Frequently Asked Tax Questions

What is Tax Law?

Tax law is found in many places - tax law is generated by the federal government, state government as well as counties, cities, and other municipalities. The variety of taxes that everyone faces is staggering - tax law affects almost every aspect of your life.

As for federal taxes, the law is primarily found in:

Title 26 of the United States Code - the Internal Revenue Code of 1986 as amended (the "Code" as promulgated by the Congress of the United States),

Title 26 of the Code of Federal Regulations (the "Regulations" as promulgated by the Internal Revenue Service),

proposed regulations issued by the Internal Revenue Service ("IRS"),

temporary regulations issued by the IRS,

revenue rulings issued by the IRS,

private letter rulings issued by the IRS,

revenue procedures, policy statements, and technical information releases issued by the IRS, and

federal tax court decisions.

Tax law for states, counties, cities and other municipalities is likewise contained in codes sections, regulations, administrative codes, procedures and statements issued by the respective government authorities, as well as state court decisions. In many instances, state law is patterned after federal law but this is not necessarily always the case.

What is subject to income tax?

All income is subject to tax. Income is very broadly defined - "gross income means all income from whatever source derived" - including such items as compensation for services (wages, fees, commissions, etc.), income from business, interest earned, rents, royalties, and dividends received, receipt of alimony, annuity or income from life insurance and endowment contracts, pensions, discharge

of debts, income in respect of a decedent, and income from an interest in an estate or trust. Even income derived from illegal activities is subject to tax.

What Estate Tax?

All property (and certain powers) that a person has at the time of his/her death is subject to tax. The estate tax is payable by your estate - it is usually paid by the estate of the decedent before property is distributed to the beneficiaries of the estate. Barring an extension, the estate tax is due within nine months after your death.

Everyone's estate is subject to the estate tax; however, there is:

(1) an unlimited estate tax marital deduction when property is passed to a surviving United States citizen spouse of the decedent (so long as certain prerequisites are met),

(2) a unified credit which enables every individual to dispose of up to a certain indexed dollar amount of property by gift during lifetime and distribution after death,

(3) an exclusion for disposition of property to a qualified charitable organization.

The unlimited marital deduction, qualified charitable organization deduction and unified transfer tax credit enables most estates to be distributed without incurring any federal estate tax. In addition, there are many ways in which you can structure your estate - to take advantage of available exclusions, exemptions, credits and deductions - so that the tax bite is reduced.

How is the gift tax imposed?

A federal tax is imposed upon all gifts from an individual to others during his/her lifetime. This tax is incurred whenever a gift is made.

There are many exceptions to the imposition of the federal gift tax, such as:

(1) every individual is allowed to make a gift of a present interest of up to $11,000 per donee per year free from gift tax (a husband and wife each has an annual exemption so a married couple can gift up to $22,000 per donee per year without incurring any tax),

(2) transfers to qualified political organizations are not subject to gift tax (although there are many laws which limit the amount that a person can contribute to a political organization),

(3) gifts to pay tuition to a qualified educational organization or to persons who qualify as a provider of

medical care made on behalf of another individual are excluded,

(4) loans of qualified artwork are not treated as a transfer subject to gift tax under certain circumstances, and

an unlimited gift tax marital deduction when property is transferred to a surviving United States citizen spouse of the donor (so long as certain prerequisites are met), and

(5) a unified credit which enables every individual to dispose of up to $1.5 million of property by gift during lifetime and distribution after death (this exclusion increases to $2 million in 2006 and to $3.5 million in 2009).

These exceptions enable most people to make gifts without incurring any federal gift tax.

What is Property Tax?

Real Property

Many counties have a real property tax that is imposed on the ownership of real estate located within its boundaries. Real Property tax is typically imposed upon the assessed value of the real property - typically set as a percentage of the most recent purchase price paid for a parcel of real property. In addition, many counties impose a one time tax or fee whenever a parcel of real property is transferred. Real property taxes are imposed and collected at the local level.

What is the property tax rate in California ?

Proposition 13 limits the general property tax rate to 1 percent of the assessed value, plus an amount for the debt service on any bonds approved by popular vote. The tax rate will vary depending upon where the property is located. You can obtain exact tax rates for a particular parcel by contacting the county auditor's office.

How is my real property tax set in California ?

County assessors must value property in accordance with the California Constitution, the

Revenue and Taxation Code, other codes that apply to property tax assessment, and Property Tax Rules . Board of Equalization publications which provide guidance include the Asses sors' Handbook and Letters

To Assessors. In addition, property tax annotations provide guidance regarding statutes and regulations as applied by Board staff.

What is the homeowners' exemption?

The California Constitution provides a $7,000 reduction in the taxable value for a qualifying owner-occupied home. The home must have been the principal place of residence of the owner on the lien date, January 1st. To claim the exemption the homeowner must make a timely filing of a simple form with the county assessor. A partial 80% exemption may be granted for homeowners who file a late affidavit and claim for exemption with the assessor between February 16th and December 10th.

Homeowners' exemption claimants are responsible for notifying the assessor when they are no longer eligible for the exemption. December 10th is the last day to terminate the homeowners' exemption without penalty; the assessor should receive notice of ineligibility by that date.

I did not pay my property taxes because I did not receive a bill. Now they want me to pay a penalty in addition to the taxes. Can they do that?

Under California law, it is the responsibility of the taxpayer to obtain all property tax bill(s) and to make timely payments. Failure to receive a tax bill does not relieve the lien of taxes, and penalties will not be waived if the taxes are paid late. The tax collector’s responsibility is to mail the tax bill to the address provided on the tax roll.

For most homeowners, the first installment of their property taxes will be due November 1st, and delinquent if not paid by December 10th; the second installment is due February 1st, and delinquent if not paid by April 10th. Taxpayers have the option of making both payments when the first installment is due.

Be sure you keep the county assessor informed of any change in address so that future tax bills will be mailed to the correct address.

I am having trouble paying my property taxes. What can I do?

If you are a senior citizen, blind, or disabled, and are having difficulty paying your property taxes and meet certain qualifications, you may be eligible to receive assistance through property tax reimbursement or postponement. If the problem is temporary, some counties may allow you to pay using your credit card; check with your local county tax collector's office.

Property Tax Reimbursement

Persons who are blind, disabled, or at least 62 years old, and meet certain minimum annual income thresholds may qualify to participate in the Franchise Tax Board's Homeowner Assistance program. This program provides cash reimbursement of a portion of the property taxes that you paid on your home.

Persons who are blind, disabled, or at least 62 years old, and meet certain minimum annual income thresholds may qualify to participate in the State Controller's Property Tax Postponement program. The postponed taxes are a lien on the home and become due (with interest) upon moving, the sale of the home, or death.

Do I qualify for tax relief if my property is damaged by a major calamity?

A county board of supervisors may adopt an ordinance that allows property tax relief to owners of damaged or destroyed property. If a major calamity such as fire or flooding damages or destroys your property, you may be eligible for property tax relief if the county where your property is located has adopted such an ordinance.

To qualify for property tax relief, you must file a claim with the assessor's office within the time specified in the ordinance or within 12 months from the date the property was damaged or destroyed, whichever is later. In such cases, state law authorizes the assessor to re-evaluate any property sustaining a loss in value of $10,000 or more, and to assist the property owner in complying with approved procedures to obtain property tax adjustments.

If the county where your property is located has not adopted such an ordinance, you may still be eligible for property tax relief. Contact the assessor's office for assistance.

In either case, if you rebuild a damaged or destroyed property in a like or similar manner, the property will generally retain its previous value for property tax purposes

Sales and Use Tax

What type of merchandise is subject to use tax?

Generally, the same types of items that are subject to sales tax are subject to use tax. Sales and use tax applies to the sale or use of tangible personal property in California . Section 6016 of the Revenue and Taxation Code defines tangible personal property as "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses."

In the Sales and Use Tax Law, the sale or use of certain tangible personal property is exempt from both sales and use tax. Examples include cold food products and prescription medicines. A list of items the sale of which are not subject to sales or use tax can be found in Publication 61 Sales and Use Taxes: Exemptions and Exclusions.

How do I pay the use tax?

If you are not required to hold a seller's permit, you may report the use tax on your purchases on your California income tax return or on the use tax return in Publication 79B, California Use Tax. If you choose to report use tax on your income tax return, follow the instructions for the use tax line and complete the use tax worksheet to determine your use tax liability.

If you hold a California seller's permit you must pay the use tax with your sales and use tax return. Report the amount of your purchase under "Purchases subject to use tax" (Line 2) of the return for the period that includes the date when you first used, stored, or consumed the item in California .

Persons or businesses that regularly incur use tax liabilities, but are not engaged in a business requiring a seller's permit, should arrange to receive Consumer Use Tax returns by applying for a Consumer Use Tax Account.

What is the rate for California use tax? What is the rate for my city?

The sales tax and use tax rates are the same. The rate of use tax is determined by where the property will be used, stored or consumed, regardless of where the sale takes place. For information on the tax rate for your area, refer to Publication 71, California City and County Sales and Use Tax Rates.

Is the California use tax new?

No. The California use tax law became effective on July 1, 1935 . Section 6201 of the Revenue and Taxation Code established the use tax to eliminate the price disadvantage of California businesses when California consumers purchase taxable merchandise from out-of-state retailers.

Legislation was passed in 2003 allowing a use tax line to be added to California 's income tax returns. This change makes it easier for consumers to report and pay use tax on their purchases. Several other states allow taxpayers to report use tax on their state income tax returns.

What is the difference between sales tax and use tax?

The California sales tax is imposed on all California retailers. It applies to all retail sales of tangible personal property in the state. Retailers making sales in the State of California are required to remit the sales tax to the Board of Equalization. Retailers are required to pay and report sales taxes to the Board of Equalization and they have the option of collecting sales tax reimbursement from their customers. Almost all retailers utilize this option. Whether or not a retailer collects the sales tax, the retailer is liable to remit the tax due.

The California use tax is imposed on consumers of tangible personal property that is used, consumed, or stored in this state. Use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales. Use tax also applies to most leases of tangible personal property.

The sales tax and the use tax are "mutually exclusive," which means either sales tax or use tax applies to a single transaction, but not both.

Why would an out-of-state company charge me California sales or use tax?

Any out-of-state company that is "engaged in business" in the State of California must register with the Board of Equalization to collect use tax on their retail sales of tangible personal property to California customers.

"Engaged in business" can include:

A permanent or temporary office, distribution center, sales or sample room, warehouse, or other place of business in California.

Having a representative in California who makes sales, takes orders, installs merchandise, trains customers, or makes deliveries.

Receiving rental payments from the lease of tangible personal property that is located in California . There are many out-of-state companies not physically "engaged in business" in the State of California that make retail sales to California consumers. These companies usually solicit orders via the Internet or through mail order. Their only connection to California is shipping merchandise by U.S. mail or other common carrier to California customers.

Some out-of-state companies with no physical presence voluntarily register with the Board of Equalization as a courtesy to their California customers. They collect the California use tax from their

California customers. This relieves California customers of their use tax liability, if they retain proof of their payment of use tax to the vendor. Once registered with the Board of Equalization the out-of-state company is legally obligated to collect the use tax.

California consumers are advised to review their receipts from out-of-state companies to determine if they were charged California use tax. It is also important for customers to determine if they were charged the proper rate of tax for the area where they use, store or consume the merchandise. For example, if an Alameda County consumer was only charged 7.25 percent use tax on taxable merchandise, he/she would be liable for the remaining 1.00 percent tax on the purchase because Alameda County has an 8.25 percent sales and use tax rate.

Can the Board of Equalization require out-of-state companies to register to collect California use tax?

It depends. If an out-of-state company is "engaged in business" in California they must register with the Board of Equalization to collect use tax on their retail sales of tangible personal property to California customers. However, if an out-of-state company is not "engaged in business" in California , U. S. Supreme Court cases have been interpreted to mean that the Board of Equalization is prohibited from requiring these companies to register to collect California use tax from their customers.

What is the Generation Skipping Tax Transfer? Generation Skipping Transfer (GST) Tax is scheduled for repeal in 2010 but is reinstated in its entirety in 2011. Until 2010, the exemption amount ($1,500,000 in 2004-2005) will be the same as the estate tax exemption amount in effect for that calendar year.

This tax is somewhat confusing and often misunderstood. The basic premise behind the generation skipping transfer tax - which is a tax that is separate and apart from income, estate and gift taxes - is to trap transfers of property within each successive generation. In other words, it is designed to allow transfers to spouses and children but tax transfers going to grandchildren and those deemed to be two or more generations below that of the person making the transfer. This tax is very steep - it is a flat 55% of the value of the property transferred (the rate drops from 55% to 45% in steps through 2007 where it will remain until 2010).

Those who transfer all of their property to someone who is deemed to be in the same or one generation below do not have to worry about this tax. No tax is imposed at this level.

In addition, every individual is allowed a $1.5 million generation skipping exemption in 2004 (in years thereafter, the current estate tax exemption level applies). Thus, no tax is incurred on the first $1.5 going to grandchildren and those deemed to be two or more generations below that of the transferor.

Many people escape imposition of the generation skipping transfer tax by transferring property only to

those at his/her same generation or no more than one generation below - along with the allocation of the $1.5 million (in 2004) exemption.

What is an Assessment?

An assessment is a determination by a government agency that you owe tax.

In general, an assessment must be made within 3 years from the date the return was filed.

In the case of a false return, a willful attempt to evade tax, failure to file a return, or pursuant to agreement between you and the government agency, the assessment can be made at any time.

Audits

What is an Audit?

An audit is an investigation to determine whether the information provided to the government on the information/tax return is correct - and as a result the audit can determine whether the proper amount of tax was paid. The burden of proof during the audit is on the taxpayer - you have to prove to the government that all of the information on the return (the amounts of income, the exclusions, exemptions, deductions and credits) is true and correct. Bear in mind that although you have the burden of proof, that does not mean that you are compelled to show every document to the government agent - some documents are simply none of their business. Some audits are conducted by mail, some require you to go to the government agency's office, and other audits require that the government's agent go out and meet with you at your home or business.
Some audits are relatively routine matters. Many audits result in no change - the required information on the return was accurate and there is no change in the amount of tax. While some audits do result in an assessment, some audits actually result in a refund.

Whether you need outside assistance with an audit depends on your particular circumstances. If your tax matters are simple, you may be able to handle it yourself. But if your tax matters are complex or if you don't fully understand taxes, you should get a professional

What if I am unable to pay the taxes I owe?

If the tax is a sales tax, excise tax, or license/permit - you may have to do without. If you are not able to afford it, you don't get the enjoyment of it.

Other taxes, primarily income tax, can be paid over time if you are unable to pay for it. You will be required to provide financial information about all the property that you own and establish that you are truly unable to pay the tax - even if you liquidated (turned property into cash) all of the property which you owe. If the government agrees, you can get a payment schedule - the tax is paid over a period of time. Just like a credit card, the amount due will be increased by interest on the "loan, ".

The California Board of Equalization offers tax amnesty. This program allows you to pay taxes back on a monthly basis and even waives the penalties incurred as a result of the taxes not being paid in the past. The deadline for filing the amnesty is March 31 St .