

## New declaration form can help clients validate critical facts

Taxpayers involved in an audit, protest, appeal, settlement, or similar situation, can use a legal device called a declaration to provide us with information from third parties that may help us understand their particular situation.

A declaration is an unsworn statement that is admissible as evidence in a legal transaction. Declarations are most helpful when they properly substantiate the facts or events in question. Unfortunately, too many times they fail to give us what we need. To help taxpayers get the most out of a declaration, we have created a standardized declaration form and made it available on our Website.

The form, FTB 2153 C1 PC, *Declaration Form*, greatly simplifies the third party verification process for taxpayers. Taxpayers can access it online, fill it out, print and mail it. The form asks the third parties to provide information such as their relationship to the taxpayers, the length of time they have known the taxpayers, and the exact dates and locations of specific events. The third parties must also sign it and declare under penalty of perjury under the laws of the State of California that their statement is true and correct.

To access FTB 2153 C1 PC, log onto our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov), go to our *Forms and Publications Webpage*, and scroll through the 2004 Forms. Or type the keyword phrase 2153 into our search engine.

## Credits, deductions, and more being considered by lawmakers

Among the measures being considered by the Legislature during its 2005/2006 session are some that would provide tax credits. They include bills dealing with these subjects: **Editor's note:** *These are only summaries. You can review the entire text of each bill as well as our analysis by visiting the Laws and Legislation section of our Website. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov) and click on the Laws and Legislation link.*

### Enterprise zones, targeted tax areas, etc...

AB 199 (Tran) would authorize the Department of Housing and Community Development to designate an additional 10 enterprise zones, increasing the maximum total of enterprise zones to 52.

AB 1361 (Dymally) would allow the Central City, Mid-Alameda, and Northeast Valley enterprise zones located in the County of Los Angeles to have a 20-year designation period.

AB 1497 (Baca) would require the Department of Housing and Community Development to designate a specified geographic area in the City of San Bernardino as an enterprise zone.

SB 6 (Ducheny) would allow all enterprise zones to keep their designation for 20 years if they meet certain criteria.

SB 565 (Migden) would increase the maximum amount of low-income housing tax credit that may be set aside for small developments.

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# Tax News

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**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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## FTB closes Bakersfield office

We will close our Bakersfield public lobby and field office on July 1, 2005. The closure is due to the current state budget situation.

We now have six remaining open lobbies. Although these facilities no longer have staffed public service counters, you can use the facilities' telephones to contact our customer service call centers. The six open lobbies are located in:

- Fresno
- San Bernardino
- San Jose
- Santa Rosa
- Stockton
- Ventura

We have six staffed public service counters located in our field offices in the most densely populated areas of the state. They are located at:

Los Angeles Field Office  
300 S. Spring Street, Suite 5704  
Los Angeles CA 90013

San Diego Field Office  
7575 Metropolitan Drive, Suite 201  
San Diego CA 92108

Oakland Field Office  
1515 Clay Street, Suite 305  
Oakland CA 94612

Santa Ana Field Office  
600 W. Santa Ana Blvd. Suite 300  
Santa Ana CA 92701

Sacramento Field Office  
3321 Power Inn Road, Suite 250  
Sacramento CA 95826

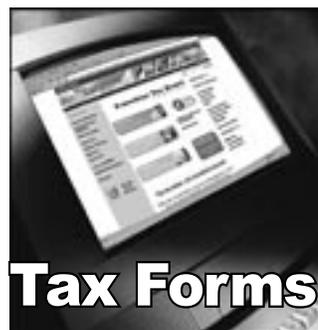
San Francisco Field Office  
121 Spear Street, Suite 400  
Rincon II Annex  
San Francisco CA 94105

You can obtain walk-through revivor service, for a fee, at all staffed public service counters. Our lobbies and public service counters are open from 8:00 a.m. to 5:00 p.m., Monday through Friday. We are closed on state holidays.

## Interest rates to change in July

For the period of July 1, 2005 through December 31, 2005, the adjusted interest rate on underpayments of California personal income tax, and, corporate income and franchise taxes will be **5 percent**. The interest rate on corporation overpayments for the same period will be **2 percent**.

For past interest rate information, visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and type the phrase *interest rate* into our search engine.



**Updates  
available online  
[www.ftb.ca.gov](http://www.ftb.ca.gov)**

# Tax Forms

# Ask the Advocate



**Debbie Newcomb**  
Taxpayer Advocate

A tax practitioner writes:

*You use mortgage interest statement information that you receive from the Internal Revenue Service to create substitute returns for nonfilers. Why do you send bills based on these substitute returns to individuals who are below the gross income threshold for filing California returns?*

*This happened to one of my clients and when I contacted you about it, you told me that my client must provide evidence that someone else paid the mortgage via cancelled checks or file the return. Why can't a tax representative's phone call be sufficient? Why must my client incur professional fees to file a return showing no income?*

Because we treat income information reports such as the 1098 as official reporting documents, we cannot disregard them based on verbal statements regarding their validity. That is not to say though, that we require returns to be filed. As you indicated in this case, the taxpayer can avoid filing a no-income return by providing evidence that someone else paid the mortgage and that the payments were not in place of salaries or wages.

We do not prepare substitute returns using this income indicator. While we do use information reports as a primary means of identifying individuals who have not filed the required returns, the reports are not the sole basis for our decision to create substitute returns. When individuals meet a particular filing threshold and we cannot locate a matching return for them, we first send them a letter asking them to either file the missing return or explain why they are not required to file. If they do not respond to our letter, we issue a demand for the return and an (proposed) assessment of the tax due based on a reasonable interpretation of their reported income.

Even at this point, it is still not too late for individuals to provide information to us. However, if they do not the assessment will become final and eventually a collectible tax obligation. The bottom line is: instruct your clients to respond to our request for return letters promptly, even if they do not have a filing requirement. Contact us immediately using the information on the notice, or go online to visit our INC Website, located at [www.ftb.ca.gov](http://www.ftb.ca.gov), keyword: INC.



## California e-File CD

In December we began mailing the e-file CD to all approved California e-file participants. Did you get yours? It contains the *2004 e-file Handbook* (FTB Pub. 1345), *2004 e-file Handbook Supplement* (FTB Pub. 1345A), new signature options, e-file quick references, and other resource information.

This is our third year of providing the publications on CD instead of paper. Our CD includes a link to our online survey to give you an opportunity to tell us what you think.

You can also obtain our e-file publications and information about our new signature options from the *Tax Professionals Gateway* located on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov).

## You can e-file through October 15, 2005

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 15, 2005 (**note:** the extended due date for the Internal Revenue Service is August 15, 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 Form 8633) online at [www.ftb.ca.gov](http://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.

## Include all California corporation numbers when listing affiliates on clients' Schedule R-7

Not so long ago, all the members of a combined reporting group had to file their own Form 100, *Corporation Tax Return*, and attach a copy of the same combined report to their returns. This resulted in a lot of duplication and more mistakes. In general, filing combined group returns was burdensome for you, your clients, and us.

Lawmakers eventually found a way to make our lives easier. *California Revenue and Taxation Code* Section 25101.15 gave us the authority to allow two or more corporations conducting a unitary business wholly within California to file a combined report. Then *California Code (of) Regulations* Section 25106.5-11 took things one step further, allowing members of the same combined reporting group to file a single group return, thereby satisfying each affected taxpayers' filing requirements. Affiliated taxpayers were able to avoid filing duplicative returns and we were able to work with one corporation per combined report instead of many.

Unfortunately, today we are experiencing an excess of corporation returns with incomplete information, a condition that is creating significant return processing delays and threatening to return us to those more burdensome times. However, there is something you can do to help us to work faster and at the same time, help you ensure that your corporation clients' tax returns receive our prompt attention.

When your client is the designated key corporation for a combined reporting group, be sure to provide the California corporation number for your client and for every member of the combined

reporting group. It is not enough to give us just the federal employer identification number. Record the information on the Schedule R-7, *Election to File a Unitary Taxpayers' Group Return and List of Affiliated Corporations*.

List all the California corporation numbers into the table entitled, Part 1, *List of Taxpayers Making Election to File a Single Unitary Taxpayers' Group Tax Return* (See page 5).

The California corporation number is critical because it provides us with the most effective and reliable way to verify the information on the return. We can process returns faster and more accurately with the California corporation number.

When your clients are the designated key corporation, they are also required to list for us any members of their commonly controlled group that they did not list in Part 1 of the Schedule R-7. Record the California corporation numbers for these taxpayers in the section entitled, Part 2, *List of Affiliates Not Included in Part 1* (See page 5).

If the number of taxpayers in the group exceeds the space provided, you can attach additional sheets to the return. Just ensure the attachments provide the same information as the schedule. **Tip:** Many tax preparation programs can create these attachments for you. Ask your software provider.

You can find more information in FTB Pub. 1061, *Guidelines for Corporations Filing a Combined Report*.

## Using technology, teamwork, to close the tax gap

Our *Integrated Nonfiler Compliance Program* (INC) is one of our most effective tools we use against California's growing tax gap. A highly sophisticated information warehouse, INC identifies nonfilers by accurately associating income information with individuals and business entities who have not filed state tax returns and information reporters who have failed to meet their filing requirements.

Each year, INC collects income information from financial institutions, the Employment Development Department, the Internal Revenue Service, and other various sources to help us identify people who should have filed California personal income tax returns for the previous tax year.

This year we mailed more than 615,000 notices to individuals who should have filed tax returns for tax year 2003. So far we have received 20,000 tax returns and more than \$55 million of revenue as a result. We anticipate that we will collect approximately \$390 million in tax revenue by June 30, 2005, when our fiscal year ends.

INC efficiency has helped us to also eliminate unnecessary taxpayer contacts as well as improve customer service.

For example, nonfilers who receive a notice can access a Website that contains information that can assist them in filing a tax return and resolving any questions they may have concerning their notice. They can reply to their specific notice, verify their balance due amount, and get tax forms there as well.

When we conducted a survey in 1999 to find out why people do not file their tax returns, we found that:

- 21 percent failed to file due to personal problems (e.g., divorce, death in family, etc.).
- 17 percent did not have the necessary paperwork (e.g. Form W-2, Schedule K-1, 1099s, etc.) to file.
- 13 percent did not have the money to file.
- 10 percent simply procrastinated.

Regardless of which category they fall in, if any of your clients have filing requirements but have not filed their return, urge them to file now and avoid further penalties and interest.

If they have already received a nonfiler notice from us, advise them to contact us immediately using the information on the notice, or go online to visit our *INC Website*. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov), keyword: INC.



## Lawmakers consider deductions for disasters, education

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### Enterprise zones, targeted tax areas, etc...

SB 1001 (Ashburn) would increase the qualified property limitation for the *Targeted Tax Area Sales and Use Tax Credit* from \$1 million to \$10 million under the personal income tax law and from \$20 million to \$50 million under the corporate income tax law. It would modify the definition of qualified taxpayer to include limited liability companies.

### Health insurance

SB 195 (Maldonado) would create a tax credit for taxpayers that provide health insurance for their employees.

### Long-term care

AB 247 (Walters) would allow a credit to taxpayers who purchase long-term care or long-term care insurance.

AB 298 (Berg) would extend the long-term caregiver credit six years.

SB 139 (Margett) would allow a credit equal to 30 percent of the amount paid or incurred by the taxpayer during the taxable year for the cost of the long-term care or long-term care insurance.

### Manufacturers' Investment Credit

AB 344 (Villines) declares the Legislature's intent to reinstate the *Manufacturers' Investment Credit*, which was repealed by its own terms on January 1, 2004.

AB 845 (Ridley-Thomas) would create a 6 percent tax credit for certain manufacturing businesses. The bill would allow qualified taxpayers subject to the *Corporation Tax Law* a tax credit of 6 percent of the cost of qualified property used in a qualified activity.

### Manufacturers' Investment Credit

SB 631 (Dutton) would:

- Reinstate indefinitely the *Manufacturers' Investment Credit*.

- Extend the *Manufacturers' Investment Credit* to activities related to electric services (power generation, transmission, or distribution).
- Extend the *Manufacturers' Investment Credit* to activities related to providing broadband services or leasing equipment to a broadband services provider.

### Military

SB 243 (Dutton) would allow members of the Armed Forces who are deployed in a combat or war zone a tax credit for the amount of property taxes paid on their primary residence.

### Teacher Retention Credit

AB (Nava) would repeal the current suspension of the *Teacher Retention Credit*.

AB 1631 (Klehs) would provide an exception to the estimated tax underpayment penalty for individuals who underpaid their estimated taxes for the 2004 taxable year due to the unexpected suspension of the *Teacher Retention Credit*.

### Transportation

AB 1629 (Bermudez) would provide tax incentives for the purchase and installation of particulate traps for use on diesel fuel trucks that are operated primarily within this state.

AB 810 (Parra and McCarthy) would provide a tax credit and an accelerated deduction to taxpayers that make expenditures to produce less polluting diesel fuel.

### Changes to existing tax credits

SB 27 (Escutia) would, for taxable years 2005 and 2006, make the following changes to existing law:

- Reduce the amount of tax credits, except the *Low Income Housing Credit*, that can be used for any year from 100 percent of the taxpayer's

tax liability to 50 percent.

- Extend the carryover period, which vary from four years to unlimited, of the affected credits by two years.

### Tax deductions

The Legislature is considering several bills involving tax deductions. They include bills dealing with these subjects:

#### Disasters

AB 18 (La Malfa) would allow taxpayers special tax treatment for losses sustained as a result of the Shasta County wildfires.

AB 164 (Nava) would allow taxpayers special tax treatment for losses sustained as a result of the severe rainstorms and related events that occurred in Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura Counties.

SB 923 (Florez and Ashburn) would allow taxpayers special tax treatment for losses sustained as a result of the West Nile virus.

#### Education

AB 3 (Blakeslee) would allow a deduction, not to exceed \$750 per taxable year per each designated beneficiary, as a deduction to taxpayers who make contributions to a qualified tuition program and to a *Coverdell Education Savings Account*.

SB 30 (Speier) would allow qualified taxpayers a deduction for contributions to a *Golden State Scholarship Trust Account*.

### Conformity

Here are several bills the Legislature is considering that would conform California income tax laws to federal laws:

AB 115 (Klehs) would conform California law to two federal changes made by the *American Jobs Creation Act of 2004* relating to income from the discharge or cancellation of indebtedness.

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## Some bills would conform certain state laws to federal laws

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AB 398 (Villines) would increase the dollar amount of business assets that a California business taxpayer may elect to deduct currently, in lieu of depreciation, up to the current federal maximum amount of \$100,000.

SB 173 (Maldonado) would, starting in 2006, allow the same deduction on California returns for contributions to a health savings account as is allowed on the federal return.

SB 217 (Dutton) would conform current law to federal law on what is known as the claim of right deduction. This relief would be retroactive.

SB 995 (Florez, et al) would expand the list of bonds that are treated as California tax-exempt to include, in conformity with federal income tax laws, certain bonds issued by Indian tribal governments located in California, if they meet specific requirements.

### Voluntary contributions and more:

Among the bills the Legislature is considering are some that deal with compliance, the military, voluntary contributions, and more:

#### Capital gains

AB 249 (DeVore and Walters) would require us to make additional types of income reportable on Form 540 2EZ, including capital gain income.

#### Compliance

AB 853 (Jones) would extend the life of a state tax lien, only for purposes of the use of our *Earnings Withholding Orders for Taxes*, until the underlying tax liability is satisfied.

AB 1628 (Klehs) would permit the failure to withhold penalty to be assessed immediately after a failure to withhold occurs and to base the imposition of the

penalty solely on the agent's failure to withhold.

#### Homeowner's Property Tax Exemption/Senior Citizens

AB 185 (Plescia) would increase the homeowner's property tax exemption for individuals 62 years or older.

#### Limited liability companies and limited liability partnerships

AB 180 (J. Horton) would allow engineers and land surveyors to do business in the form of a limited liability partnership.

SB 555 (Machado) would:

1. Coordinate the tax payment and withholding requirements applicable to nonresident members of certain limited liability companies.
2. Repeal *Revenue and Taxation Code* Section 24348.5, an obsolete provision relating to savings and loans.

#### Military

SB 1002 (Machado) would make a separate, one-time \$250,000 appropriation to the Military Department from the *California Military Family Relief Fund* for the 2004/2005 fiscal year. The appropriation would be for California National Guard families experiencing severe financial hardships.

#### Payment options

SB 157 (Ackerman) would allow taxpayers, including business entities, to enter into partial payment installment agreements to satisfy a tax liability.

SB 860 (Bowen) would prohibit any state agency or its agents that accept credit cards or debit cards for the payment of services or obligations from imposing a processing fee or

charge for the use of a credit or debit card that is not also imposed upon persons who pay for the same service or obligation by cash or check.

#### Penalties

SB 14 (Campbell/Runner) would protect taxpayers from underpayment of estimated tax penalties incurred through no fault of their own.

#### S Corporations

SB 259 (Campbell) would allow corporations, required in 2002 to be S corporations, to use C corporation tax attributes created prior to 2002.

#### Tax preparation

AB 483 (Nunez) would prescribe guidelines to regulate income tax refund anticipation loans.

AB 1167 (Chu) would require us to develop guidelines and adopt regulations that assist tax advisors and practitioners in complying with state income tax laws.

#### Tax rates

AB 6 (Chan and Vargas) would increase the top personal income tax rates to 10 percent and 11 percent for certain taxpayers and would increase the alternative minimum tax rate to 8.5 percent. This bill also would reduce the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63.

AB 1375 (Nation) would increase the tax rate by 2.5 percent to 13.34 percent on banks and financials making certain types of loans.

AB 1403 (Coto) would increase the top personal income tax rates to 10 percent and 11 percent and would increase the alternative minimum tax rate to 8.5 percent.

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# Some bills would establish funds for voluntary contributions

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SB 26 (Hollingsworth) would:

- Reduce all personal income tax rates over a five-year period to zero.
- Eliminate the alternative minimum tax by January 1, 2009.
- Modify how nonresidents and part-year residents are taxed.
- Repeal Proposition 63 that imposes an additional 1 percent tax on the portion of a taxpayer's taxable income that exceeds \$1,000,000.

## Tax Rebates

SB SCA and SCAX 2 (McClintock) would require the State to rebate to personal income tax return filers revenues collected in excess of the amount appropriated by the Legislature.

The rebate would occur in the following fiscal year and the amount would be in proportion to social security taxes paid.

## Voluntary contributions

AB 357 (S. Horton) would establish the *Veterans' Quality of Life Fund* for taxpayers to designate a contribution on the personal income tax return.

AB 483 (Nunez) would extend the sunset dates of the *California Firefighters' Memorial Fund* and the *California Peace Officer Memorial Foundation* from January 1, 2006, to January 1, 2011.

AB 819 (Ridley-Thomas) would establish the *California Colorectal Cancer Prevention Fund*.

SB 407 (Margett) would establish the *Postsecondary Education Trust Fund*.

## Water's-edge

SB 663 (Migden) would:

- Clarify that a controlled foreign corporation that is a California taxpayer cannot exclude its subpart F income from a water's-edge return.
- Clarify that a controlled foreign corporation that has U.S.-source income cannot exclude its subpart F income from a water's-edge return.
- Coordinate existing laws so that the U.S.-source income rules and the subpart F income rules would operate simultaneously and apply consistently to corporations regardless of whether they are California taxpayers.
- Require us to issue regulations to resolve problems relating to potential double taxation of U.S.-source and subpart F income.

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