



State of California
Franchise Tax Board

01.11.2008

FTB NOTICE 2008-1

Subject: Reporting Requirements Pursuant to Revenue and Taxation Code Section 18628; Conformity to Treasury Regulation Section 301.6111-3, Effective August 3, 2007.

Purpose: The purpose of this Notice is to explain the disclosure obligations under Revenue and Taxation Code (RTC) section 18628 for various time periods described below and to advise organizers and material advisors that if they previously failed to disclose as required, the Franchise Tax Board (FTB) will not impose penalties under RTC sections 19173 and 19182 if they comply with the reporting obligations by March 11, 2008.¹

This Notice further advises that for disclosures that are required to be filed after October 31, 2007, material advisors must file Internal Revenue Service (IRS) Form 8918 (or successor form), which replaced IRS Form 8264.²

Description of Filing Obligations:

1. January 1, 2004 to October 6, 2005

Prior to the enactment of the American Jobs Creation Act of 2004, Pub. L. No. 108-357 (Jobs Act), IRC section 6111(a) required organizers of a tax shelter to register the shelter with the IRS no later than the day on which interests in the shelter were first offered for sale. Under former IRC section 6111(c), an investment was considered a tax shelter if it met a tax ratio test and was (1) required to be registered under a Federal or state law regulating securities; (2) sold under an exemption from registration requiring the filing of a notice with a Federal or state agency regulating the offering or sale of securities; or (3) a substantial investment.³

A substantial investment was one in which the total amount that was offered for sale to all investors exceeded \$250,000 and at least five investors were expected.

¹ The FTB recently issued Notices 2007-3 and 2007-4 regarding taxpayer disclosure of participation in reportable transactions, and in particular, transactions with contractual protection. These Notices triggered questions regarding disclosure obligations under RTC section 18628 of persons who advised taxpayers regarding their participation in this category of reportable transactions.

² This Notice does not address list maintenance requirements under RTC section 18648 or Internal Revenue Code (IRC) section 6112 and the corresponding regulations.

³ Investments that met certain requirements as confidential corporate tax shelters were also treated as tax shelters for purposes of former IRC section 6111(a).

Former RTC section 18628 conformed to former IRC section 6111 and applied to any organizer of a tax shelter that was (1) organized in California; (2) did business in California; (3) derived income from California sources; or (4) had at least one California investor. Organizers were instructed to mail a copy of IRS Form 8264, *Application for Registration of a Tax Shelter*, and include the federal tax shelter registration number, if applicable, to the FTB no later than the first day the tax shelter interests were offered for sale or within the time periods provided in former RTC section 18628 for transactions that later became listed transactions.⁴

2. October 7, 2005 to August 2, 2007

The Jobs Act, enacted on October 22, 2004, repealed the tax shelter registration regime and replaced it with a requirement for material advisors to file an information return identifying and describing reportable transactions, any potential tax benefits expected to result from the transactions, and any other information that the IRS prescribed.

In IRS Notices 2004-80 (2004-50 I.R.B. 963) and 2005-22 (2005-12 I.R.B. 756), the IRS provided interim guidance for material advisors who were required to comply with amended IRC section 6111, pending the issuance of regulations. IRS Notice 2004-80 defined a material advisor as a person who makes a tax statement for the benefit of a person identified in Treasury Regulation section 301.6112-1(c)(2)(i)(A) – (E), with respect to a reportable transaction and who receives or expects to receive a minimum fee specified under Treasury Regulation section 301.6112-1(c)(3). A reportable transaction was defined as a transaction that fell within one of the categories defined under Treasury Regulation section 1.6011-4(b).

In IRS Notice 2005-22, the IRS provided that a person becomes a material advisor under IRC section 6111 when all of the following events have occurred: (1) the material advisor makes a tax statement, (2) the material advisor receives (or expects to receive) fees in excess of the threshold amount (\$250,000 for a transaction if all participants are corporations and \$50,000 for any other transaction), and (3) the transaction is entered into by the taxpayer.

The IRS also specified in IRS Notice 2005-22 that IRS Notice 2004-80 would be effective for tax statements made after the effective date of the Jobs Act, with an exception for post-filing advice described in Treasury Regulation section 301.6112-1(c)(2)(iv)(A).⁵

⁴ For notices issued after January 1, 2004, the penalty for each failure to register a tax shelter was \$15,000. For listed transactions, the penalty was the greater of \$100,000 or 50% of gross income derived from the activity.

⁵ Under the Jobs Act, the IRC section 6707 penalty for failing to file an information return by the due date or for filing a false or incomplete information return was increased to \$50,000 for any failure with respect to a reportable transaction and for listed transactions, the greater of \$200,000 or 50% of the material advisor's gross income with respect to the aid, assistance, or advice provided regarding the transaction. RTC section 19182 conforms to IRC section 6707, except as otherwise provided.

RTC section 18628, as amended by AB 115 (Stats. 2005, Ch. 691 § 42.5), conforms to IRC section 6111, as amended by the Jobs Act, except as otherwise provided.⁶ RTC section 18628 now requires a material advisor to send a duplicate of the federal return, if applicable, or the same information required on the federal reportable transactions return for California reportable transactions, to the FTB by specified dates. This requirement applies to any material advisor, with respect to any reportable transaction defined in IRC section 6707A(c), who satisfies any one of the following requirements:

1. Is organized in this state;
2. Is doing business in this state;
3. Derives income from sources in this state; or
4. Provides any 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 who is either organized in this state, does business in this state or derives income from sources in this state.

In FTB Notice 2005-7, dated December 23, 2005, the FTB announced that it would generally follow corresponding federal interpretations and procedures relating to material advisors filing information returns required under IRC section 6111, including the rules provided under IRS Notices 2004-80 and 2005-22, to the extent they did not conflict with any California rules or procedures. FTB Notice 2005-7 also provided instructions for filing Forms 8264 for advisors who became material advisors during 2005.

3. August 3, 2007 to the Present

The IRS issued final regulations, Treasury Regulation section 301.6111-3, effective August 3, 2007, that essentially adopted the interim rules from IRS Notices 2004-80 and 2005-22. California will follow the final federal regulations relating to material advisors filing information returns required under IRC section 6111, to the extent they do not conflict with any California statutes or regulations.

Under those final regulations, a person is a material advisor with respect to a transaction if the person provides any material aid, assistance or advice with respect to organizing, managing, promoting, selling, implementing, insuring or carrying out any reportable transaction, and if that person directly or indirectly derives gross income in excess of a threshold amount for the material aid, assistance or advice. The final regulations retain the minimum threshold amounts of \$50,000 for a

⁶ RTC section 18628, as amended by AB 115, was effective and operative as of October 7, 2005.

reportable transaction that provides substantially all of the tax benefits to individuals (looking through any partnerships, S corporations or trusts), and \$250,000 for all other transactions.

A person provides material aid, assistance or advice with respect to organizing, managing, promoting, selling, implementing, insuring or carrying out any transaction if, for example, the advisor makes or provides a tax statement to or for the benefit of a taxpayer who the advisor knows is or reasonably expects to be required to disclose the transaction under Treasury Regulation section 1.6011-4 because the transaction is or is reasonably expected to become a reportable transaction, other than a listed transaction or a transaction of interest.

A tax statement is any statement, oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction under Treasury Regulation sections 1.6011-4(b)(2) through (7). The final regulations retain the post-filing advice exception, with one modification. Now, this exception does not apply to a person who makes a tax statement with respect to the transaction if it is expected that the taxpayer will file a supplemental or amended return reflecting additional tax benefits from the transaction.

A person is treated as a material advisor when all the following events have occurred (in no particular order): (1) the person provides material aid, assistance or advice, as described above; (2) the person directly or indirectly derives gross income in excess of the threshold amounts described above;⁷ and (3) the transaction is entered into by the taxpayer.

A material advisor may file a single form for substantially similar transactions and is not required to file an additional form for each additional taxpayer that enters into the same or substantially similar transaction.

The term "substantially similar" is defined in Treasury Regulation section 1.6011-4(c)(4) as any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. The term substantially similar will be broadly construed in favor of disclosure.

Avoidance of Penalties under RTC sections 19173 and 19182:

⁷ The final regulations provide that the threshold amount must be met independently for each transaction that is a reportable transaction and aggregation of fees among transactions is not required. For example, assume a person provides advice with respect to two categories of reportable transactions - (1) transactions with contractual protection and (2) a second category of transactions under Treasury Regulation section 1.6011-4(b) - where substantially all of the benefits are provided to an individual. Assume the person receives gross income of \$75,000 for the transactions with contractual protection and \$30,000 for the other category of transactions. In this example, the person is a material advisor with respect to the transactions with contractual protection but not with respect to the second transaction type.

1. Reporting Periods January 1, 2004 to October 6, 2005 and October 7, 2005 to August 2, 2007

The FTB will not impose penalties under RTC sections 19173 or 19182 against any organizer or material advisor who failed to file any Forms 8264 with the FTB for the periods (1) January 1, 2004 to October 6, 2005 and (2) October 7, 2005 to August 2, 2007, providing they file complete Forms 8264 with the FTB at the address provided below on or before March 11, 2008. A duplicate copy of Form 8264 (if one was already filed with the IRS) or an original Form 8264 must be submitted. In lieu of an original Form 8264, material advisors may alternatively submit a Form 8918. If there is a filing requirement under California law but not under federal law, these forms should be completed on a California-only basis. Transactions disclosed on a Form 8264 should be completed as instructed in IRS Notice 2004-80, as clarified and modified by IRS Notice 2005-22.

2. Reporting Periods after August 3, 2007

The FTB will not impose penalties under RTC section 19182 against persons who became material advisors between August 3, 2007, and September 30, 2007, and failed to file an information return with the FTB by October 31, 2007, providing they file a completed Form 8918 with the FTB at the address provided below on or before March 11, 2008.

Form 8918: For disclosures required to be filed after October 31, 2007, material advisors must use IRS Form 8918 (or a successor form) and must file a copy of IRS Form 8918, or a Form 8918 completed on a California-only basis if there is a filing requirement under California law but not under federal law, on the same date Form 8918 is required to be filed with the IRS for a reportable transaction that is not a listed transaction. According to the final regulations, a material advisor currently must file Form 8918 by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur.

For listed transactions, California law requires material advisor disclosure by the later of 60 days after entering into the transaction or 60 days after the transaction becomes listed.

Where a material advisor is required to file a Form 8918 with the FTB under the provisions of RTC section 18628, as amended by AB 115, and that person registered the transaction under RTC section 18628, as it existed prior to the amendments made by AB 115, by filing a Form 8264, the material advisor is not required to file an amended or duplicate Form 8264 or a Form 8918 for the same transaction. However, the material advisor must supplement information provided on a previously filed Form 8264 if the information is no longer accurate or if additional required information that was not disclosed on Form 8264 becomes available. The supplemental information should be disclosed on IRS Form 8918.

Incomplete Forms: An incomplete form will not meet the filing requirements described in this Notice and may result in the imposition of penalties under RTC sections 19173 or 19182. For example, a form containing a statement that information will be provided upon request is not considered complete. If the Form 8264 is not completed as required under IRS Notices 2004-80 and 2005-22 or if the Form 8918 is not completed in accordance with the final regulations and the instructions to that form, the FTB will not consider the person to have complied with the requirements under RTC section 18628 and that person will be subject to the imposition of penalties under RTC sections 19173 or 19182.

The IRS issues reportable transaction numbers to material advisors who must provide the number to all taxpayers and material advisors for whom the material advisor acted as a material advisor. At the present time the FTB will not be issuing reportable transaction numbers for California-only transactions.

Who Should File: Organizers of tax shelters and material advisors who meet the requirements described above for the various filing periods must file the required forms. A material advisor may enter into a designation agreement that allows multiple material advisors to the same reportable transaction to designate a single material advisor to disclose the transaction. The designated material advisor must disclose the transaction by the last day of the month following the end of the calendar quarter that includes the earliest date on which a material advisor who is a party to the agreement became a material advisor with respect to that transaction. The designation agreement does not relieve the other material advisors of their obligation to disclose the transaction to the FTB, if the designated material advisor fails to disclose the transaction in a timely manner.

Where to Send: Persons filing in response to this Notice should write in red on the top of IRS Form 8264 or IRS Form 8918 "FTB Notice 2008-1"

Mail the Form 8264 or Form 8918 to the Franchise Tax Board at the following address:

US Mail:

ATSU 398 MS: F385
FRANCHISE TAX BOARD
P.O. BOX 1673
SACRAMENTO, CA 95812-9900

For Courier Service Delivery or Private Courier Mail:

ATSU 398 MS: F385
FRANCHISE TAX BOARD
SACRAMENTO, CA 95827-9900

The principal author of this notice is Craig Scott of the Franchise Tax Board, Legal Division. For further information regarding this notice, contact Mr. Scott at the Franchise Tax Board, Legal Division, P.O. Box 1720, Rancho Cordova, CA 95741-1720.