

## Comparison of New Federal Tax Shelter Law to California's Current Tax Shelter Law

As of October 27, 2004

STATUTE TITLE	SB 614 California Tax Shelter Law	2004 HR.4520 American Jobs Creation Act
<b>INVESTOR PENALTIES</b>		
Non-economic substance transaction	<ul style="list-style-type: none"> <li>▪ Penalty is:                             <ul style="list-style-type: none"> <li>- 20% of understatement if adequately disclosed.</li> <li>- 40% of understatement if not adequately disclosed.</li> </ul> </li> <li>▪ FTB Chief Counsel may rescind reportable transaction penalty. No appeal for refusal to rescind penalty</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Reportable transaction understatement	<ul style="list-style-type: none"> <li>▪ Penalty is:                             <ul style="list-style-type: none"> <li>- 20% if transaction adequately disclosed.</li> <li>- 30% if transaction not adequately disclosed.</li> </ul> </li> <li>▪ 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 ATS.</li> <li>▪ FTB Chief Counsel may rescind the penalty. No appeal for refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Penalty is the same as CA.</li> <li>▪ The 20% penalty can only be avoided if the taxpayer satisfies the "strengthened reasonable cause" exception.</li> <li>▪ Any understatement upon which penalty is imposed is not subject to the valuation misstatement penalty under Sections 6662(e) and (h).</li> </ul>
Failure to disclose reportable transaction	<ul style="list-style-type: none"> <li>• Penalty is:                             <ul style="list-style-type: none"> <li>- \$15K for reportable transactions.</li> <li>- \$30K for listed transactions.</li> </ul> </li> <li>• Applies only to large entities or high</li> </ul>	<ul style="list-style-type: none"> <li>• Penalty is                             <ul style="list-style-type: none"> <li>- \$10K – individuals; increased to \$100K for listed transaction.</li> <li>- \$50K – all other taxpayers;</li> </ul> </li> </ul>

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	<p>net worth individuals.</p> <ul style="list-style-type: none"> <li>• FTB Chief Counsel may rescind reportable transaction penalty. No appeal for refusal to rescind penalty.</li> <li>• Applies to taxable years beginning on or after January 1, 2003, except for:               <ol style="list-style-type: none"> <li>(1) Taxpayers who invested in a transaction after February 28, 2000 and before January 1, 2004, and that transaction becomes listed at any time, or</li> <li>(2) Taxpayers who invested in California listed transactions on or after September 2, 2003.</li> </ol> </li> </ul>	<p>increased to \$200K for listed transaction.</p> <ul style="list-style-type: none"> <li>• Commissioner may rescind reportable transaction penalty. No judicial appeal for refusal to rescind penalty.</li> <li>• IRS must send Congress an annual report summarizing application of penalties, description of penalties rescinded and reason for rescission.</li> <li>• A public entity required to pay a penalty for failing to disclose a listed transaction must disclose the imposition of the penalty in reports to the SEC for the period as the Secretary shall specify.</li> </ul>
Frivolous submission penalty	<ul style="list-style-type: none"> <li>▪ Penalty is \$5000 for submitting a "specified frivolous submission".</li> <li>▪ FTB Chief Counsel may rescind penalty. No appeal for FTB's refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Frivolous return penalty	<ul style="list-style-type: none"> <li>▪ Penalty is \$5000 if FTB contacts taxpayer regarding a potentially ATS.</li> <li>▪ FTB Chief Counsel may rescind penalty. No appeal for FTB's refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>▪ No change to existing federal law. Current penalty is \$500.</li> </ul>
Accuracy related penalty changes	<ul style="list-style-type: none"> <li>• Modifies definition of "substantial" for corporate taxpayers contacted by FTB regarding potentially abusive tax shelter.</li> </ul>	<ul style="list-style-type: none"> <li>• Modifies definition of "substantial" for corporate taxpayers.</li> <li>• A corporate taxpayer has a substantial understatement if the amount of the</li> </ul>

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	<ul style="list-style-type: none"> <li>• 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, <b>if greater, \$2,500</b>), or (2) <b>\$5 M.</b></li> <li>• 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.</li> </ul>	<p>understatement for the taxable year exceeds, the lesser of (1) 10% of tax required to be shown on return (or, <b>if greater, \$10K</b>), or (2) <b>\$10 M.</b></p> <ul style="list-style-type: none"> <li>• Does not raise standard to “more likely than not”.</li> </ul>
Waive suspension of interest	<ul style="list-style-type: none"> <li>▪ Interest not suspended for individual taxpayers with revised taxable income greater than \$200K if FTB contacts the taxpayer regarding the use of a potentially ATS.</li> </ul>	<ul style="list-style-type: none"> <li>▪ No change to existing federal law, which allows suspension of interest on tax shelter assessments.</li> </ul>
Interest Based Penalty	<ul style="list-style-type: none"> <li>▪ Penalty is equal to 100% of the accrued interest on the underpayment of tax if taxpayer contacted by FTB regarding a potentially ATS.</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Qualified amended return interest rate	<ul style="list-style-type: none"> <li>▪ Amended returns self-assessing tax that are filed after 4/15/04 are subject to a 50% increased interest rate for understatements of tax related to a reportable transaction.</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>

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<b>PROMOTER/ORGANIZER PENALTIES</b>		
Promoter penalty	<ul style="list-style-type: none"> <li>• Penalty is 50% of gross income derived by the person from the activity.</li> <li>• Does not apply to a gross valuation overstatement.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Same</b></li> </ul>
Failure to register tax shelter	<ul style="list-style-type: none"> <li>• Penalty for failing to register tax shelter or filing incomplete registration. - \$15K</li> <li>• Penalty for listed transaction is the greater of: (1) \$100K, or (2) 50% of gross income derived from the activity. Intentional disregard – penalty is 75% of gross income.</li> <li>• FTB Chief Counsel cannot waive penalty for listed transactions. No right to appeal refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>• Repealed registration regime and associated penalties.</li> <li>• Created information return reporting requirements.</li> </ul>
Failure of Material Advisor to File Information Return for Reportable Transactions	<ul style="list-style-type: none"> <li>▪ None</li> </ul>	<ul style="list-style-type: none"> <li>▪ Penalty - \$50K</li> <li>▪ For listed transaction penalty is greater of: (1) \$200K, or (2) 50% gross income with respect to the transaction. Intentional disregard – penalty is 75% of gross income.</li> <li>• Commissioner cannot waive penalty with respect to listed transaction. No right to judicial appeal for refusal to rescind penalty.</li> <li>• IRS must send Congress an annual</li> </ul>

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		report summarizing application of penalties, description of penalties rescinded and reason for rescission.
Failure to Provide Investor List for Reportable Transactions	<ul style="list-style-type: none"> <li>• Penalty is \$10K a day after 20<sup>th</sup> day for reportable transactions.</li> <li>• 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.</li> <li>• SOL for imposing penalty is 8 yrs after failure to provide or maintain list.</li> <li>• FTB Chief Counsel can only waive penalty for reportable transactions. No right to appeal refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>• Penalty is the same as for CA.</li> <li>• Penalty can be waived if failure to make the list available is due to reasonable cause.</li> </ul>
Failure to Automatically Provide Investor List for Listed Transactions	<ul style="list-style-type: none"> <li>• Penalty is the greater of:                             <ul style="list-style-type: none"> <li>- \$100K, or</li> <li>- 50% of gross income derived from the activity. Intentional disregard – 75% of gross income.</li> </ul> </li> <li>• SOL for imposing penalty is 8 yrs after failure to provide or maintain list.</li> <li>• FTB Chief Counsel cannot waive penalty for listed transactions. No right to appeal refusal to rescind penalty.</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
Preparer penalty	<ul style="list-style-type: none"> <li>▪ Penalty - \$1000. If willful/reckless conduct - \$5,000</li> <li>▪ Replaced “possibility standard” with</li> </ul>	<ul style="list-style-type: none"> <li>▪ No change to existing federal law. Current penalty is \$250.</li> <li>▪ If willful/reckless conduct penalty</li> </ul>

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	<p>requirement that there be a reasonable belief the tax treatment of the position was more likely than not standard.</p> <ul style="list-style-type: none"> <li>▪ Replaced the not frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.</li> </ul>	<p>increased to \$1000.</p>
<b>Extended SOL</b>	<ul style="list-style-type: none"> <li>▪ FTB has 8 years after taxpayer files a return to mail a proposed deficiency assessment relating to an abusive tax avoidance transaction.</li> </ul>	<ul style="list-style-type: none"> <li>▪ If listed transaction not properly disclosed on return, the SOL is extended 1 year after the earlier of the date:               <ul style="list-style-type: none"> <li>(1) Disclosure information is furnished to IRS, or</li> <li>(2) Material advisor satisfies list maintenance requirements with respect to IRS request.</li> </ul> </li> </ul>
<b>Confidentiality related to taxpayer communications</b>	<ul style="list-style-type: none"> <li>▪ Communications with respect to tax shelters are not subject to the confidentiality provision that applies to communications between a taxpayer and a tax practitioner.</li> <li>▪ <b>Ch. 412 (AB 1416) extends repeal date from 1/1/05 to 1/1/09.</b></li> </ul>	<ul style="list-style-type: none"> <li>▪ <b>Same – except no sunset date.</b></li> </ul>
<b>Tax Shelter Injunctions</b>	<ul style="list-style-type: none"> <li>• An injunction may be sought against a material advisor to enjoin the advisor from failing to:               <ul style="list-style-type: none"> <li>(1) File an information return with respect to a reportable transaction, or</li> <li>(2) Maintain, or to timely furnish upon</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• <b>Same</b></li> <li>• May also seek injunctions for violations of any of the rules under Circular 230.</li> </ul>

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	written request by FTB, a list of investors for each reportable transaction.	
<b>Interest Deduction</b>	<ul style="list-style-type: none"> <li>Allows deduction for interest paid on underpayment of tax attributable to potentially ATS.</li> </ul>	<ul style="list-style-type: none"> <li>Disallows deduction for interest paid or accrued within a taxable year on underpayment of tax attributable to non-disclosed reportable and listed transactions.</li> </ul>