



Tax Law

California Franchise Tax Board Releases Guidelines for New Voluntary Disclosure Initiative

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In March of this year, Governor Brown signed into law Senate Bill 86, which, among other things, authorizes the Franchise Tax Board (“FTB”) to administer a new California voluntary disclosure initiative (the “2011 California Initiative”) for eligible California taxpayers (each, a “Taxpayer”).

Under the 2011 California Initiative, Taxpayers may report previously underreported income from (1) offshore financial arrangements and/or (2) abusive tax avoidance transactions in exchange for relief of certain penalties, interest associated with such penalties and criminal prosecution. The 2011 California Initiative is based in part on the Federal Offshore Voluntary Disclosure Initiative (the “2011 Federal Initiative”) announced by the Internal Revenue Service (“IRS”) earlier this year, and represents the first voluntary disclosure program in California in several years. A more detailed description of the 2011 California Initiative, including eligibility and procedural requirements, follows below.

Eligibility Requirements

For purposes of the 2011 California Initiative, a Taxpayer includes any taxpayer subject to California tax who has underreported income or income/franchise tax

liability in one or more prior tax years due to previously undisclosed “offshore financial arrangements” or “abusive tax avoidance transactions,” including those Taxpayers currently under examination, audit, protest or appeals with the FTB. For purposes of the foregoing, there is no limit to the number of years a Taxpayer may look back to determine his, her or its underreported income or income/franchise tax liability (which is a significant difference when compared to the 2011 Federal Initiative). Taxpayers not included are those taxpayers who, with regard to offshore financial arrangements and/or abusive tax avoidance transactions, are the subject of criminal investigation or have had a criminal complaint filed against them on or before July 31, 2011.

Under the 2011 California Initiative, “offshore financial arrangements” include any transaction involving financial arrangements that in any manner rely on the use of offshore payment cards, including credit, debit or charge cards, issued by banks in foreign jurisdictions or other offshore financial arrangements, including arrangements with foreign banks, financial institutions, corporations, partnerships, trusts or other entities to avoid or evade California income or franchise tax. “Abusive tax avoidance transactions” is more broadly defined to include any abusive tax shelters (as defined in Internal Revenue Code (“IRC”) §6662(d)(2)(C)), listed transactions (as defined in IRC §6707A(c)(2)), gross misstatements of tax (as defined in IRC §6404(g)(2)(D)), transactions subject to a noneconomic substance penalty (as defined in Revenue and Taxation Code (“RTC”) §§19763(c) and 19777), and reportable transactions (as defined in IRC §6707A(c)(1)) not adequately disclosed.

Procedural Requirements

To participate in the 2011 California Initiative, a Taxpayer must (1) make an election to participate under RTC §19762 and complete and sign a participation agreement, the form of which will be provided by the FTB; (2) file an amended tax return for each tax year that the Taxpayer failed to include income from the offshore financial arrangement and/or abusive tax avoidance transaction; and (3) pay in full all taxes and interest due according to the amended return(s). No

deductions are permitted to be taken for transaction or similar costs associated with the offshore financial arrangement or abusive tax avoidance transaction. Taxpayers also will not be credited or refunded any money from any penalties paid in prior years up to August 1, 2011. For many Taxpayers, installment plans are authorized to be available so long as final payment is made by June 15, 2012.

Taxpayers seeking participation in the 2011 California Initiative must satisfy the procedural requirements set forth above at any time during the period of August 1, 2011 to October 31, 2011 (the "Participation Period"). The Participation Period generally coincides with the 2011 Federal Initiative's participation period, which was recently extended by the IRS up to December 1, 2011 for those participants who in good faith tried to meet the prior deadline.

Conclusion

The 2011 California Initiative affords Taxpayers an opportunity to report many types of previously underreported income without civil or criminal penalty, interest charge on penalties or incurrence of litigation costs. However, Taxpayers should consider the consequences associated with the unlimited look-back and reporting of underreported income for prior tax years, including potentially significant accruals of interest. In addition, certain Taxpayers will remain subject to penalties for large understatements of income (i.e., corporations subject to large corporate understatement penalties) and for failing to participate in California's prior voluntary disclosure program, which ended on April 15, 2004 (i.e., those Taxpayers who did not make voluntary disclosure under the prior program but could have done so).

Taxpayers who have opted to participate in the 2011 Federal Initiative should strongly consider participation in the 2011 California Initiative so as to be in full compliance with applicable federal and state income tax laws. Taxpayers opting to participate in the 2011 California Initiative should coordinate with their tax advisors all California and federal disclosures because the IRS and FTB actively

share taxpayer information. Finally, because the 2011 California Initiative also covers abusive tax avoidance transactions, the costs and benefits of participation should be carefully evaluated (including the aforementioned consequences of taxpayer information sharing) by Taxpayers who are not otherwise eligible to participate in the 2011 Federal Initiative.

If you have questions concerning the subject matter of this newsletter, please feel free to contact a Manatt tax professional.