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## **VOLUNTARY DISCLOSURE DEADLINES LOOM**

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California taxpayers have two voluntary disclosure programs to consider as we approach August, 2011. The first is the federal Second Supplemental Offshore Voluntary Disclosure (OVDI) which ends August 31, 2011 (subject to extension discussed below). The second is California's recently enacted Voluntary Compliance Initiative Two (California Amnesty) which runs from August 1, 2011 - October 31, 2011. The two programs have a common theme in that they both provide amnesty from a wide variety of civil and criminal penalties for qualifying taxpayers. A qualifying taxpayer is generally understood in both contexts as a person (which includes individuals and legal entities) who is not at the time of filing the voluntary disclosure under examination or investigation by taxing authorities. If other non-tax issues are involved, like non-tax criminal activity, then person is not qualified. However, the programs also differ in material ways beyond timing. The OVDI program offers relief from criminal prosecution and a myriad of potential civil penalties only to taxpayers who have unreported foreign financial accounts. This means that the taxpayer failed to timely file a Foreign Bank Account Report (FBAR) for each year in which aggregate foreign financial account balances were \$10,000 or more. The California Amnesty applies to taxpayers who either (a) were participants in what are called abusive tax avoidance transactions (ATAT) OR (b) had unreported income from offshore financial arrangements. The similarity in the two programs is the requirement to disclose previously undisclosed offshore accounts and report unreported income. But, whereas the OVDI starts with the fact that an FBAR was due the California Amnesty programs starts with unreported income. This is an important distinction for the OVDI incorporates two statutory schemes, the Bank Secrecy Act under which establishes the obligation to file FBAR's and the Internal Revenue Code which requires the reporting of income from foreign held accounts. The OVDI incorporates relief from both statutory systems into a single approach administered by the IRS under which requires taxpayers to pay an FBAR penalty in the form of a "miscellaneous civil penalty" of 25% of the single year highest account balance (FOR NOT FILING THE FBARS) and payment of tax on unreported income, plus a 20% accuracy related penalty and interest. The California Amnesty requires filing of amended returns to report previously unreported income and payment of the tax, plus interest on the tax. There is no similar provision in California law to the FBAR filing requirement.

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The California Amnesty program goes on to include relief from penalties for taxpayers who participated in abusive tax avoidance transactions (ATAT). An abusive tax avoidance transaction is a tax scheme that has no significant purpose other than reducing tax. In other words, the transaction lacks any significant economic substance independent of income tax considerations. While there are similar disclosure rules regarding ATAT's and analogous penalty regimes the OVDI does NOT include relief from ATAT penalties and thus the point of departure between the two programs exists.

There are numerous decisions a taxpayer has to make in determining whether to enter either or both programs. In most cases a taxpayer who enters the OVDI should also enter the California Amnesty program and file amended returns, pay the tax and interest and get a closing agreement from California as well as the IRS. However, there are some cases where the taxpayer should take advantage of the California Amnesty offer because of an ATAT investment. In that case, the taxpayer is admitting for California purposes, but not federal purposes the ATAT investment. For taxpayer's with open years (the statute of limitations has not run for federal purposes) the decision to make disclosures for California purposes may (subject to information exchange agreements between the IRS and FTB) result in exam action by the IRS and imposition of civil penalties. The penalty (which is a strict liability penalty) for federal purposes for failure to disclose what is known as a "reportable transaction" is generally 75% of the reduction in tax with a minimum of \$5,000 and a maximum of \$200,000. By contrast the California statute applies only to taxpayers with taxable income of \$200,000 or more and the penalty for failure to disclose a reportable transaction is \$15,000. California draws a distinction for penalty purposes between what is known as a reportable transaction and what is known as a "listed transaction" for penalty purposes. The penalty for failure to disclose a list transaction is \$30,000. The result is that there is a cost benefit analysis that needs to be considered if a taxpayer is entering the California Amnesty program for ATAT purposes as opposed to a person who is disclosing unreported income from foreign sources.

The choice to enter the OVDI and California Amnesty programs is limited by time. Although the IRS recently agreed to extend the time on OVDI by 90 days for "reasonable cause", taxpayers who wish to enter both programs need to move quickly.

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