
Legal Updates & News

Legal Updates

California FTB Offers 60-Day Period for Taxpayers to Complete Reportable Transaction Disclosure Statements In Order to Avoid Penalties

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The California Franchise Tax Board (“FTB”) has recently issued a Legal Notice generally providing that taxpayers who previously filed incomplete IRS Forms 8886 or failed to file Forms 8886 with FTB will avoid penalties by filing completed forms within 60 days. Taxpayers that may have concerns regarding Form 8886 FTB compliance issues should take this opportunity to review and correct any prior errors or omissions.

On July 31, 2007, the FTB issued Legal Notice 2007-3 (“Notice”) regarding completion of IRS Form 8886, “Reportable Transaction Disclosure Statement” for taxpayers who participated in reportable transactions. The stated purpose of the Notice is to advise the public that the FTB will allow taxpayers who (1) filed incomplete IRS Forms 8886 or any successor form; or (2) failed to file a Form 8886 when it was originally due for each taxable year for which the taxpayer participated in a reportable transaction, to file complete disclosure statements within 60 calendar days of the date of the Notice for any transaction that should have been disclosed on or before July 31, 2007. According to the notice, taxpayers who fail to complete the required disclosure statement on or before the conclusion of this 60-day period “will” be assessed penalties by the FTB pursuant to Revenue and Taxation Code section 19772.

Under California law, which incorporates by reference the federal reportable transaction provisions, the general rule is that IRS Form 8886 must be attached to the taxpayer’s original or amended tax return for each taxable year for which the taxpayer participates in a reportable transaction, including a listed transaction. (Rev. & Tax. Code § 18407.) In addition, in circumstances involving the filing of IRS Form 8886 for the initial year of participation, the taxpayer is required to mail a copy of that disclosure statement to the FTB’s Abusive Tax Shelter Unit (“ATSU”).

The Notice states that a Form 8886 containing a statement that information will be provided upon request is not considered a complete disclosure statement. The Notice further provides that if the taxpayer failed to complete the Form 8886 in accordance with the federal reportable transaction provisions, the taxpayer is not considered to have complied with the disclosure requirements for California purposes. For example, if the taxpayer failed to file Form 8886 with the FTB’s ATSU for the initial year of participation at the same time the taxpayer filed Form 8886 with the taxpayer’s return, the Notice states that in this instance the taxpayer is not considered to have complied with the disclosure requirements, even though disclosure was made on the return.

Taxpayers who failed to fully comply with the reportable transaction disclosure requirements are now being given 60 calendar days from the date of the FTB’s Notice to file complete Forms 8886 for each taxable year for which they participated in a reportable transaction. Taxpayers filing Form 8886 in accordance with the Notice need only file the statement with the FTB’s ATSU and need not file an amended return to make the disclosure. For disclosure statements being filed in response to the Notice, taxpayers are instructed to write in red on the top of the Form 8886 “FTB Notice 2007-3” and send the statement to an address set forth in the Notice.

The Notice goes on to provide that for taxpayers who are required to file a disclosure statement but

fail to file a “complete” Form 8886 within the 60-day period specified in the Notice, the FTB will impose a penalty under Revenue and Taxation Code (“section”) section 19772 with respect to each failure to disclose a reportable transaction. As a general rule, the Section 19772 disclosure penalty applies to all taxpayers who: (1) fail to attach a complete disclosure statement to an original or amended return, and/or (2) fail to file a separate IRS Form 8886 with the FTB’s ATSU when required. The amount of the penalty for each failure to provide a disclosure statement is \$15,000 for reportable transactions and \$30,000 for listed transactions. (Rev. & Tax. Code § 19772(b).)

Section 19772 was generally operative for taxable years beginning on or after January 1, 2003, and, due to a subsequent amendment, before January 1, 2005. Section 19772 was also specifically operative for any transaction that a taxpayer invested in after February 28, 2000, and before January 1, 2004, where at any time the transaction became a listed transaction. For taxable years beginning on or after January 1, 2003, and before January 1, 2005, the failure to disclose penalty under Section 19772 was limited to large entities or high net worth individuals, as defined in former section 19772(c)(1)-(2). The current provisions of Section 19772, operative for taxable years beginning on or after January 1, 2005, provide the disclosure penalty may be imposed on taxpayers with taxable income greater than \$200,000.