

Penalties-SB 614

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SEC. 6. Section 19164 of the Revenue and Taxation Code is amended to read:

19164. (a) (1) An accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662 of the Internal Revenue Code, relating to imposition of accuracy-related penalty, except as otherwise provided.

(2) With respect to corporations, this subdivision shall apply to all of the following:

(A) All taxable years beginning on or after January 1, 1990.

(B) Any other taxable year for which an assessment is made after July 16, 1991.

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated group that files a consolidated federal return, are modified to apply to those entities required to be included in a combined report under Section 25101 or 25110. For these purposes, entities included in a combined report pursuant to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be considered only to the extent required to be included in the combined report.

(3) Section 6662(d)(1)(B) of the Internal Revenue Code is modified to provide that in the case of a corporation, other than an S corporation, that has been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777), there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of:

(A) Ten percent of the tax required to be shown on the return for the taxable year (or, if greater, two thousand five hundred dollars (\$2,500)), or

(B) Five million dollars (\$5,000,000).

(4) Section 6662(d)(2)(A) of the Internal Revenue Code is modified to additionally provide that the excess determined under Section

6662(d)(2)(A) of the Internal Revenue Code shall be determined without regard to items to which Section 19773 applies and without regard to items with respect to which a penalty is imposed by Section 19774.

(5) 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), Section 6662(d)(2)(B)(i) of the Internal Revenue Code is modified to substitute the phrase "the tax treatment of any item by the taxpayer if the taxpayer had reasonable belief that the tax treatment was more likely than not the proper treatment" for the phrase "the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment" contained therein.

(b) For purposes of Section 6662(d) of the Internal Revenue Code, Section 6664 of the Internal Revenue Code (as modified by subdivision (d)), Section 6694(a)(1) of the Internal Revenue Code, and this part, the Franchise Tax Board may prescribe a list of positions for which the Franchise Tax Board believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper tax treatment. That list (and any revisions thereof) shall be published through the use of Franchise Tax Board Notices or other published positions. In addition, the "listed transactions" identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board. This subdivision applies only to the list of positions relating to abusive tax shelters, within the meaning of Section 19777.

(c) A fraud penalty shall be imposed under this part and shall be determined in accordance with Section 6663 of the Internal Revenue Code, relating to imposition of fraud penalty, except as otherwise provided.

(d) Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply, except as otherwise provided.

(1) 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), Section 6664 of the Internal Revenue

Code is modified to additionally provide that no penalty shall be imposed under Section 19773 with respect to any portion of a reportable transaction understatement if it is shown that there was a reasonable cause for that portion and that the taxpayer acted in good faith with respect to that portion.

(2) Paragraph (1) does not apply to any reportable transaction understatement unless all of the following requirements are met:

(A) (i) The relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with the regulations prescribed under Section 6011 of the Internal Revenue Code, as modified by Section 18407.

(ii) A taxpayer failing to adequately disclose in accordance with Section 6011 of the Internal Revenue Code, as modified by Section 18407, shall be treated as meeting the requirements of this subparagraph, if the penalty for that failure was rescinded under subdivision (e) of Section 19772.

(iii) For taxable years beginning on or before January 1, 2003, "adequately disclosed" includes the disclosure of the tax shelter identification number on the taxpayer's return, as required by subdivision (c) of Section 18628.

(B) There is or was substantial authority for that treatment.

(C) The taxpayer reasonably believed that that treatment was more likely than not the proper treatment.

(3) For purposes of subparagraph (C) of paragraph (2) all of the following shall apply:

(A) A taxpayer shall be treated as having a reasonable belief with respect to the tax treatment of an item only if that belief meets both of the following requirements:

(i) Is based on the facts and law that exist at the time the return of tax that includes that tax treatment is filed.

(ii) Relates solely to the taxpayer's chances of success on the merits of that treatment and does not take into account the possibility that the return will not be audited, that the treatment will not be raised on audit, or that the treatment will be resolved through settlement if it is raised.

(B) (i) An opinion of a tax advisor may not be relied upon to establish the reasonable belief of a taxpayer if either of the

following conditions are met:

(I) The tax advisor is described in clause (ii).

(II) The opinion is described in clause (iii).

(ii) A tax advisor is described in this clause if the tax advisor meets any of the following conditions:

(I) Is a material advisor (within the meaning of subdivision (d) of Section 18648) who participates in the organization, management, promotion, or sale of the transaction or who is related (within the meaning of Sections 267(b) or 707(b)(1) of the Internal Revenue Code) to any person who so participates.

(II) Is compensated directly or indirectly by a material advisor with respect to the transaction.

(III) Has a fee arrangement with respect to the transaction that is contingent on all or part of the intended tax benefits from the transaction being sustained.

(IV) As determined under regulations prescribed by either the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board, has a continuing financial interest with respect to the transaction.

(iii) For purposes of clause (i), an opinion is disqualified if the opinion meets any of the following conditions:

(I) Is based on unreasonable, factual, or legal assumptions (including assumptions as to future events).

(II) Unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person.

(III) Does not identify and consider all relevant facts.

(IV) Fails to meet any other requirement as either the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board may by forms and instructions prescribe.

(e) Section 6665 of the Internal Revenue Code, relating to applicable rules, shall apply, except as otherwise provided.

(f) 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), Section 461(i)(3)(C) of the Internal Revenue Code is modified by substituting a reference to "Section 1274

(b)(3)(B) of the Internal Revenue Code, as modified by subdivision

(g) of Section 19164" instead of the reference to "Section 6662(d)(2)

(C)(iii)" contained therein.

(g) 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), Section 1274(b)(3)(B)(i) of the Internal Revenue Code is modified to provide that for purposes of Section 1274(b)(3)(B) of the Internal Revenue Code, the term "tax shelter" means (1) a partnership or other entity, (2) any investment plan or arrangement, or (3) any other plan or arrangement, if a significant purpose of the partnership, entity, plan, or arrangement is the avoidance or evasion of federal income tax or the tax imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

SEC. 7. Section 19166 of the Revenue and Taxation Code is amended to read:

19166. A penalty shall be imposed for understatement of any taxpayer's liability by a tax return preparer. The penalty shall be determined in accordance with Section 6694 of the Internal Revenue Code, except as otherwise provided.

(a) (1) 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), Section 6694(a) of the Internal Revenue Code is modified to substitute "one thousand dollars (\$1,000)" for "two hundred fifty dollars (\$250)."

(2) Section 6694(a)(1) of the Internal Revenue Code is modified to substitute the phrase "reasonable belief that the tax treatment in that position was more likely than not the proper treatment" instead of the phrase "realistic possibility of being sustained on its merits" contained therein.

(3) Section 6694(a)(3) of the Internal Revenue Code is modified to substitute the phrase "or there was no reasonable basis for the tax treatment of that position" instead of the phrase "or was frivolous" contained therein.

(b) Section 6694(b) of the Internal Revenue Code is modified to substitute "\$5,000" for "\$1,000."

(c) Section 6694(c) of the Internal Revenue Code shall not apply and, in lieu thereof, the following shall apply:

(1) If, within 30 days after the day on which notice and demand of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is made against any person who is an income tax return preparer, that person pays an amount which is not less than 15 percent of the amount of that penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of that penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding Section 19381, the beginning of that proceeding or levy during the time that prohibition is in force may be enjoined in a proceeding in the superior court.

(2) If, within 30 days after the day on which a claim for refund of any partial payment of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is denied (or, if earlier, within 30 days after the expiration of six months after the day on which the claim for refund has been filed), the income tax return preparer fails to begin a proceeding in the superior court for the determination of his or her liability for that penalty, paragraph (1) shall cease to apply with respect to that penalty, effective on the day following the close of the applicable 30-day period referred to in this subdivision.

(3) The running of the period of limitations provided in Section 19371 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Franchise Tax Board is prohibited from collecting by levy or a proceeding in court.

SEC. 8. Section 19173 of the Revenue and Taxation Code is amended to read:

19173. (a) (1) Any person required to register under Section 18628 or maintain and provide a list under Section 18648, for any calendar year, is liable for a penalty as determined under subdivision (b) if that person does any of the following:

(A) (i) Fails to register under Section 18628 on or before the date prescribed therefor.

(ii) For reportable transactions (as defined under Section 18407), fails to furnish the list within 20 days of a request.

(iii) For listed transactions, fails to provide the list on or before the date prescribed therefor in Section 18648.

(B) Registers a tax shelter or provides a list which fails to show the information required under Section 18628 or Section 18648.

(C) Fails to furnish the required statement to each investor.

(2) Paragraph (1) of this subdivision does not apply if it is shown that subdivision (d) applies or that the information required under paragraph (2) of subdivision (b) of Section 18628 was not identified in a Franchise Tax Board Notice issued prior to the date the transaction or shelter was entered into.

(b) (1) (A) For purposes of subdivision (a), the amount determined under this subdivision for a tax shelter required to be registered under Section 18628 is, except as provided in subparagraph (B), fifteen thousand dollars (\$15,000).

(B) If the penalty is with respect to a listed transaction (as defined under Section 18407), the amount determined under this subdivision for a tax shelter required to be registered under Section 18628 shall be the greater of:

(i) One hundred thousand dollars (\$100,000).

(ii) Fifty percent of the gross income that the organizer or material advisor derived from that activity.

(C) In the case of intentional disregard by an organizer or material advisor of the requirement to maintain and provide information regarding a listed transaction (as defined under Section 18407) the percentage of gross income under clause (ii) of subparagraph (B) is "75 percent" instead of "50 percent."

(2) For purposes of subdivision (a), the amount determined under this subdivision for the failure to provide a list required to be maintained under Section 18648 is as follows:

(A) For reportable transactions, the penalty amount shall be ten thousand dollars (\$10,000) for each day after the 20th day that the organizer or material advisor has failed to make the list available to the Franchise Tax Board after written request for that list was made by the Franchise Tax Board.

(B) For listed transactions, the penalty amount shall be determined under subparagraph (B) of paragraph (1).

(c) The penalty imposed by subdivision (a) shall be assessed against the person required to file a copy of the federal registration or required to register under Section 18628, or the person required to maintain or provide a list under Section 18648. The penalty may be assessed at any time during the period ending eight years after the failure has occurred.

(d) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by subdivision (a) with respect to any violation with respect to a tax shelter required to be registered under Section 18628, or a list required to be maintained or provided under Section 18648, if all of the following apply:

(A) The violation is with respect to a reportable transaction, other than a listed transaction (as defined under subdivision (a) of Section 18407).

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(e) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed by subdivision (a).

(f) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part

11 (commencing with Section 23001), or this part.

SEC. 9. Section 19177 of the Revenue and Taxation Code is amended to read:

19177. (a) A penalty shall be imposed for promoting abusive tax shelters. The penalty shall be determined in accordance with the provisions of Section 6700 of the Internal Revenue Code, except as otherwise provided.

(b) Notwithstanding Section 6700(a) of the Internal Revenue Code, if an activity with respect to which a penalty imposed under Section 6700(a) of the Internal Revenue Code involves a statement described in Section 6700(a)(2)(A) of the Internal Revenue Code, the amount of the penalty imposed under subdivision (a) shall be equal to 50 percent of the gross income derived (or to be derived) from that activity by the person on which the penalty is imposed.

SEC. 10. Section 19179 of the Revenue and Taxation Code is amended to read:

19179. A penalty shall be imposed for filing a frivolous return. The penalty shall be determined in accordance with Section 6702 of the Internal Revenue Code, except as otherwise provided.

(a) Section 6702 of the Internal Revenue Code shall be applied to returns required to be filed under this part.

(b) 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), Section 6702(a) of the Internal Revenue Code is modified as follows:

(1) By substituting "\$5,000" instead of "\$500."

(2) By substituting the phrase "person" instead of the phrase "individual" in each place that it appears.

(3) By substituting "tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001) or this part" instead of the phrase "tax imposed by subtitle A" contained therein.

(4) By substituting the phrase "is based on" instead of the phrase "is due to" contained therein.

(5) By substituting the phrase "frivolous or is based on a

position that the Franchise Tax Board has identified as frivolous under subdivision (c) of Section 19179" instead of the phrase "frivolous" contained therein.

(6) By substituting the phrase "reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001) or this part as determined by the Franchise Tax Board" instead of the phrase "a desire (which appears on the purported return) to delay or impede the administration of Federal income tax laws" contained therein.

(c) (1) The Franchise Tax Board shall prescribe (and periodically revise) a list of positions which the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board has identified as being frivolous for purposes of this section.

(2) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or prescribed by the Franchise Tax Board pursuant to paragraph (1).

(d) (1) Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of five thousand dollars (\$5,000).

(2) For purposes of this section, all of the following shall apply:

(A) The term "specified frivolous submission" means a specified submission if any portion of that submission meets any of the following conditions:

(i) Is based on a position which the Franchise Tax Board has identified as frivolous under subdivision (c).

(ii) Reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001) or this part as determined by the Franchise Tax Board.

(B) The term "specified submission" means any of the following:

(i) A protest under Section 19041.

(ii) A request for a hearing under Section 19044.

(iii) An application under any of the following sections:

(I) Section 19008 (relating to agreements for payment of tax liability in installments).

(II) Section 19443 (relating to compromises).

(III) Section 21004 (relating to actions of the Taxpayer Right's Advocate).

(3) If the Franchise Tax Board provides a person with notice that a submission is a specified frivolous submission and the person withdraws that submission within 30 days after the notice, the penalty imposed under paragraph (1) does not apply with respect to that submission.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section if both of the following apply:

(A) Imposing the penalty would be against equity and good conscience.

(B) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) The penalties imposed by this section shall be in addition to any other penalty provided by law.

19772. (a) Any large entity or high net worth individual who fails to include on any return or statement any information with respect to a reportable transaction that is required under Section 6011 of the Internal Revenue Code, as modified by Section 18407, to be included with that return or statement shall pay a penalty for each omission in the amount determined under subdivision (b).

(b) (1) Except as provided in paragraph (2), the amount of the

penalty under subdivision (a) shall be fifteen thousand dollars (\$15,000).

(2) The amount of the penalty under subdivision (a) with respect to a listed transaction shall be thirty thousand dollars (\$30,000).

(c) For purposes of this section:

(1) The term "high net worth individual" means, with respect to a transaction, an individual whose net worth exceeds two million dollars (\$2,000,000) immediately before the transaction.

(2) The term "large entity" means, with respect to any taxable year, a person (other than an individual) with gross receipts in excess of ten million dollars (\$10,000,000) for either the taxable year in which the reportable transaction occurs or in the preceding taxable year. Rules similar to the rules of Section 448(c)(2) and 448(c)(3) of the Internal Revenue Code, other than Section 448(c)(3) (A) of the Internal Revenue Code, shall apply for purposes of this paragraph.

(d) For purposes of this section:

(1) The term "reportable transaction" means any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed by the Secretary of the Treasury under Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board under Section 18407, that transaction is of a type that the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board determines as having a potential for tax avoidance or evasion.

(2) Except as provided in regulations prescribed by the Secretary of the Treasury or by the Franchise Tax Board, the term "listed transaction" means a reportable transaction (as defined in paragraph (1)) that is the same as, or substantially similar to, a transaction specifically identified by the Secretary of the Treasury for purposes of Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board for purposes of Section 6011 of the Internal Revenue Code or Section 18407, as a tax avoidance transaction.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with

respect to any violation if all of the following apply:

(A) The violation is with respect to a reportable transaction other than a listed transaction.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) Article 3

(commencing with Section 19031) of Chapter 4 (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed under this section.

(g) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

19773. (a) If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of that understatement.

(b) For purposes of this section, both of the following shall apply:

(1) The term "reportable transaction understatement" means the sum of subparagraphs (A) and (B).

(A) The product of:

(i) The amount of the increase (if any) in taxable income which

results from a difference between the proper tax treatment of an item to which this section applies and the taxpayer's treatment of that item (as shown on the taxpayer's return of tax).

(ii) The highest rate of tax imposed on the taxpayer under Part 10 (commencing with Section 17001) in the case of a taxpayer subject to tax under that part or under Part 11 (commencing with Section 23001) in the case of a taxpayer that is subject to tax under that part.

(B) The amount of the decrease (if any) in the aggregate amount of credits determined under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001), as applicable, that results from a difference between the taxpayer's treatment of an item to which this section applies (as shown on the taxpayer's return of tax) and the proper tax treatment of that item.

(C) For purposes of subparagraph (A), any reduction of the excess of deductions allowed for the taxable year over gross income for that year, and any reduction in the amount of capital losses which would (without regard to Section 1211 of the Internal Revenue Code) be allowed for that year, shall be treated as an increase in taxable income.

(2) This section shall apply to any item that is attributable to either of the following:

(A) Any listed transaction.

(B) Any reportable transaction (other than a listed transaction) if a significant purpose of that transaction is the avoidance or evasion of tax imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(c) (1) Subdivision (a) shall be applied by substituting "30 percent" for "20 percent" with respect to the portion of any reportable transaction understatement with respect to which the requirement of Section 6664 of the Internal Revenue Code, as modified by subparagraph (A) of paragraph (2) of subdivision (d) of Section 19164, is not met.

(2) (A) If the notice of proposed assessment of additional tax has been sent with respect to a penalty to which this section applies, only the Chief Counsel of the Franchise Tax Board may compromise all or any portion of that penalty.

(B) The exercise of authority under subparagraph (A) shall be at

the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(C) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(d) For purposes of this section, the terms "reportable transaction" and "listed transaction" have the respective meanings given to those terms by subdivision (a) of Section 18407.

(e) (1) In the case of an understatement (as defined in Section 6662(d)(2) of the Internal Revenue Code) all of the following shall apply:

(A) The amount of the understatement (determined without regard to this paragraph) shall be increased by the aggregate amount of reportable transaction understatements and noneconomic substance transaction understatements for purposes of determining whether the understatement is a substantial understatement under Section 6662(d) (1) of the Internal Revenue Code.

(B) The addition to tax under subdivision (a) of Section 19164 shall apply only to the excess of the amount of the substantial understatement (if any) after the application of subparagraph (A) over the aggregate amount of reportable transaction understatements and noneconomic substance transaction understatements.

(2) (A) In determining the fraud penalty imposed under subdivision (c) of Section 19164, references to an underpayment in Section 6663 of the Internal Revenue Code shall be treated as including references to a reportable transaction understatement and a noneconomic substance transaction understatement.

(B) This section does not apply to any portion of an understatement on which a penalty is imposed under Section 19774.

(3) Except as provided in regulations, in no event may any tax treatment included with an amendment or supplement to a return of tax be taken into account in determining the amount of any reportable transaction understatement or noneconomic substance transaction understatement, if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by either the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board regarding the examination of the return or such

other date as is specified by the Franchise Tax Board.

(4) For purposes of this subdivision, the term "noneconomic substance transaction understatement" has the meaning given that term by subdivision (c) of Section 19774.

19774. (a) If a taxpayer has a noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of that understatement.

(b) (1) Subdivision (a) shall be applied by substituting "20 percent" for "40 percent" with respect to the portion of any noneconomic substance transaction understatement with respect to which the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or a statement attached to the return.

(2) For taxable years beginning before January 1, 2003, "adequately disclosed" includes the disclosure of the tax shelter identification number on the taxpayer's return as required by subdivision (c) of Section 18628.

(c) For purposes of this section:

(1) The term "noneconomic substance transaction understatement" means any amount which would be an understatement under paragraph (1) of subdivision (b) of Section 19773 if Section 19773 were applied by taking into account items attributable to noneconomic substance transactions rather than items to which Section 19773 applies.

(2) A "noneconomic substance transaction" includes the disallowance of any loss, deduction or credit, or addition to income attributable to a determination that the disallowance or addition is attributable to a transaction or arrangement that lacks economic substance including a transaction or arrangement in which an entity is disregarded as lacking economic substance. A transaction shall be treated as lacking economic substance if the taxpayer does not have a valid nontax California business purpose for entering into the transaction.

(d) (1) If the notice of proposed assessment of additional tax has been sent with respect to a penalty to which this section applies, only the Chief Counsel of the Franchise Tax Board may compromise all or any portion of that penalty.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

19777. (a) If a taxpayer has been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter, and has a deficiency, there shall be added to the tax an amount equal to 100 percent of the interest payable under Section 19101 for the period beginning on the last date prescribed by law for the payment of that tax (determined without regard to extensions) and ending on the date the notice of proposed assessment is mailed.

(b) "Potentially abusive tax shelter" means:

(1) Any tax shelter (as defined in Section 6111 of the Internal Revenue Code) with respect to which registration is required under Section 6111 of the Internal Revenue Code.

(2) Any entity, investment plan or arrangement, or other plan or arrangement which is of a type that the Secretary of the Treasury or the Franchise Tax Board determines by regulations as having a potential for tax avoidance or evasion.

(c) The penalty imposed by this section is in addition to any other penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23000), or this part.

(d) This section shall apply to notices of proposed assessments mailed after the effective date of the act adding this section.