

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes
November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
EFFECTIVE DATE	The amendments made by Chs. 654 and 656 are effective beginning January 1, 2004.	The amendments made by P.L. 108-357 are effective after October 22, 2004, the date of enactment. That is, returns/statements due after that date, taxable years ending after that date, activities occurring after that date, communications after that date, etc.	The amendments made by Ch. 691 are effective beginning January 1, 2005.
REPORTING REQUIREMENTS			
Tax Shelter Registration (CR&TC Section 18628/IRC Section 6111)	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6111 with the following modifications: <ul style="list-style-type: none"> - Organizer required to register with CA when the tax shelter meets any of the following: <ul style="list-style-type: none"> ▪ The tax shelter is organized in CA, ▪ Does business in CA, ▪ Derives income from CA sources, or ▪ Has at least one CA investor. - Transactions entered into February 28, 2000 or later that become listed at anytime must register with the FTB within prescribed timeframes. - Transactions entered into September 2, 2003 or later that become a CA listed transaction must be registered with the FTB within prescribed timeframes. 	<ul style="list-style-type: none"> ▪ Repealed the tax shelter registration regime under IRC Section 6111, including furnishing tax shelter registration number and disclosing the number on the return. ▪ Added: material advisor required to file new information return for reportable transactions, including listed transactions defined under IRC Section 6707A(c). 	<ul style="list-style-type: none"> ▪ Conforms to new federal reporting requirements under IRC Section 6111 with the following modifications: <ul style="list-style-type: none"> - Material advisor must file reportable transaction information return with the FTB if the advisor meets any of the following: <ul style="list-style-type: none"> ▪ Is organized in CA, ▪ Does business in CA, ▪ Derives income from CA sources, or ▪ Provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction with respect to a taxpayer that is organized in CA, does business in CA, or derives income from CA sources. - Transactions entered into February 28, 2000 or later that become listed at

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
			<p>anytime, the material advisor must be file an information return with the FTB by the later of 60 days after: (1) entering into the transaction, (2) the transaction becomes a listed transaction, or (3) the effective date of the act amending Section 18628.</p>

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
<p>List of Investors (CR&TC Section 18648/IRC Section 6112)</p>	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6112 with the following modifications: <ul style="list-style-type: none"> - Organizers, sellers, or material advisors required to maintain list of investors for federal purposes must also maintain that list for the FTB if the tax shelter meets any of the following: <ul style="list-style-type: none"> ▪ Is organized in CA, ▪ Does business in CA, ▪ Derives income from CA sources, or ▪ Has at least one CA investor. - Transactions entered into February 28, 2000 or later that become listed at anytime must register with the FTB within prescribed timeframes. - Transactions entered into September 2, 2003 or later that become a CA listed transaction must be registered with the FTB within prescribed timeframes. 	<ul style="list-style-type: none"> ▪ Amended IRC Section 6112. ▪ Requires each material advisor to maintain a list that (1) identifies each person to whom the advisor acted as a material advisor with respect to the reportable transaction, and (2) contains any other information that may be required in regulations. ▪ The requirement to maintain the lists applies whether or not the material advisor is required to file an information return under IRC Section 6111. 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6112 with the following modifications: <ul style="list-style-type: none"> - Material advisor must maintain list of advisees if the advisor meets any of the following: <ul style="list-style-type: none"> ▪ Is organized in CA, ▪ Does business in CA, ▪ Derives income from CA sources, or ▪ Provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction with respect to a taxpayer that is organized in CA, does business in CA, or derives income from CA sources. - Transactions entered into February 28, 2000 or later that become listed at anytime, the material advisor must automatically mail the list of advisees to the FTB by the later of 60 days after: (1) entering into the transaction, or (2) the transaction becomes a listed transaction. - Transactions entered into September 2, 2003 or later that become a CA listed transaction, the material advisor must automatically mail the list of advisees to the FTB by the later of 60 days after: (1) entering into the transaction, or (2)

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
			the transaction becomes a listed transaction.
INVESTOR PENALTIES			
Noneconomic Substance Transaction (NEST) Understatement Penalty (CR&TC Section 19774)	<ul style="list-style-type: none"> ▪ Penalty is: <ul style="list-style-type: none"> - 20% of understatement if adequately disclosed. - 40% of understatement if not adequately disclosed. ▪ FTB Chief Counsel may rescind the penalty for reportable transactions other than listed transactions. No appeal for FTB's refusal to rescind penalty 	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ Retains CA penalty ▪ Modifies definition of noneconomic substance transaction understatement under Section 19774(c)(1).
Reportable Transaction Understatement Penalty (CR&TC Section 19773)	<ul style="list-style-type: none"> ▪ Penalty is: <ul style="list-style-type: none"> - 20% if transaction adequately disclosed. - 30% if transaction not adequately disclosed. ▪ The 20% penalty can only be avoided if the taxpayer (1) satisfies "strengthened reasonable cause" exception and (2) has been contacted by the FTB regarding a potentially abusive tax shelter. ▪ FTB Chief Counsel may rescind the penalty. No appeal for FTB's refusal to rescind penalty. 		<ul style="list-style-type: none"> ▪ Repeals CR&TC Section 19773
Reportable Transaction Accuracy Related Penalty (CR&TC Section 19164.5/ IRC)		<ul style="list-style-type: none"> ▪ Penalty is: <ul style="list-style-type: none"> - 20% if transaction adequately disclosed. - 30% if transaction not adequately disclosed. 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6662A with the following major modifications <ul style="list-style-type: none"> - The penalty cannot be imposed on any

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
Section 6662A)		<ul style="list-style-type: none"> ▪ The 20% penalty can only be avoided if the taxpayer satisfies the "strengthened reasonable cause"ⁱ exception under IRC Section 6664(d)(2)(C). ▪ Any understatement upon which the penalty is imposed is not subject to the valuation misstatement penalty under Sections 6662(e) and (h). ▪ A public entity required to pay a penalty with respect to a reportable transaction must disclose the imposition of the penalty in reports to the SEC for the period, as specified by the Secretary.ⁱⁱ 	<p>understatement to which the NEST understatement penalty has been assessed.</p> <ul style="list-style-type: none"> - The NEST understatement amount is included in determining whether a substantial understatement exists for purposes of imposing the penalty. - Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No appeal for FTB's refusal to rescind penalty. <ul style="list-style-type: none"> ▪ Penalty amounts are the same as federal.
Failure to Disclose Reportable Transaction Penalty (CR&TC Section 19772/IRC Section 6707A)	<ul style="list-style-type: none"> ▪ Penalty is: <ul style="list-style-type: none"> - \$15,000 for reportable transactions. - \$30,000 for listed transactions. ▪ Applies only to large entities or high net worth individuals. ▪ FTB Chief Counsel may rescind the penalty for reportable transactions other than listed transactions. No appeal for FTB's refusal to rescind penalty. ▪ Applies to taxable years beginning on or after January 1, 2003, except for: <ul style="list-style-type: none"> - Taxpayers who invested in a transaction after February 28, 2000 	<ul style="list-style-type: none"> ▪ Penalty amounts: <ul style="list-style-type: none"> - Individuals <ul style="list-style-type: none"> ▪ Reportable transactions - \$10,000 ▪ Listed transactions - \$100,000 - All other taxpayers <ul style="list-style-type: none"> ▪ Reportable transactions - \$50,000 ▪ Listed transactions - \$200,000 ▪ Commissioner may rescind the penalty for reportable transactions other than listed transactions. No judicial appeal for Commissioner's refusal to rescind penalty. ▪ A public entity required to pay a penalty for failing to disclose a listed transaction 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6707A with the following major exceptions: <ul style="list-style-type: none"> - Taxpayers with taxable income greater than \$200,000 subject to the penalty. - Penalty is: <ul style="list-style-type: none"> ▪ \$15,000 for reportable transactions ▪ \$30,000 for listed transactions - Includes reportable and listed transactions defined under Section 18407. - Reporting requirements to the SEC do not apply. - FTB Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No

Prepared by Terre Davis

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
	<p>and before January 1, 2004, and that transaction becomes listed at any time, or</p> <ul style="list-style-type: none"> - Taxpayers who invested in California listed transactions on or after September 2, 2003. 	<p>must disclose the imposition of the penalty in reports to the SEC for the period as specified by the Secretary shall.ⁱⁱⁱ</p>	<p>appeal for FTB's refusal to rescind penalty.</p>
Frivolous Submission Penalty (CR&TC Section 19179)	<ul style="list-style-type: none"> ▪ Penalty is \$5,000 for submitting a "specified frivolous submission". ▪ FTB Chief Counsel may rescind the penalty. No appeal for FTB's refusal to rescind penalty. 	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ No change to CR&TC Section 19179
Frivolous Return Penalty (CR&TC Section 19179/IRC Section 6702)	<ul style="list-style-type: none"> ▪ Penalty is \$5,000 if FTB contacts taxpayer regarding a potentially abusive tax shelter. ▪ FTB Chief Counsel may rescind the penalty. No appeal for FTB's refusal to rescind penalty. 	<ul style="list-style-type: none"> ▪ No change to existing federal law. ▪ Penalty is \$500. 	<ul style="list-style-type: none"> ▪ Retains CA penalty amount. ▪ Substituted "for taxpayers that have a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code" for "taxpayers that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777)".
Accuracy Related Penalty (CR&TC Section 19164/IRC Section 6662)	<ul style="list-style-type: none"> ▪ Modifies definition of "substantial" for corporate taxpayers contacted by FTB 	<ul style="list-style-type: none"> ▪ Modifies definition of "substantial" for corporate taxpayers. ▪ A corporate taxpayer has a 	<ul style="list-style-type: none"> ▪ Retains CA substantial understatement thresh holds for corporations. ▪ Deletes "contact by FTB

Prepared by Terre Davis

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
	<p>regarding potentially abusive tax shelter.</p> <ul style="list-style-type: none"> ▪ Corporate taxpayer has a substantial understatement if the understatement for taxable year exceeds the lesser of (1) 10% of tax required to be shown on the return (or, if greater, \$2,500), or (2) \$5 M. ▪ Elevates the standard a taxpayer must satisfy to reduce the amount of the understatement for items not adequately disclosed. The understatement is only reduced if taxpayer had a reasonable belief that the tax treatment was more likely than not the proper treatment (Section 19164(a)(5)). 	<p>substantial understatement if the amount of the understatement for the taxable year exceeds, the lesser of (1) 10% of tax required to be shown on return (or, if greater, \$10,000), or (2) \$10 M.</p> <ul style="list-style-type: none"> ▪ Does not raise standard to “more likely than not”. 	<p>regarding potentially abusive tax shelter (within the meaning of Section 19777)” for purposes of defining “substantial” for corporate taxpayers.</p> <ul style="list-style-type: none"> ▪ Repeals the reportable transaction understatement penalty (now Section 19164.5) and noneconomic substance transaction understatement penalty provisions under subdivision (d). ▪ Repeals the “more likely than not standard”.
<p>Interest Based Penalty (CR&TC Section 19777)</p>	<ul style="list-style-type: none"> ▪ Penalty is equal to 100% of the accrued interest on the underpayment of tax if taxpayer contacted by FTB regarding a potentially abusive tax shelter. 	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ Retains CA penalty ▪ Substituted “has been contacted by the Franchise Tax Board regarding a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code” for “contacted by the Franchise Tax Board regarding the use of a potentially abusive tax

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
			shelter” . ▪
Qualified amended return interest rate (CR&TC Section 19778)	<ul style="list-style-type: none"> ▪ Amended returns self-assessing tax that are filed after April 15, 2004 are subject to a 50% increased interest rate for understatements of tax related to a reportable transaction. 	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ No change to CR&TC Section 19778
Waive Suspension of Interest (CR&TC Section 19116/ IRC Section 6404)	<ul style="list-style-type: none"> ▪ Interest not suspended for individual taxpayers with revised taxable income greater than \$200,000 if FTB contacts the taxpayer regarding the use of a potentially abusive tax shelter. 	<ul style="list-style-type: none"> ▪ Amended to include that interest suspension also does not apply to amounts with respect to gross misstatements or amounts relating to any reportable transaction not adequately disclosed or any listed transaction as defined under IRC Section 6707A(c). 	<ul style="list-style-type: none"> ▪ Retains CA provision ▪ Amended to include that interest suspension also does not apply to amounts with respect to gross misstatements or amounts relating to any reportable transaction not adequately disclosed or any listed transaction as defined under IRC Section 6707A(c). ▪ The amendments made to Section 19116 are effective for notices issued after January 1, 2005.
PROMOTER/ MATERIAL ADVISOR PENALTIES			
Promoter Penalty (CR&TC Section 19177/IRC Section 6700)	<ul style="list-style-type: none"> ▪ Penalty is 50% of gross income derived by the person from the activity. ▪ Does not apply to a gross valuation overstatement. 	<ul style="list-style-type: none"> ▪ Penalty is now 50% of gross income derived (or to be derived) by the person from the activity. 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6700
Failure to Register Tax Shelter Penalty (CR&TC Section 19173/IRC Section 6707)	<ul style="list-style-type: none"> ▪ Penalty for failing to register tax shelter or filing incomplete registration. - \$15,000 ▪ Penalty for failing to register a listed transaction is the greater 		<ul style="list-style-type: none"> ▪ Repeals the provisions under Section 19173 for failing to register a tax shelter.

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
	<p>of:</p> <ul style="list-style-type: none"> - \$100,000, or - 50% of gross income derived from the activity. Intentional disregard – penalty is 75% of gross income. <ul style="list-style-type: none"> ▪ FTB Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No right to appeal FTB's refusal to rescind the penalty. 		
<p>Failure of Material Advisor to File Information Return for Reportable Transactions Penalty (CR&TC Section 19182/IRC Section 6707)</p>	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ Amended IRC Section 6707 to provide that any material advisor failing to file an information return, or files a false or incomplete return, is subject to the following penalties: <ul style="list-style-type: none"> - For reportable transactions the penalty is \$50,000 - For listed transactions the penalty is the greater of: <ol style="list-style-type: none"> 1) \$200,000, or 2) 50% gross income with respect to the transaction. Intentional disregard – penalty is 75% of gross income. ▪ Commissioner can only rescind penalty for reportable transactions other than listed transactions. No right to judicial appeal for Commissioner's refusal to rescind the penalty. 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6707, including penalty amounts, with the following major exception: <ul style="list-style-type: none"> - FTB Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No right to appeal FTB's refusal to rescind the penalty.

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
<p>Failure to Maintain List of Advisees - Reportable Transactions Penalty (CR&TC Section 19173/IRC Section 6708)</p>	<ul style="list-style-type: none"> ▪ Penalty for failure to make list available within 20 days of written request for reportable transactions, other than listed transactions, is \$10,000 a day after 20th day. ▪ Licensed attorneys, who are material advisors due solely to the practice of law, do not have to maintain investor lists if a transaction was entered into before January 1, 2004. ▪ Statute of limitations for assessing the penalty is 8-years after failure to provide or maintain list. ▪ FTB Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No right to appeal FTB's refusal to rescind penalty. 	<ul style="list-style-type: none"> ▪ Penalty for failure to make list available within 20 days of written request for reportable transactions, other than listed transactions, is \$10,000 a day after 20th day. ▪ Penalty can be waived if failure to make the list available is due to reasonable cause. 	<ul style="list-style-type: none"> ▪ Conforms to IRC Section 6708, including penalty amount, with the following major exceptions: <ul style="list-style-type: none"> - Retains 8-year statute of limitations for assessing the penalty. - Licensed attorneys, who are material advisors due solely to the practice of law, do not have to maintain investor lists if a transaction was entered into before January 1, 2004. - Chief Counsel may rescind the penalty for reportable transactions, other than listed transactions, if certain criteria are met. No right to appeal FTB's refusal to rescind penalty.
<p>Failure to Automatically Provide List of Advisees - Listed Transactions Penalty (CR&TC Section 19173/IRC Section 6708)</p>	<ul style="list-style-type: none"> ▪ The penalty for failure to submit the investor list to the FTB by the prescribed due date is the greater of: <ul style="list-style-type: none"> - \$100,000, or - 50% of gross income that material advisor derived from the activity. Intentional disregard –75% of gross income. ▪ Statute of limitations for assessing the penalty is 8-years after failure to provide or maintain list. 	<ul style="list-style-type: none"> ▪ None 	<ul style="list-style-type: none"> ▪ Retains CA penalty for listed transactions, as defined in IRC Section 6707A(c). ▪ Repeals the 75% intentional disregard penalty.

Prepared by Terre Davis

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
	<ul style="list-style-type: none"> ▪ FTB Chief Counsel cannot waive penalty for listed transactions. No right to appeal FTB's refusal to rescind penalty. 		
<p>Preparer Penalty (CR&TC Section 19166/ IRC Section 6694)</p>	<ul style="list-style-type: none"> ▪ For taxpayer's contacted by the FTB regarding the use of a potentially abusive tax shelter the penalty is \$1,000. ▪ If willful/reckless conduct the penalty is increased to \$5,000 ▪ Replaced "possibility standard" with requirement that there be a reasonable belief the tax treatment of the position was more likely than not standard. ▪ Replaced the not frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position. 	<ul style="list-style-type: none"> ▪ No change to existing federal law. ▪ Penalty is \$250. ▪ If willful/reckless conduct penalty increased to \$1,000. 	<ul style="list-style-type: none"> ▪ Retain CA provision ▪ Substituted "has been contacted by the Franchise Tax Board regarding a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code" for "contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter" .

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
OTHER			
Extended Statute of Limitations (CR&TC Section 19755/IRC Section 6501)	<ul style="list-style-type: none"> ▪ FTB has 8 years after taxpayer files a return to mail a proposed deficiency assessment relating to an abusive tax avoidance transaction. 	<ul style="list-style-type: none"> ▪ If a listed transaction not properly disclosed on return, the statute of limitations is extended 1 year after the earlier of the date the: <ul style="list-style-type: none"> - Disclosure information is furnished to IRS, or - Material advisor satisfies list maintenance requirements under IRC Section 6112 with respect to the IRS request. 	<ul style="list-style-type: none"> ▪ No change to CR&TC Section 19755
Confidentiality Related to Taxpayer Communications (CR&TC Section 21028/IRC Section 7525)	<ul style="list-style-type: none"> ▪ Communications with respect to tax shelters are not subject to the confidentiality provision that applies to communications between a taxpayer and a tax practitioner. ▪ Chapter 412 (AB 1416) extends repeal date from 1/1/05 to 1/1/09. 	<ul style="list-style-type: none"> ▪ Federal law is the same as CA except there is no repeal date. 	<ul style="list-style-type: none"> ▪ No change to CR&TC Section 21028
Tax Shelter Injunctions (CR&TC Section 19715/IRC Section 7408)	<ul style="list-style-type: none"> ▪ An injunction may be sought against a material advisor to enjoin the advisor from failing to: <ul style="list-style-type: none"> - File an information return with respect to a reportable transaction, or - Maintain, or to timely furnish upon written request by FTB, a list of investors for each reportable transaction. 	<ul style="list-style-type: none"> ▪ An injunction may be sought against a material advisor to enjoin the advisor from failing to: <ul style="list-style-type: none"> - File an information return with respect to a reportable transaction, and subject to the penalty under Section 6707, and ▪ Maintain, or to timely furnish upon written request by the IRS, a list of investors for each reportable transaction, and subject to the penalty 	<ul style="list-style-type: none"> ▪ No change to CR&TC Section 19715

Prepared by Terre Davis

Comparison of Federal Tax Shelter Law to California's 2003 Tax Shelter Law and 2005 Tax Shelter Law Changes

November 2005

STATUTE TITLE	Chs. 654 (A.B. 1601) and 656 (SB 614) California Tax Shelter Law (2003)	P.L. 108-357 (HR 4520) 2004 American Jobs Creation Act	Ch. 691 (AB 115) California Conformity Bill - Tax Shelters (2005)
		under Section 6708. ▪ May also seek injunctions for violations of any of the rules under Circular 230.	
Interest Deduction (CR&TC Section 17201 and Section 24344/IRC Section 163(m))	▪ Allows deduction for interest paid on underpayment of tax attributable to potentially abusive tax shelter.	▪ Disallows deduction for interest paid or accrued within a taxable year on underpayment of tax attributable to non-disclosed reportable transactions.	▪ No change to CR&TC Section 17201 and Section 24344.

ⁱ The strengthened reasonable cause exception is available only if the relevant facts affecting the tax treatment are adequately disclosed, there is or was substantial authority for the claimed tax treatment, and the taxpayer reasonably believed that the claimed tax treatment was more likely than not the proper treatment.

ⁱⁱ The penalty must be disclosed in reports to the SEC once the taxpayer has exhausted its administrative and judicial remedies with respect to the penalty (or if earlier, when paid). However, the taxpayer is only required to report the penalty one time. This requirement also applies to a public entity that is subject to a gross valuation misstatement penalty under 6662(h) attributable to a non-disclosed listed transaction or non-disclosed reportable avoidance transaction.

ⁱⁱⁱ See endnote 2.