 2002 is being used rather than 2000?</p>	<p>2000 is the first year that individuals could register as domestic partners. 2002 is the first year that RDPs could take a deduction for medical benefits.</p>	<p>Update history language in Pub. 737 to the following: Effective January 1, 2000, California legislation provided for the definition, registration, and termination of a domestic partnership with the California Secretary of State. It also provided an option for state and local public employers to extend benefits to domestic partners under the Public Employees' Medical and Hospital Care Act and specified domestic hospital visitation rights. Effective January 1, 2002, California legislation was enacted that treated a registered domestic partner (RDP) as a spouse of the taxpayer for certain medical tax benefits. Effective January 1, 2005, rights, benefits and privileges were added which treated RDPs the same as married persons, with the exception that they could not file a California income tax return in the same manner as married persons. Included within those rights, benefits, and privileges were community property rights (with the exception of earned income), which were applied to a registered domestic partnership as of the date of registration. This changed with the passage of law effective January 1, 2007, and now RDPs must file their 2007 California income tax returns using the Married/RDP Filing Jointly or Married/RDP Filing Separately filing status. For more detailed</p>

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			information go to our Website at www.ftb.ca.gov and search for Registered Domestic Partners and view legislative history.
Question 2 - Attachments	It indicates on page 1 of Pub. 737 to "Recalculate your AGI using a pro forma federal Form 1040 or the worksheet in this booklet. A pro forma federal Form 1040 must be prepared using the same filing status used on your California return." Is the Filing Status Adjustment Worksheet to be filed with the return or may a pro forma Form 1040 be substituted instead?	RDPs who have filing status adjustments due to the difference in their federal and state filing status can complete either a Pro Forma Form 1040 or the Filing Status Adjustment Worksheet. Whichever method the taxpayer uses is what should be included with the California return.	Add instructions to Pub. 737 explaining what attachments FTB expects.
Question 3 - Alimony	The lines for alimony received and alimony paid include an adjustment for the California amounts not included in federal income. If those are included in Column A on Schedule CA, is this really the Federal AGI that is calculating? Would the adjustments for those items in the Schedule CA instructions then be eliminated from the Schedule CA columns B and C if they are already in column A.	Alimony should be included as a filing status difference. RDPs will not make the adjustment on the Schedule CA. California conforms to federal for the treatment of alimony except for nonresident aliens. The Schedule CA instructions are accurately stated and are the same for married individuals and RDPs.	No action required.
Question 4 - Worksheet – v- Pro Forma	Are the amounts from Column D of the FSA Worksheet meant to be the same as the amounts that would calculate on the Pro Forma federal Form 1040? Including line 38 from Federal Schedule A, line 29?	Yes, the application of the worksheet and federal pro forma Form 1040 have the same result.	No action required.

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Question 5 - Tax Favored Accounts	<p>Several places indicate that an RDP will not be considered a spouse for purposes of calculating "tax favored accounts" when it would result in disqualifying the account for federal income tax purposes. And that more information will follow. Does that mean that Schedule CA lines 15/16 will differ from the federal return, as it would have recalculated with married filing joint filing status? Where and when will more information be available on that adjustment?</p>	<p>An RDP will not be treated as a spouse where such treatment would result in a tax-favored account not being qualified as a tax-favored account for federal income tax purposes. An RDP may have an adjustment to line 15 of the California RDP Adjustments Worksheet in Pub. 737, Tax Information for Registered Domestic Partners, if the RDP has a California-only basis in an IRA, which is recoverable from an IRA distribution. For example, an RDP may have a California-only basis in an IRA if the RDP's partner is an "active participant" in an employer-provided retirement plan. Based on the RDPs' combined adjusted gross income, the available deduction for an IRA contribution may be reduced for California income tax purposes. The disallowed amount of an otherwise deductible IRA contribution creates a California-only basis in the IRA, which the RDPs must keep track of, in order to recover from IRA distributions reported on future California income tax returns. Additional information regarding this adjustment will be available in the upcoming edition of Pub. 737.</p>	<p>Add instructions to Pub. 737 explaining possible adjustments to lines 15/16.</p>
Question 6 - Attachments	<p>What federal attachments are required to be filed with a paper filed return?</p>	<p>RDP's will follow the same attachment guidelines as married individuals. The resident tax booklet</p>	<p>Add instructions to Pub. 737 explaining what attachments FTB expects.</p>

RDP Draft Instructions and Worksheet - Questions and Responses

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		<p>states that if you completed federal forms or schedules other than Schedule A or Schedule B, attach a copy of your federal return and all supporting federal forms and schedules. RDPs should attach both individual federal form 1040's filed with the IRS. In addition if the RDPs completed the RDP Adjustment Worksheet or federal Pro Forma Form 1040 they should attach that document also. If software prohibits taxpayers from filing the required attachment(s), they should retain copies of all documentation as it may be requested through correspondence at a later date.</p>	
<p>Question 7 - Schedule S</p>	<p>For Schedule S, Other State Tax Credits, if both of the RDPs have taxes paid to another states on two single filing status returns, would the joint California return have one Schedule S with combined amounts? Or are two Schedule S forms calculated for taxes paid to the same state, one for each person?</p>	<p>RDPs would have one recalculated (as if they where spouses) Schedule S for each state.</p>	<p>No action required.</p>
<p>Question 8 – Reporting of wages, salaries, and other compensation</p>	<p>I request that you delete the last sentence on page 4 of the 9/14 draft of Publication 737. That sentence reads as follows: For federal purposes, you must report all wages, salaries, and other compensation received for your personal services on your own</p>	<p>The last sentence being referred to will be removed. Information will be added to inform RDPs how to proceed if they applied community property rules when reporting wages, salaries, and other compensation on their federal return.</p>	<p>Revise Pub. 737 to read: For more information on community property, see federal Publication 555, Community Property. RDPs will use the rules in federal Publication 555 for married people to determine how to apply those rules for California income tax purposes. The note in</p>

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	<p>return. I believe that the source of this position is in CCA 200608038 dated February 24, 2006. The Franchise Tax Board should not base its statements concerning federal tax law on the CCA. The CCA specifically states that "[i]n accordance with section 6110(k)(3) this advice may not be used or cited as precedent." Given that the CCA is the only federal document that takes the position quoted above, it is clear that the FTB is using the CCA as precedent, contrary to the prohibition of such use. Further, the CCA is legally indefensible and is contrary to United States Supreme Court precedent, specifically, <i>Poe v. Seaborn</i>, 282 U.S. 101 (1930) and <i>United States v. Malcolm</i>, 282 U.S. 792 (1931). See Ventry, <i>NO INCOME SPLITTING FOR DOMESTIC PARTNERS: HOW THE IRS ERRED</i>, 110 Tax Notes 1221 (2006). That precedent provides that community income is to be equally split between the owners of the income if those owners file separate income tax returns. Finally, the IRS is unwilling to reaffirm the position taken in the CCA. In response to a request for a private ruling on the income splitting issue, the IRS responded in April 2007 that the</p>		<p>Publication 555 regarding California RDPs applies to filing of your federal return.</p>

RDP Draft Instructions and Worksheet - Questions and Responses

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	<p>question should not be answered "in the general interests of tax administration." Accordingly, the FTB should not make the statement contained in the sentence that I have asked be deleted. If the FTB feels it must alert California RDP's to the 2006 position of the IRS, at a minimum the sentence should begin: "In 2006 the Internal Revenue Service has announced that . . ." The sentence should be followed the following sentence: "Many commentators believe that the IRS's stated position is incorrect, and taxpayers should consult with their tax advisers to determine the proper method for reporting their community property income on their federal income tax returns."</p>		
<p>Question 9 – SB 1827</p>	<p>A recent article in the San Jose Mercury News addressed the confuins and illogical discrepancy between California and Federal taxes laws for same sex couples filing status. Can you clarify the purpose and legality of changing the tax filing status of long term; lawfully married California couples where one partner undergoes gender reassignment?</p>	<p>SB 1827 did not change the law as described in the question. SB 1827 applies to taxpayers who are registered domestic partners.</p>	<p>No action required.</p>
<p>Question 10 – comment regarding federal conformity.</p>	<p>I don't think we should have this complexity of filing single for federal and married for state until the IRS allows us to file as</p>		<p>No action required.</p>

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	<p>married. I am already double taxed by the feds on my domestic partners insurance and now this. What a nightmare.</p>		
<p>Question 11 – Line 32 Instructions</p>	<p>I read through publication 737 draft instructions for California Registered domestic partners and would recommend that you include some examples for line 32 instructions regarding IRA's. The verbiage is not clear with respect to the tax consequences of one partner deducting an IRA on a Federal return when the joint income for California purposes would exceed the dollar limit for opening an IRA account.</p>	<p>For federal income tax purposes, RDPs are not treated as spouses. For California income tax purposes, RDPs are treated as spouses and are subject to the income-related phase out limitations for calculating an IRA deduction. For example, if an RDP's partner is an "active participant" in an employer-provided retirement plan the available deduction for an IRA contribution may be reduced for California income tax purposes depending on the RDPs' combined adjusted gross income. This California adjustment to an IRA deduction would be reported on line 32 of the California RDP Adjustments Worksheet. The disallowed amount of an otherwise deductible IRA contribution creates a California-only basis in the IRA, which an RDP must keep track of, in order to recover from IRA distributions reported on future California income tax returns.</p>	<p>Add instructions to Pub. 737 explaining examples of adjustments to line 32.</p>
<p>Question 12 - Examples</p>	<p>I think examples of how to file Form 540 or 540 NR for the various scenarios you outlined with one partner out of state part of the year or when one partner earns income outside of California would be very helpful as well.</p>	<p>Nonresident and part-year resident RDPs would follow the same general rules as a nonresident or part-year married couple would. The Nonresident Booklet and FTB Pub. 1100, Taxation of Nonresidents and Individuals Who Change Residency</p>	<p>No Action Required</p>

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		provides information for individuals who have moved into or out of California or has earned income outside of California.	
Question 13 – State Income Tax Refunds	I think some more caveats of potential Federal problems would be worthwhile as well. I realize there are a lot of unknowns, but the draft offers no guidance on how tax refunds of State Income Tax will affect the individual Federal tax returns of rdp's.	Taxpayers should consult the IRS on how to report their joint California refund on their federal return. FTB will issue a joint refund and a joint 1099, to RDPs who file their California returns using the MFJ filing status. 1099's are issued using the primary SSN and Primary First and Last Name if both taxpayers share the same last name. If the taxpayers have different last names and file as MFJ the 1099 will have the Primary SSN, Primary RDP First and Last Name and RDP Last Name. FTB will issue individual refunds and individual 1099s, to RDPs who file their California returns using the MFS filing status. Taxpayers may need to consult their tax professionals on how tax refunds of State Income Tax will affect the individual Federal tax returns.	No action required.
Question 14 – IRS Coordination	A little verbiage on efforts being made to coordinate information with the IRS to avoid causing audits on all California rdp's would be helpful as well, unless there are no efforts to coordinate with the IRS.	FTB is aware that RDPs will be reporting different AGIs, etc. on their federal and state return(s). Information about income differences for all taxpayers is only passed to the IRS if the FTB conducts an audit. An RDP would not be singled out for a difference between federal and state income.	No action required.

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Question 15 - Alternative Minimum Tax	Will the computation of AMT be different for Registered Domestic Partners?	RDPs will compute their AMT the same as married individuals. RDPs will base their California AMT from each partner's individual tax return filed with the Internal Revenue Service (IRS). Exception: RDPs who completed the California RDP Adjustments Worksheet or federal pro forma Form 1040 will compute their AMT using their recomputed AGI.	Language will be added to Schedule P.
Question 16 – Identifying RDP's	How are you going to identify RDP returns, if they are simply checking the Married/RDP filing joint, or Married/RDP filing separate boxes, there will be nothing on the California return to identify that they are RDPs. We are concerned that this is going to create an AGI matching problem, because there won't be anything on the Schedule CA to explain the difference. So, is there anything in place to prevent them getting notices?	A new line was added to Forms 540, 540A, 5402EZ, and 540NR long and short that asks the taxpayer " If your California filing status is different from your federal filing status, fill in the circle here..." This line will identify taxpayers with different filing status, such as certain military servicemembers and RDPs.	Add language to Pub. 737 instructing taxpayers to check the box on the return.
Question 17 - Purpose	The introduction discourages RDPs from reading the Publication, since it indicates that not all RDPs will need it. Even if an RDP doesn't have a filing status adjustment, the application of community property rules needs to be addressed, as this in and of itself affects all RDPs, when they choose to file separately to	We will revise the purpose in Pub. 737 to include information for RDPs filing separately and RDPs that have dissolved or terminated their registered domestic partnership.	Add language to the purpose to cover these situations.

RDP Draft Instructions and Worksheet - Questions and Responses

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Question 18 – Worksheet instructions	<p>California and if the RDPs dissolve or terminate their community.</p> <p>We find the worksheet and instructions confusing. For example, page one instructs the reader to prepare a “proforma” Federal Form 1040, but Columns A and B use the words “taxable amounts from your revised Federal return”. Since revised and proforma have two completely different meanings, it is unclear what should be entered into Columns A & B. It could suggest to the unwary, that they need to revise the Federal return that is prepared to begin the basis of deciding if there are filing status adjustments.</p>		Update Pub. 737 for column’s A and B to indicate "original federal return."
Question 19 - Acquisition indebtedness and Home equity indebtedness	The instructions say to enter the amount of your mortgage on line 38, up to \$1M and home equity indebtedness to \$100K, rather than the interest on those amounts and a reference to IRS regs for how to calculate the appropriate amounts.		<p>Update New Line 38 Instructions, Pub. 737.</p> <p>Acquisition indebtedness - The aggregate amount treated as acquisition indebtedness for a period shall not exceed \$1,000,000 (\$500,000 in the case of a married individual or an RDP filing a separate return). If your combined acquisition indebtedness is over \$1,000,000, enter the amount of interest on your indebtedness (up to \$1,000,000) on your refigured federal Form 1040, line 10 or line 11, Schedule A.</p>

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			<p>Home equity indebtedness - The aggregate amount treated as home equity indebtedness for any period shall not exceed \$100,000 (\$50,000 in the case of a married individual or an RDP filing a separate return). If your combined home equity indebtedness is over \$100,000 enter the amount of interest on your indebtedness (up to \$100,000) on your refigured federal Form 1040, line 10 or line 11, Schedule A.</p>