

FTB NOTICE

California Franchise Tax Board - Legal Division

P.O. Box 1468
Sacramento, CA 95812-1468Telephone: (---) -----
FAX: (---) -----**FTB NOTICE 93-5**

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Control Number:
410:BRL:CN-93-0157**Subject: Substantial Understatement Penalty - 18 CCR 25934.4**

Title 18, California Code of Regulations (CCR), Section 25934.4 generally provides that an accuracy-related penalty for substantial understatement of tax liability will not be assessed with respect to taxpayers' good faith determinations of the components of a unitary business or classification of items of income as business or nonbusiness income. The regulation provides certain exceptions to this general rule and allows the penalty to be assessed where the taxpayer has treated the same item or issue differently in previous years, or has received a final administrative or court determination on the same item or issue. As explained below, the regulation continues to apply now that California has conformed to federal accuracy-related penalty provisions.

18 CCR 25934.4 was promulgated under former Revenue and Taxation Code (RTC) §25934.4. As originally enacted by SB 813 (Stats. 1983, Ch. 498), that section incorporated by reference former Internal Revenue Code §6661, generally imposing the substantial understatement penalty. In 1984, RTC §25934.4 was amended to apply the penalty only to tax shelter items (SB 2224, Stats. 1984, Ch. 1565); the regulation therefore no longer had general application.

Internal Revenue Code (IRC) §6661 was repealed by P.L. 101-239 (1989 OBRA) and the substantial understatement penalty provisions were moved to current IRC §6662(d) as part of the federal accuracy-related penalty. California incorporated this federal change by reference in AB 274 (Stats. 1990, Ch. 452), effectively reinstating the pre-1984 substantial understatement penalty without the tax shelter limitation.

As the underlying California statute (RTC §25935, incorporating IRC §6662(d)) is essentially the same as the statute under which 18 CCR 25934.4 was promulgated, the regulation continues to apply under current law. As RTC §25935 incorporates IRC §§6662, 6663 and 6664, the federal regulations applicable to those sections also apply, except as modified by 18 CCR 25934.4. (See RTC §23051.5(f); FTB Notice 92-9; FTB Notice 92-12.)

NOTE: ((---)) = Indicates obsolete information.

DRAFTING INFORMATION

The principal author of this Notice is Bruce R. Langston of the Franchise Tax Board Legal Division. For further information regarding this Notice, contact Mr. Langston at the Franchise Tax Board Legal Division, P.O. Box 1468, Sacramento, CA 95812-1468.