

## **2011 FTB QUESTIONS AND ANSWERS**

The following are questions presented by the CalCPA Committee on Taxation to the FTB for their November 2011 liaison meeting, along with the FTB's answers.

### **1. FTB PRACTITIONER HOTLINE**

#### **Question:**

We appreciate the FTB's quick response to the Practitioner Community's complaints about the one (1) case per call policy adopted by the FTB last April. Increasing the number of cases per call to three (3) certainly will make our dealings with the Hotline more efficient. What is the FTB's reasoning behind limiting the cases per call at any amount? Your response may help us understand the hurdles you face in providing this very valuable service to the Practitioner Community.

Most times we can work with the Hotline personnel without a Power of Attorney, but in other instances it is necessary to have one. It used to be that the Hotline would accept a faxed Power of Attorney, but some Practitioners are saying that the Hotline will not accept Powers of Attorney via fax but require that they be filed in a central data base. The process of mailing or faxing a Power of Attorney and then having it processed can take some time. At times, Practitioners' calls to the Hotline have an urgency to them that can complicate matters if they aren't dealt with quickly. Is it possible to reinstate the capability?

Also, could you provide in your response to this question what type matters will require a Power of Attorney when dealing with the Hotline and the providing of a taxpayer's AGI, address, etc. aren't enough?

#### **Answer:**

To minimize call wait times, maintain a high level of access, and service as many Practitioners as possible, we must limit the number of cases per phone call. Staffing is the major reason for our limitations to handling unlimited amounts of requests per call, which is why we are currently at 3 cases per call. In order to meet your needs, FTB has developed other alternatives to provide service. The Practitioner Community has asked FTB over the years to estimate tax information available on our web site. More than 10 years ago we were able to accommodate some of those requests, having PIT estimated tax information viewable on the FTB website. Over the years more PIT features have been added. Just this past February, current-year BE estimates were added and we will continue to add other BE features over the next few years as budget allows. Even with our newest feature, the ability to view current BE estimate tax payments, Hotline staff continue to receive many calls wanting to verify current BE estimates.

A POA is not needed if you are able to give specific information in order to pass Security and Disclosure regarding your client such as:

- Your name, your phone number and how you represent the taxpayer
- Taxpayer's address/account number
- Billing notice information
- AGI or "secret" you would have from a return filed.

We can only verbally convey information to the Practitioner, via the Tax Practitioner Hotline. In order for us to send written information, a POA is required. If you were not able to give information to the satisfaction of the agent, you would be asked to fax in a POA before any further discussion on the account.

The current Hotline procedures for accepting a faxed POA are as follows:

- The Hotline agent requests a POA because the Practitioner did not pass Security and Disclosure.
- The Practitioner is asked to fax the completed POA to the agent and is advised to call back in 2 hours (which is our turnaround timeframe).
- When we receive the POA, the information will be updated on their client's file.
- Upon the return call from the Practitioner, any agent can handle the call to resolution.

To help expedite service, when your new client completes a POA, immediately fax it to the POA Unit at (916) 843-5440. The information is updated in 7 to 10 business days. By doing this ahead of time, the information would be on file in our database and Hotline staff would be able to assist you during your first contact.

## **2. E-FILING FIDUCIARY TAX RETURNS**

### **Question:**

IRS has mandated that preparers filing 100+ returns file fiduciary returns electronically. Not being able to file the Form 541 electronically makes the filing more complicated. Either the taxpayers have to elect out of federal e filing or they have to deal with two different methods of filing for the same year.

When will the Form 541 be available for e-filing? Have you considered approaching the programming in small steps? The first year, you could just accept simple trusts with no tax due, and then next add simple trusts paying tax on capital gains, eventually getting to fiscal year returns with multiple beneficiaries and tax due. It would be better to e-file some returns than none.

**Answer:**

The current format that the IRS allows for fiduciary e-file is a legacy platform that will be discontinued within the next 2-3 years and replaced by a new modernized format. The e-filing of FTB Form 541 (fiduciary return) will likely be implemented in conjunction with the implementation of Form 1041 in the new modernized format in either 2013 or 2014, after the IRS has completed implementing the modernized format for personal income tax. Most software providers have indicated to FTB they would not support fiduciary e-file for CA until then.

Regarding the suggestion to implement Form 541 in small steps and/or accept simple returns initially would not necessarily resolve the development issue. The technical complexity is not really the concern of the software developers. The concern is more centered on the issue of having to invest resources (time and money) to develop something that would have to be re-written in a couple of years.

**3. MY FTB ACCOUNT****Question:**

We as Practitioners appreciate the information that the FTB is making available on My FTB Account. That said, we would like to make some suggestions that would help us use this more efficiently and effectively.

1. If we want to access multiple years for one particular client, we have to go back to the Client Selection page and re-enter all of the data. It would be a lot more efficient if we could move from year to year using minimal amount of keystrokes.

**Answer:**

Once a client has been selected, it is not necessary to re-enter all the information/"secrets" to see different tax years. Once in a client's account, you can select different options or tax years by using the navigation buttons at the bottom of the page (e.g., the "Back" button or the "MyFTB Account Options" link). If you click the "Exit MyFTB Account" link or "Select another client" link, then you will need to enter all the information/secrets again to view that client's information.

2. Account Summary – it doesn't appear that any information is available under this option if there isn't a balance due. This type of history can be valuable when looking to see what transactions the FTB has on file in the current or previous years.

**Answer:**

Currently, tax year information is not available in MyFTB Account if there is no balance due on a tax year. We understand this information may be important and valuable. We are currently evaluating when we will be able to make this information available.

3. Under the View Estimated Tax Payments and View Payment History options it appears that the history is available if a return has been filed. As with the Account Summary, this history still contains valuable information that can be used by Practitioners in subsequent years.

**Answer:**

Under “View Estimated Tax Payments”, you can view up to 25 estimated payments, estimate transfers, and extension payments that have not been applied to a tax year (i.e., a return hasn’t been filed). Under “View Payment History”, you can view up to 60 of the most recent payments applied to a balance due. Currently, the payments that are viewable are those that were applied to a tax year in the current calendar year or the preceding calendar year. As we are evaluating the ability to view zero balance tax years, we are evaluating the ability to allow viewing payments applied more than the current and previous calendar years.

More questions regarding logging on to My FTB Account:

1. One of the required pieces of information for logging on to a taxpayer’s account is an item shown on the prior year’s California return. In the case of a business entity in its first year, this information is not available. Is it possible to access this taxpayer account in the first year?

**Answer:**

At this time, there is no option to access a taxpayer’s account that hasn’t filed a return. The issue is that without a return being filed, there isn’t really information in our system that we would be able to use for authentication/verification online.

2. Do you have an estimated date when we will be able to get information related to trust and estates on My FTB Account?

**Answer:**

Currently, we estimate trusts and estates will be able to access MyFTB Account mid to late 2012.

#### 4. WEB PAY

**Question:**

LETTER ATTACHED

In April of 2011, I set up Web Pay estimated tax payments for my client, XXXXXXXX X XXXXX SSN: XXX XX XXXX because she is required to make her payments electronically. XXX XXXXX is elderly and not computer literate, so she asked me to set up the payments for her. Inadvertently, I set up duplicate payments for all three quarters of 2011. When we discovered in May that the FTB had taken two installment payments from her bank account on April 15, 2011, I called the Web Pay phone number and cancelled all the remaining payments scheduled for 2011. I was told over the phone that the payments had cancelled as of that date. I received no confirmation number of the cancellation, only verbal assurance that the cancellations had taken place. I then set up the remaining payments for the corrected amounts for the rest of the year. On June 15<sup>th</sup> the taxpayer called me to tell me that the FTB had taken THREE estimated tax payments from her bank account on the 14<sup>th</sup> of June and was wondering what was going on. After repeated phone calls to the Web Pay phone line we, I think, have corrected the problem.

Your Web Pay system is flawed and needs to be changed so that when a scheduled payment needs to be cancelled or changed, the caller is given a confirmation number or record that this has been done. There is no way a caller has any assurance that the payment has been cancelled or changed. We spoke with 4 different agents in trying to resolve this matter and they each were only able to give us their name and suggest that we note the date and time of the phone call. This is not very useful when we are dealing with large sums of money.

When a payment is scheduled the caller can download a confirmation of the transaction for their records. This should also be the procedure when a scheduled payment needs to be cancelled. Your instructions for Web Pay indicate that a payment can be cancelled if done by phone by at least two business days before the scheduled payment date. In this instance the payments for June 14, 2011 were supposedly cancelled on May 24, 2011, well within the allotted time for cancellation. However, the payments for June 14<sup>th</sup> had NOT been cancelled at all but they did cancel one of the payments scheduled for December 28<sup>th</sup>.

When I called today, the person I spoke with (Heather) said there was a method whereby a taxpayer could call and set up a payment if required to pay electronically. I can find no such phone number in any of the Web Pay literature; nor is one provided by my tax preparation software. If this is the case, this phone number needs to be circulated so that non computer literate taxpayers have an alternate way to electronically pay their taxes when required to do so by the Franchise Tax Board.

Lately, there is no way to remedy this situation according to the agents we spoke with today other than waiting until the 2011 tax returns are filed and my client can then request a refund. That means my client won't get the fund replenished for close to 12 months. The only way to remedy this before that time is to challenge the transaction through the bank but then you are subject to a 2% penalty on the amount. There should be a process in place to reverse an incorrect payment without penalty.

I can tell you that I will no longer volunteer to set up Web Pay for my clients as the risk to my practice is too high.

I would appreciate a reply to this letter that I can forward to my client as explanation for your incompetence in following printed instructions regarding Web Pay cancellation policy.

**Answer:**

When Web Pay was developed, it was not designed to generate a confirmation number when a payment was canceled. However, we see that this can be an important piece of information for a taxpayer/tax representative, and it will give assurance to the FTB staff that the payment they attempted to cancel was truly canceled. We are currently looking into the effort and what system changes are needed to develop and implement this functionality. We have reviewed the processes and procedures with staff to make sure they understand how to cancel a pending Web Pay request.

In January 2012, we plan to enhance our individual and business Web Pay applications. Currently, businesses can make Web Pay payments by creating and/or accessing their MyFTB Account. Beginning in January 2012, businesses that make Web Pay payments in their MyFTB Account will be able to view pending Web Pay requests they've submitted, and cancel them online if needed. They will no longer need to call FTB to inquire if a Web Pay transaction is pending or to have the payment canceled. They will be able to cancel the payment request themselves. Payment requests submitted prior to these enhancements being implemented (January 2012) will not be available for cancellation online.

Currently, the Web Pay application for individuals does not exist within MyFTB Account. However, in January 2012 we will add an enhanced version of Web Pay for individuals to MyFTB Account. The new version will give individuals the same enhanced functionality we're adding to Web Pay for businesses (view and cancel pending payments).

The current Web Pay application, which requires taxpayers to enter their social security number (SSN) and last name to access the application, will continue to exist even after the new enhanced version is added to MyFTB Account. The "old" version will still exist for taxpayers who are unable or do not want to establish a MyFTB Account. However, taxpayers using the old version of Web Pay will not be able to view or cancel pending Web Pay requests.

## **5. MANDATORY E-PAY PROGRAM**

### **Question:**

Several California Practitioners have expressed a desire to have the FTB make available to Practitioners whether a taxpayer is subject to mandatory ePay. Clients, especially new ones, are sometimes unaware that they are subject to it and incur penalties when they don't use it. It has been suggested that information could be noted in their My FTB Account page.

### **Answer:**

This suggestion is already being worked on, and is planned for implementation, within MyFTB Account, beginning January 2012.

## **6. CONFORMITY LEGISLATION – SB 401**

### **Question:**

In April 2010, the California Legislature passed SB 401, which conformed many of the provisions of the R&TC to the IRC effective January 1, 2010. Later in the year, the voters of California passed Proposition 26 which required a two-thirds (2/3) vote to pass increases in certain tax and fees. The Proposition was effective for legislation passed after January 1, 2010. Legislation which this proposition retroactively applied could be reinstated if re-passed by a two-thirds (2/3) majority within one (1) year of passage of the Proposition. This period is set to expire, I believe, on November 10, 2011. The FTB's position with regard to SB 401 was it is law and the changes it made to R&TC remain in effect. One of the bigger provisions of this conformity legislation was the conformity to the federal relief from income from cancellation of mortgage debt on taxpayers' principal residences. We haven't heard of any legislation that would make SB 401 permanent. Is this the case and, if so, what will the FTB's position be with regard to 2009 and 2010 returns that were filed using these conformity provisions?

**Answer:**

No legislation has been introduced or passed to re-enact any provision of SB 401. Early this year we issued Legal Division Guidance 2011-01-1, regarding our views with respect to the impact of Proposition 26 on SB 401. Our views have not changed. Legal Division Guidance 2011-01-1 provides in part, as follows:

Constitution Requires FTB to Apply SB 401 Until Determination By An Appellate Court

There is considerable uncertainty regarding the continuing viability of the provisions of SB 401 if the Legislature fails to take any action prior to November 3, 2011, with respect to SB 401 or any of the provisions contained therein. However, after careful consideration of applicable law, it appears that the Constitution of California, in particular Section 3.5 of Article III, requires FTB to enforce SB 401 even after the adoption of Proposition 26. Section 3.5 of Article III prohibits an administrative agency, such as FTB, from declaring a statute invalid or unenforceable in the absence of an appellate court determination that the statute is unenforceable or unconstitutional. As a result, FTB is required to enforce SB 401 until an appellate court has made a determination that some portion or all of SB 401 is 'void' pursuant to Proposition 26 and, therefore, unenforceable.

**7. FILING THRESHOLD FOR FORM 199N**

**Question:**

A Practitioner recently had a situation while requesting guidance from the Exempt Organization people at the FTB relative to his exempt client that had been in existence for three years. The gross receipts for those three years, in order, were \$0, \$12,000 and \$32,000+. Pursuant to R&TC Section 23772, a Form 199N can be filed if an organization's gross receipts are "not normally more than \$25,000". The Practitioner was told by FTB personnel that, since the third year was in excess of \$25,000, the organization could not file a Form 199N but rather should file a Form 199. The FTB offers guidance on its website as to how the threshold was to be determined. In this case it is the average of the three years and not the final year as was suggested.

Going under the assumption that the FTB's position hasn't changed, might the FTB consider a little more training for its personnel responding to questions?

**Answer:**

The Franchise Tax Board's position has not changed and the website is correct. We recently hired several new staff, which received training on this subject matter in June 2011. We will provide a refresher training to the staff during the next Exempt Unit meeting and forward them the regulation and power point from the training for their reference.

## 8. FTB AS THE COLLECTION ARM FOR OTHER STATE AGENCIES

### **Question:**

The FTB acts as the collection arm for many California governmental agencies. In this case the FTB was attempting to collect the \$250 non-filing penalty for failing to file the Annual Information Statement with the Secretary of State's (SOS) office. The taxpayer had corresponded with the SOS requesting that the penalty be abated due to reasonable cause. In September 2011 the taxpayer's accountant had contacted the SOS to determine the status of their correspondence sent in July 2011. They were told that due to staffing issues they were just getting to correspondence received in the middle of May 2011. With that knowledge the Practitioner called the FTB to see if they would put a hold on the collection effort until the SOS could respond to their correspondence but was told that that wasn't an option and that the penalty had to be paid and, if abated, they could request a refund.

The response seems to be against proper tax administration, especially in light of the fact that it is the State's inability to timely process correspondence creating the delay. As in most tax matters, taxpayers are given the right to a hearing of their case before they have to pay taxes or penalties. This policy seems to strip taxpayers of this right. Does the FTB have the authority to suspend collection efforts on behalf of a state agency if requested by a taxpayer? If so, under what circumstances?

### **Answer:**

FTB does suspend collections on a case-by-case basis, e.g. for hardships or processing delays. Regarding the SOS penalty specifically, R&T Code Section 19141 requires FTB to collect the penalty until it receives a decertification of the penalty from SOS. When there are processing delays, FTB collectors can place a hold on collections when provided with information that validates the SOS statement was filed timely. We have notified our collectors of the SOS's significant increase in processing timeframes and reminded them of the appropriate procedures to place a hold on collection actions due to processing delays.

## 9. SECTION 645 ELECTIONS

### **Question:**

IRC Section 645 allows certain trust or trusts to join with the grantor's estate in filing fiduciary income tax returns for the first two years of administration. If there is no estate, no court appointed executor or administrator, the trustee of the decedent's grantor trust or trusts can still make the election to be taxed as an estate for a period normally not to exceed two years. California determines the residency of an estate based on the residency of the decedent and determines the residency of the trust based on the residencies of the trustees and beneficiaries. There is a question on how the residency of a trust is determined when it enters into a Section 645 election. The question is two-part: firstly, how is it determined if there is an estate entering into the election; and secondly, if there is no estate and the election is being made by the decedent's trust or trusts?

### **Answer:**

Generally, tax applies to the entire taxable income of a trust, if the fiduciary or beneficiary, other than a contingent beneficiary, is a California resident, regardless of the residence of the settlor. (California Revenue & Taxation Code (R&TC) Section 17742(a).) In contrast, tax applies to the entire taxable income of an estate if the decedent was a resident, regardless of the residence of the fiduciary or beneficiary. (*Ibid.*) An election under Internal Revenue Code (IRC) Section 645(a) shall be treated as an irrevocable election made by the executor, if any, of the estate and the trustee of the qualified revocable trust for state purposes. (R&TC Section 17751(a).) If the executor, if any, of the estate and the trustee of the qualified revocable trust fail to make an election under IRC Section 645(a) with respect to that qualified revocable trust, that trust shall be treated and taxed for purposes of this part as a separate trust and no election under IRC Section 645(a) or R&TC Section 17024.5(e)(3) shall be allowed. (R&TC Section 17751(b).)

If both the executor of the estate and trustee of the qualified revocable trust elect IRS Section 645(a) treatment, such trust shall be treated and taxed as part of such estate, not as a separate trust, for all taxable years of the estate ending after decedent's death and before the applicable date in IRS Section 645(b)(2). (IRC Section 645(a).) The election under subsection (a) of IRC Section 645 shall be made not later than the time prescribed for filing a return for the first taxable year of the estate, determined with regard to extensions, and shall be irrevocable. (IRC Section 645(c).) Whether or not there is an executor, the electing trust is treated as part of the related estate for all purposes of Subtitle A of the IRC. (Treas. Reg. Secs. 1.645-1(e)(2) & (3).)

### Executor & Trust

Consistent with Federal treatment of a trust making an IRC Section 645(a) election, California treats the trust as part of the decedent's estate during the applicable period described in IRC Section 645(b)(2). During such period, it is the residence of the decedent that determines whether there is California tax imposed and a California filing requirement. Federal Form 1041 requires the attachment of Federal Form 8855 to support an IRC Section 645(a) election. In contrast, CA Form 541 does not explicitly describe how a taxpayer should indicate an IRC Section 645(a) election. It is recommended the taxpayer who made an IRC Section 645 election attach to their California return a statement describing the election and provide a copy of Federal Form 8855 with the name of the executor, if any, and trustee, as well as the applicable date of the election and a copy of their corresponding Federal Form 1041. The taxpayer will select "Decedent's Estate" on the front of CA Form 541 and complete the "Other Information" Section of the CA Form 541.

### Trust Only

A qualified revocable trust making an IRC Section 645(a) election without an estate executor, or related estate, is still treated as an estate for IRC purposes while the election is in effect. (Treas. Reg. Sec. 1.645-1(e)(3).) The trustee making the election should follow a similar procedure as described above: the trustee completes Federal Form 8855 and submits it as an attachment to both Federal Form 1041 and CA Form 541. In addition, the trustee should attach a copy of the corresponding Federal Form 1041, reflecting the 645(a) election, to their CA Form 541. It is recommended the filing trustee also attach a statement to their CA Form 541 indicating the election and stating the trust is electing to be treated as an estate under IRC Section 645(a) and R&TC Section 17751 but is without an estate or executor, as applicable. Upon appointment of an estate executor or discovery of the related estate, the trustee should file an amended return indicating whether the election remains in effect, with agreement of the estate executor, or if the election has been terminated consistent with Federal regulations.

## 10. PAYMENTS MADE TO ACCOUNTS WITH NO BALANCE DUE

### **Question:**

A Practitioner recently experienced a problem in attempting to have a refund check applied to a taxpayer's account for 2010 which showed no tax due, but which would show additional tax due once an amended return for that year was processed. The Practitioner had the taxpayer return the 2010 refund check with a letter explaining that an amended 2010 return was filed and the refund check was to be applied to the tax that would be due with the amended return. The amount of the refund was again refunded to the taxpayer with another check. A call to the Practitioner's Hotline resulted in the following. It was suggested by the Hotline personnel that they couldn't post a payment to an account that didn't show a balance owing; therefore, we should wait until the amended return has been processed and the additional tax is added to the account. At that time, the refund check can be returned to the FTB with request that it be applied to the balance due.

In a somewhat similar situation, a taxpayer wanted to make a payment towards a 2007 tax liability but was told by FTB personnel that they couldn't accept payment because there was a matter pending on the account. The matter pending was a 2007 return, which had been filed by the taxpayer to replace a return that had been filed by the FTB.

In both of these situations it seems that the FTB is rather rigid and selective when it will and won't accept payments made by taxpayers to be applied to a particular year. Is there any restriction on the FTB to apply payments to tax years at the request of the taxpayer, either as a payment or deposit? If there aren't restrictions, why won't the FTB accept these types of payments? If the FTB is restricted in accepting these types of payments, might it be subject to proposed FTB legislation to allow for such authority?

### **Answer:**

In the first situation, unfortunately, since the refund was submitted prior to the amended return being processed, due to system limitations, another refund was issued to the taxpayer. Staff have already spoken to the representative and advised that in future situations like this, to send the refund check (or payment) and the amended return together so they could be linked. This will result in the payment being accurately credited to the appropriate account and tax year.

After discussing the second situation with the representative, the taxpayer was attempting to enter into a payment arrangement for the balance owed as a result of a final filing enforcement assessment and had not yet filed a tax return. Although a payment could have been made toward the assessment at that time, generally an income tax return must first be filed before entering into an Installment Agreement. However, a Provisional Payment Plan may be established provided all required income tax returns are filed within 30 days of the request.

In regards to future efforts to apply payments as a “deposit” to any particular tax year without any association to a specific tax return, FTB will explore this option through our on-going EDR Project efforts.

## **11. FTB NON-RESPONSIVE TO TAXPAYER CORRESPONDENCE**

### **Question:**

A California Practitioner has a married couple client who left California in 2007. He has had to assist with matters involving the FTB that should have been resolved more promptly without his involvement had the correspondence from the taxpayer to the FTB been acted upon properly.

In the first matter, the wife held a California real estate license but filed no return for 2008, or since, due to no California source income. The FTB attempted to contact her via US mail but the notice was sent to an incorrect address, therefore, the taxpayer never received the correspondence. She did receive the Final Notice Before Levy correspondence and called the FTB on October 20, 2010. After receiving copies of the previous correspondence, she communicated with the FTB on October 29, 2010, via certified mail. No further correspondence was received from the FTB until the Tax Lien Notice was received on December 28, 2010. At this point the Practitioner got involved and resolved the matter.

In a separate matter for the same year, 2008, a Notice of Proposed Assessment was sent to the husband of the above taxpayer. The notice was sent because the proceeds from the sale of their personal residence and a Form 1099R weren't included on a 2008 CA tax return. The taxpayer responded to this notice in late July 2011 and received correspondence back from a Mr. Dang with the Executive and Advocate Services Division of the FTB indicating an attempt to reach the taxpayer via phone but was unable to do so. The correspondence suggested that the matter could be more easily resolved over the telephone and a phone number for a return call was provided. Both the taxpayer and the Practitioner have been attempting to reach to Mr. Dang at the number provided but have been unable to reach him and messages left haven't been responded to.

In both cases, the taxpayers have been diligent in responding to FTB inquires but in both instances it appears that the FTB has been less diligent in properly dealing with taxpayer correspondence. We would hope that the FTB has in place safeguards against correspondence from taxpayers being lost in the shuffle or unduly delayed because of workloads. Particularly unsettling is the filing of the lien in the first case because, as it stated in the notice, the lien can have a serious impact on a taxpayer's financial life.

We have enclosed for FTB's use only copies of the notices and correspondence related to both of these matters.

**Answer:**

In both cases, notices were sent to the taxpayers' last known address since FTB was not aware that the taxpayers had relocated. The taxpayers responded to FTB inquires when they became aware of the assessments, but in both instances FTB did not respond in a timely manner due to the backlogs in incoming correspondence. We apologize for our delay in responding and handling the issues mentioned. We continually seek improvements to the correspondence processing. Within this environment of budgetary constraints, we were able to commit some overtime resources to address the correspondence backlog. Through the FTB Tax System Modernization project (Enterprise Data to Revenue); business process re-engineering will include scanning of correspondence to streamline the distribution of incoming mail.

In regards to the cases cited in the question, FTB canceled the assessments for both taxpayers and released the lien as filed in error. When a lien is released as filed in error, notices are sent to the three primary credit reporting agencies advising that the lien was erroneously filed.

**12. COD AND COMPUTATION OF GROSS INCOME FOR LLC FEE**

**Question:**

An article entitled "Determining the Limited Liability Company (LLC) Annual Tax and Fee" appeared in the August 2011 issue of *Tax News*. In discussing the annual fee required to be paid by LLCs based on the LLC's total income, the article stated:

Total income, for this purpose, means gross income plus the cost of goods sold, paid, or incurred in connection with the trade or business of the entity per R&TC Section 24271 which, in turn, points to Internal Revenue Code (IRC) Section 61.

However, there are specific income items that may be excluded from gross income. Under R&TC Section 24301, which conforms to IRC Sections 101 through 136, items such as contributions to the capital of a corporation, improvements by lessee on lessor's property, and income from specific discharges of indebtedness are not included in gross income. So, when determining total income for purposes of the LLC fee, if an item is excluded from gross income, it is also excluded from total income for the purposes of the LLC fee.

For example, if an LLC's debt is discharged it is to be included in gross income under IRC Section 61, and, consequently, the total income for purposes of the LLC fee. However, if the debt is discharged while the LLC is insolvent, it now is one of the income items specifically excluded from gross income under R&TC Section 24301, which references IRC Section 108(a)(1)(B). Thus, the amount of this discharged debt should not be included in either gross income or the total income amount used for purposes of computing the LLC fee.

Assuming that the LLC has more than one member, it would be treated as a partnership for income tax purposes. IRC Sec. 108(d)(6) states that in the case of a partnership, any exclusions of cancellation of debt income (COD income) are applied at the **partner level**, not the partnership level. California conforms to this section. See R&TC secs. 17131 and 24307. See also sections 11.1 and 11.2.1 of the FTB's S Corporation Manual. As a result, it appears that the LLC is required to include the COD income in gross income, and then any exclusions of COD income that might be available under IRC Sec. 108 would apply to the individual LLC members.

I brought this to the FTB's attention by an email sent to *Tax News* Aug. 1, 2011. I did not receive a reply. I also brought this to the FTB's attention by an email I sent to Brenda Voet July 29, 2011, who contacted one of the members of the Sacramento Chapter and gave her the same information as was shown on the *Tax News* article. On Aug. 15, 2011, Brenda Voet sent me an email stating that FTB would be "re-evaluating the computation of total income from all sources derived from or attributable to this state under R&TC Sec. 17942," and that she would contact me when the re-evaluation process had been completed. On Aug. 17, 2011, FTB rewrote the *Tax News* article and removed the above-referenced text. I have heard nothing further. What is the status of this issue?

**Answer:**

The reevaluation process is not completed. However, it is our position that for purposes of calculating the fee for a Limited Liability Company (LLC), classified as a partnership, that the gross income exclusion for cancellation of debt income applies only at the member/partner level, not the LLC level.

## **2011 CPA FOLLOW-UP QUESTIONS AND RESPONSES:**

**1. Since FTB is reengineering its return filing and payment processing systems as part of the EDR Project, why didn't they use this opportunity to partner with EDD and establish an agreement to capture each other's data as part of their business resumption plan?**

### **FOLLOW-UP RESPONSE 1:**

FTB and EDD do have an agreement to open each other's mail as part of their business resumption plans.

The Tax Agency Return Processing and Cashiering Workgroup, comprised of representatives from FTB, EDD, and BOE, looked at consolidating all mail processing and data capture activities as recently as 2009/2010. However, because each agency processes 100s of individual tax forms, the group found the short term cost to reconfigure each agency's scanners to recognize the other agencies' tax forms and capture data from them was far too prohibitive to justify the long-term benefit.

An analysis performed by the California Legislative Analyst's Office reached the same conclusions in 2005.

**2. Can FTB return a rejected POA to the practitioner as well as the taxpayer?**

### **FOLLOW-UP RESPONSE 2:**

During the last fiscal year, our POA unit processed over 105,000 POA requests. Unfortunately we were unable to process approximately 32,000 POAs because they were either incomplete or incorrect. Over the last year, in an effort to reduce the number of POAs we cannot process we have:

- Published two Tax News Articles: "Why We Send Your Power of Attorney Back" in January and "Change in POA Process" in July
- Presented a POA webinar in February
- Completely revised and expanded our POA webpage, including a section on the most common errors and how to avoid them

Based on your recent comments, we will examine our procedures for incomplete or incorrect POAs. In addition, FTB's current Enterprise Data to Revenue project includes business requirements that hopefully will assist us better in immediately identifying and resolving incomplete or incorrectly prepared POA issues.

**3. Can taxpayer use FTB stale dated check to pay a liability when E-filing?**

### **FOLLOW-UP RESPONSE 3:**

No, the refund warrant is considered stale dated when it is no longer negotiable. A stale dated warrant is not negotiable, but the taxpayer may request a replacement check either from us or California Victim Compensation and Government Claims Board, depending on the issue date of the warrant. If the warrant is more than one year but less than three years from the issue date of the check, the taxpayer must return the check to:

FRANCHISE TAX BOARD  
PO BOX 942840  
SACRAMENTO, CA 94240-0040

If the warrant is more than three years from the issue date of the check, the taxpayer must return the check to:

CALIFORNIA VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD  
PO BOX 3035  
SACRAMENTO, CA 95812-3035  
800.955.0045

Taxpayers must pay a \$25 application fee when submitting the claim. They can download the claim form and find additional information at:

[www.governmentclaims.ca.gov](http://www.governmentclaims.ca.gov)

**Use Tax:** Does FTB share taxpayer information with BOE regarding those taxpayers that report use tax on their income tax return? **Response** – Yes, FTB reports certain information to the BOE regarding taxpayers who report use tax on their tax return. This information includes name, address, SSN, and amounts reported, adjusted, and paid for use tax.

**Form 3541:** The Draft 3541 (California Motion Picture and Television Production Credit) is now available online on our draft forms page. When the form is finalized in December, it will be located within the form locator under the 2011 tax year.

Nov. 30, 2011