Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Frommer Analyst: Jeff Garnier Bill Number: AB 1601

Related Bills: See Prior Analysis Telephone: 845-5322 Amended Date: May 19, 2003

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Tax Shelters/Statute of Limitations/Penalties

X	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended April 10, 2003.
____	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
____	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ________________________.
____	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ________________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 10, 2003 STILL APPLIES.
X	OTHER - See comments below.

SUMMARY

This bill would increase the accuracy related penalty (ARP) and the length of time the Franchise Tax Board (FTB) may assess tax deficiencies for investors in certain tax shelters. This bill would also increase the penalties both for promoting and for failing to register a tax shelter.

SUMMARY OF AMENDMENTS

The May 19, 2003, amendments would broaden the definition of a "California tax shelter" for purposes of registering the shelter with the Franchise Tax Board. The amendments also resolved the department's technical concerns outlined in the prior analysis and made other technical changes.

EFFECTIVE/OPERATIVE DATE

The bill would be effective and operative January 1, 2004. Changes to penalties would be operative for taxable years beginning on or after that date.

POSITION

Pending.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP	Brian Putler	6/4/03
____ SA	____ O	____ NAR		
____ N	____ OUA	X PENDING		

LSB TEMPLATE (rev. 5-03)

ANALYSIS

For convenience, the pertinent law discussion that was affected by the May 19, 2003, amendment is restated below.

FEDERAL LAW

An organizer of a tax shelter is required to register the shelter not later than the day on which the shelter is first offered for sale. A "tax shelter" means any investment with respect to which the tax shelter ratio for any investor as of the close of any of the first five years ending after the investment is offered for sale may be greater than two to one. The tax shelter ratio is basically the amount of the income tax deductions and 350% of the credits offered by the shelter bears to the taxpayer's investment. Additionally, the shelter must be: (1) required to be registered under federal or state securities laws, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a federal or state securities agency, or (3) a substantial investment (greater than $250,000 and at least five investors).

Other promoted arrangements are treated as tax shelters for purposes of the registration requirement if: (1) a significant purpose of the arrangement is the avoidance or evasion of income tax by a corporate participant; (2) the arrangement is offered under conditions of confidentiality; and (3) the promoter may receive fees in excess of $100,000 in the aggregate.

A transaction has a "significant purpose of avoiding or evading income tax" if the transaction: (1) is the same as or substantially similar to a "listed transaction" or (2) is structured to produce tax benefits that constitute an important part of the intended results of the arrangement and the promoter reasonably expects to present the arrangement to more than one taxpayer.

The penalty for failing to timely register a tax shelter (or for filing false or incomplete information with respect to the tax shelter registration) generally is the greater of 1% of the aggregate amount invested in the shelter or $500. In addition, if the tax shelter involves an arrangement offered to a corporation under conditions of confidentiality, the penalty is the greater of $10,000 or 50% of the fees payable to any promoter with respect to offerings prior to the date of late registration. Intentional disregard of the requirement to register increases the penalty to 75% of the applicable fees.

STATE LAW

California law conforms to the federal tax shelter registration requirements and penalty amount. Current state law specifies the tax shelter must be organized in California in order for California registration to be required. Many shelters are organized outside of California and solicit California investors. As a result, very few shelters are required to register in California.

THIS BILL

This bill would require a "California tax shelter" to register with the Franchise Tax Board. A tax shelter would be considered a "California tax shelter" if the shelter satisfies any of the following:

- The shelter is organized in California,
- The shelter is doing business in California,
- The shelter is deriving income from sources within California,
- One of its investors is a California taxpayer, or
- The shelter solicits investments from California taxpayers.

ECONOMIC IMPACT

Revenue Estimate

The changes made to this bill by the May 19, 2003, amendments do not significantly impact the prior revenue estimate. Thus, the revenue estimate of $5 million annually beginning with the 2004/05 fiscal year provided in the April 10, 2003, analysis still applies.

LEGISLATIVE STAFF CONTACT

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