



Client Alert

A *WEST* RHODE & ROBERTS

PUBLICATION

IRS NOTICES REGARDING STATE TAX REFUNDS ALERT

The Internal Revenue Service and the Franchise Tax Board have been in communication with each other on taxpayer returns. Currently, we are seeing clients receiving notices from the Internal Revenue Service regarding the non-reporting of the state tax refund received in 2005 from the 2004 tax year due to information from the Franchise Tax Board.

So far, the notices we have seen have been incorrect regarding the taxability of these refunds. The Internal Revenue Service regulations state that refunds of state taxes are only taxable if the taxpayer received a tax benefit in connection to the refund. Typically, this benefit is in the form of state income tax deductions claimed on the Schedule A of the federal form. For some taxpayers who fall into the realm of Alternative Minimum Tax, this benefit may be reduced or removed. This has been the case with the notices we have seen. We have been responding to the notices showing that the refunds are clearly not taxable under the regulations set forth by the Internal Revenue Service.

If you receive such a notice please forward it to our office immediately for us to prepare a response.

Please call if you have any questions.