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NOTE: (***) = Indicates confidential and/or proprietary information has been deleted. **Rev. 6/18**

16.1 INTRODUCTION

The California Revenue and Taxation Code (R&TC) and the Internal Revenue Code (IRC) contain reciprocal provisions permitting an exchange of information. Under these provisions, the department receives copies of Revenue Agent's Reports (RARs) and other federal tax information from the Internal Revenue Service.

An RAR is a document showing the changes to a taxpayer's return after examination by an IRS agent. The changes are recorded on IRS Form 4549. The reports are associated with the taxpayer's return and then forwarded to FTB for audit. Taxpayers may have also reported RAR changes by correspondence or by filing an amended return(s).

RARs for apportioning corporations that are received in Sacramento will be screened and sorted by NBA Sac-Region. Apportioning corporation RARS received by the district offices should be screened and processed appropriately by that office. The Federal/State & Special Audit Section (FSSAS) processes personal income tax and c-corp RARs, while the Exempts Unit processes Exempt RARs.

Under FTB policy, if the IRS has examined and changed, or no-changed, an issue, we will not pursue it **unless** there is clear information to show that the IRS was wrong. This is a rare event. However, if the IRS never examined an issue (even though they reviewed the year), we have no limitations on our review of the issue.

To request information directly from the Internal Revenue Service, see MAP 16.2 Request for Federal Returns and Audit Report.

For special statute of limitations provisions for RARs, see MAP 16.3.1 Incorporating the RAR for PIT and General Corporations and MAP 16.3.2 Incorporating the RAR for Apportioning Corporations.

Note: If the RAR is attached to the taxpayer's return, the first page of the return must be stamped with the following **FILE CONTAINS CONFIDENTIAL IRS INFORMATION**. If

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	<p>the RAR is not attached to any other document, the RAR must be stamped with the following FILE CONTAINS CONFIDENTIAL IRS INFORMATION.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.2 REQUESTING FEDERAL TAX INFORMATION (FTI)</p>	<p>Federal Tax Information (FTI) consists of returns or return information and may contain personally identifiable information (PII). State agencies obtain FTI in accordance to IRC §6103(d) only to the extent the information is needed for, and is reasonably expected to be used for, state tax administration.</p> <p>MAP 16.2.1 Federal Tax Information Available from the IRS MAP 16.2.2 Instructions for Completing IRS Form 8796-A MAP 16.2.3 Form 8796-A Request Guidelines MAP 16.2.4 Timeframes for Receiving Federal Tax Information MAP 16.2.5 Transaction Codes on IRS Transcripts MAP 16.2.6 Safeguarding Federal Tax Information MAP 16.2.7 Disposal and Destruction of Federal Tax Information</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.2.1 Federal Tax Information (FTI) Available from the IRS</p>	<p>FTI includes any data received directly from the Internal Revenue Service (IRS) or obtained through an authorized secondary source, such as Social Security Administration (SSA), or another entity acting on behalf of the IRS, per agreement. FTI must be tracked from its original receipt or re-creation to its destruction. Each time you receive, print, copy, upload, move, or destruct FTI you are required to record your actions on an FTI Tracking Log. For further information go to FTI Tracking Procedures. PASS users refer to MAP 28.7, <i>Recording Federal Tax Information in PASS</i>.</p> <p>Federal documentation provided by a taxpayer or their representative is not considered FTI.</p> <p>You may request the following information from the IRS:</p> <ul style="list-style-type: none">• Master File Transcripts for the Individual Master File (IMF) and Business Master File (BMF) The IMF/BMF transcripts provide a listing of Transaction Codes, which represent an individual or business entity's federal account activity with the Internal Revenue Service. Each Transaction Codes identifies the type of transaction being processed and is used to maintain a history of actions posted to a taxpayer's account on the Master File. Refer to MAP 16.2.5, <i>Transaction Codes on IRS Transcripts</i>, for additional information.

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- **Transcript Delivery System (TDS)**

TDS is used to electronically request certain federal tax information. All TDS requests are handled at the FTB by a limited number of authorized users. There are four products available through this system:

(1) Account Transcript (ACTR)

The account transcript is available for all valid IMF/BMF accounts and provides the following information:

- Limited data from the return (i.e. for individuals, information may include filing status, exemptions, AGI, and taxable income; for business entities, information may include net receipts, total income, total deductions, and taxable income).
- Transaction Codes posted to the taxpayer's account. In addition, a brief definition for each code is also provided (i.e. if Transaction Code 420 is posted, then the definition "Examination of Tax Return" will appear next to it). These codes provide an account history, which may include payments, credits, amended returns, penalties, interest, etc.

(2) Return Transcript (RETR)

The return transcript contains significant data transcribed from the original return. The following return transcripts are available:

- For individuals: Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR-EZ, and 1040 SS/PR.
- For business entities, Forms: 1120, 1120-A, 1120-H, 1120-L, 1120-S, and 1065. Fiduciary Returns are not available.

Return transcripts are available for the current and three prior tax years. Transcripts will not be available if the return was filed within the last six weeks.

Please note that return transcripts will not show amendments or adjustments made to the account after the original return was filed.

(3) Wage and Income Transcript (WAID)

The wage and income transcript is available for individual taxpayers only and provides earnings reported to the IRS by payers. This transcript contains information derived from information returns, including but not limited to: W-2 Series Forms, Form W-3, 1098 Series Forms, and 1099 Series Forms.

Wage and income transcripts are available for the current and nine

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prior tax years. Please note that wage and income transcripts will not show state or local income tax withholding.

(4) Record of Account Transcript (RECA)

The record of account transcript combines information from the account transcript and return transcript. This transcript contains the most current information from the return and will show changes (e.g. amendments or adjustments) made to an account after the original return was processed.

Record of account transcripts are available for the current and three prior tax years.

- **Copies of Revenue Agent Reports (RARs)**

RARs contain federal examination information including but not limited to: Form 4549, Form 886-A, Form 4605, Form 5407, and Form 5278.

- **Copies of Tax Returns (i.e. Form 1120, 1120S, 1065, 1040, 1041, etc.)**

- **Audit Work Papers, Schedules, or Other Documents**

- **Request to Speak / Exchange Documents with a Revenue Agent or Appeals Officer**

You may request to speak / exchange documents with the IRS if a federal examination is open.

- **Social Security Number (SSN) or Federal Identification Number (FEIN)**

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**16.2.2 Instructions
for Completing IRS
Form 8796-A**

To request Federal Tax Information from the IRS, complete and submit Form 8796-A to the FTB IRS Coordination Team.

Form 8796-A can be found in the PASS 010 FTI Folder, Request for Federal Tax Information (8796-A), or on the FSSAS Audit Forms Webpage (listed under Miscellaneous FTB Forms & Worksheets).

*****IMPORTANT – Request IMF/BMF transcripts first*****

Before submitting Form 8796-A to request copies of returns, RARs, audit work papers, or to speak to a Revenue Agent, the IMF/BMF transcript must be reviewed. The transcripts are reviewed first to determine whether or not a federal examination is open (or closed) because this will let you know if the information you are requesting is available.

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The IMF/BMF transcripts reflect a taxpayer's federal account activity with the IRS. If the taxpayer's account activity indicates that a federal examination is open, then the IRS Disclosure Office will not be able to obtain the taxpayer's file to provide you with copies of returns, RARs, or other documents. The only way to obtain information is to submit a request to speak/exchange documents with the Revenue Agent assigned to the case. If the transcripts show that there is no federal examination in progress (or that the federal examination has been closed), then the IRS Disclosure Office can obtain copies of returns, RARs, or other documents to provide to you. Refer to MAP 16.2.5, Transaction Codes on IRS Transcripts, for additional information.

Completing Form 8796-A

Please refer to the following instructions for completing Form 8796-A. If you need additional assistance, please contact the IRS Coordinator/Liaison.

SECTION	INSTRUCTIONS
<p>Section B, Item 1</p>	<p>Under Section B, Item 1, enter the taxpayer's name, address, Social Security Number (SSN), Spouse SSN, or FEIN (do not enter the CCN). Be sure to verify that the information entered is correct before submitting.</p> <p>A separate 8796-A request should be completed for each taxpayer. For individuals filing jointly, only one request is needed. For business entities filing a combined report, submit the request for the parent corporation that files the consolidated return with the IRS.</p>
<p>Section B, Item 2</p>	<p>Under Section B, Item 2, check the box next to the information you are requesting and then enter the tax period(s) and the type of return forms.</p> <ul style="list-style-type: none"> • Tax periods – enter the tax year(s) (i.e. 2010, 2011-2012 or 12/2010, 12/2011-12/2012). For business entities that operate on a fiscal year, enter the fiscal month/year ending (i.e. 06/2010, 06/2011-06/2012). You may request more than one tax period on the same form. • Type of return form – enter the federal form number (i.e. 1040, 1120, 1120S, 1065, 1041, etc.) • Copy of return(s) – check this box when requesting copies of returns. Verify that you have entered the federal form number under Section B, Item 1, "Type of return Forms". • Copy of RAR – check this box when requesting copies of the Revenue Agent Report.

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- **IMF** – Check this box when requesting the Individual Master File (IMF) transcript.
- **BMF** – Check this box when requesting the Business Master File (BMF) transcript.
- **TDS** – Check this box when requesting one or more of the four TDS transcripts: Account Transcript (ACTR), Return Transcript (RETR), Wage and Income Transcript (WAID), and Record of Account Transcript (RECA). On the line provided, specify which transcript(s) you are requesting by entering ACTR, RETR, WAID, and/or RECA.
- **Audit Work Papers** – Check this box when requesting audit work papers. You must specify or provide a detailed description of the information or documents needed (i.e. Information Document Requests, Form 906 Closing Agreement, etc.).
- **Other** – Check this box when requesting the following information and enter pertinent details in the space provided on the form:
 - The SSN or FEIN
 - When requesting an SSN, you must have the complete name and current address of the taxpayer.
 - When requesting a FEIN, you must have the complete name of the corporation, all known addresses with zip codes, names of partners (if available), corporate officers, etc.
 - Any IRS information not listed on the form
 - Provide a detailed description of the information being requested (i.e. Form 1120X, etc.)
 - To speak with the Revenue Agent or Appeals Officer
 - In the space provided, write "Request to speak / exchange documents with the IRS". If applicable,

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		<p>indicate whether the request to speak with the IRS is a follow-up to a previous discussion that you already had with the Revenue Agent. If available, include the name of the Revenue Agent, their phone number, and their location.</p> <ul style="list-style-type: none"> ▪ As a reminder, review the taxpayer's IMF/BMF transcript to verify that the case is open or in litigation for the tax period you are requesting. If the federal audit is closed, you can no longer speak with the Revenue Agent. ▪ Verify that your name is included in the FTB Designee List prior to submitting your Form 8796-A request. Please see your supervisor or contact the IRS Coordinator/Liaison. If a supervisor or manager determines there is a business need, employees can be added to the Designee List through Disclosure. <ul style="list-style-type: none"> ○ <u>Rush Requests</u> <ul style="list-style-type: none"> ▪ Indicate: (1) the reason for the RUSH request (i.e. court hearings, SOL, sensitive case, etc.) and (2) the date you need the information by.
	Section B, Item 3	Under Section B, Item 3, check the appropriate box to indicate the reason for your request (Pending Examination, Pending Collection Activity, etc.)
	Section C, Item 1	Enter your full name, 10-digit phone number, and the date of your request
	Section C, Item 2	<p>Under "Group Manager's Name & Signature", enter the full name of the supervisor or lead who will be signing the request and enter their 10-digit phone number. Then, enter your Division/PUC in the appropriate field.</p> <p>Have your supervisor/lead review and sign the request. All supervisors or leads who sign Form 8796-A must be on the FTB Designee List. Please note that requesters may not sign their own request.</p>

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Submitting Form 8796-A

You may use one of the following methods to submit your Form 8796-A request:

- Route the completed Form 8796-A to Central Office, Attention: 8796-A Desk, Mail Stop 340.
- Scan and email the completed Form 8796-A to the FTB IRS Coordination Team.
- FAX the completed Form 8796-A to one of the IRS Coordinators. Be sure to double check the FAX number before sending.
- For Central Audit Staff, you may place your Form 8796-A in the basket located in the shared area.

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**16.2.3 Form 8796-A
Request Guidelines**

- Submit requests for: (1) copies of returns, (2) RARs, (3) audit work papers, or (4) requests to speak/exchange information with a Revenue Agent, within 30 days of receiving the IMF/BMF transcripts. Reminder – the IMF/BMF transcripts should be reviewed first to determine whether a federal audit is open or closed because this will let you know if the information being requested is available. If the IMF/BMF transcript is over 30 days old, your request will be rejected.
- When filling out Form 8796-A, keep the request form to one page. The IRS allows a separate sheet to be attached to the Form 8796-A if additional space is needed.
- Do not revise, change, or alter Form 8796-A. Form 8796-A is the only form used to request Federal Tax Information (FTI). Any other form submitted to the IRS to request FTI will be rejected.
- Route all completed Form 8796-A Requests to the IRS Coordinator/Liaison. **DO NOT send the request directly to the IRS.**

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	<ul style="list-style-type: none">• Do not call the IRS Disclosure Office, Revenue Agent or Appeals Officer directly without the proper authorization. • Do not give copies of the IMF/BMF transcripts to taxpayers or their representatives without first checking with the IRS Coordinator/Liaison. These transcripts contain official use only information. • The IRS will not provide an IMF/BMF transcript to FTB if the taxpayer is under criminal investigation by the IRS. <p style="text-align: right;">Rev. 11/18</p>
16.2.4 Timeframes for Receiving Federal Tax Information (FTI)	<ul style="list-style-type: none">• IMF/BMF transcript requests are processed daily and generally take about 2-4 days to receive. You will receive an automated email notification letting you know that the transcripts are ready to view. • TDS requests are handled in house at FTB and can be completed within 1-2 days. • All other federal tax information requests (e.g. copies of returns, RARs, request to speak to the Revenue Agent, etc.) can take anywhere between 8 to 12 weeks (or more) to receive the information. <p>If you do not receive a response within the time frames noted above, contact the IRS Coordinator/Liaison. Do not submit another Form 8796-A.</p> <p>NOTE: The IRS will not provide an IMF/BMF transcript to FTB if the taxpayer is under criminal investigation by the IRS. If this is the case, discuss with the IRS Coordinator/Liaison when the transcript can be re-requested.</p> <p style="text-align: right;">Rev. 11/18</p>
16.2.5 Transaction Codes on IRS Transcripts	<p>The IMF/BMF Transcripts, Account Transcript (ACTR), and Record of Account Transcript (RECA) provide a listing of Transaction Codes that represent a taxpayer's federal account activity with the IRS. The Transaction Codes consist of three digits, which identifies the type of transaction processed. For example, a Transaction Code "420", identified as an "Exam Indicator", indicates that the taxpayer's federal return has been referred to the</p>

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Examination or Appeals Division. A Transaction Code "300" will provide the additional tax assessment resulting from the Examination or Appeals Adjustment. A Transaction Code "421" identifies a "Reverse Examination Indicator", which posts to a taxpayer's account after the examination has been closed.

A review of the Transaction Codes will help you determine whether the information you are requesting is available. Generally, when Transaction Code "420" is present, a freeze code will be placed on a taxpayer's account. When an account is frozen, the IRS Disclosure Office will not be able to access or obtain the taxpayer's file to provide copies of returns, RARs, or other documents. However, you may submit Form 8796-A to request to speak/exchange documents with the Revenue Agent assigned to the case. After a federal examination has been closed, Transaction Code "421" will post to the transcript, and the freeze on the taxpayer's account will be removed. Once the audit has been closed, the IRS Disclosure Office will be able to access the taxpayer's file and provide you with RARs, Copies of Returns, or other audit work papers.

For detailed explanations of transaction codes, freeze codes, source codes, disposal codes, and more, refer to the [IRS website](#). If you need assistance reviewing the IRS transcripts, contact the IRS Coordinator/Liaison.

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**16.2.6 Safeguarding
Federal Tax
Information (FTI)**

IRC §6103(p)(4) requires the FTB to establish and maintain safeguards to prevent unauthorized use or disclosure of Federal Tax Information (FTI). In addition, we must take appropriate measures to safeguard and protect FTI, in accordance with IRS Publication 1075. FTI is defined in **Publication 1075 Section 1.4.1 Federal Tax Information (FTI)**. When you receive FTI, you must take appropriate measures to safeguard and protect this information by adhering to the following procedures:

- **Place the Confidential Coversheet (FTB 7805) on top of all physical audit files containing FTI.** The Disclosure Office recommends using Form 7805 as an additional layer of protection for both IRS and State data. The 7805 includes information and legal references for unauthorized inspection, disclosure, adjustment, destruction, or misuse of both State and/or Federal information. It is your responsibility to protect and secure all confidential tax information whether maintained on your desk or contained in a locked drawer or cabinet as well as when you're traveling with confidential information.

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- **Store FTI in a locked drawer or cabinet in accordance with Publication 1075 Section 4.0 Secure Storage - IRC §6103(p)(4)(B).** This includes all physical files containing FTI.
- **Conceal all FTI from users that do not have a business need to know.** Use the Confidential Coversheet, Form 7805, for this purpose. Keep in mind that FTI includes all information received from the IRS such as IMF/BMF transcripts, TDS transcripts, RARs, copy of returns, and federal audit work papers.
- **Ensure that all FTI documents received from the IRS have the IRS Notice 129/129A attached on the first page of the document.** The IRS Coordinator/Liaison (or designated TDS user) will place this notice on all TDS transcripts, copy of returns, RARs, etc. before sending you the information.
- **If FTI documents received from the IRS are commingled in your audit file, note "FILE CONTAINS CONFIDENTIAL IRS INFORMATION" on the first page of your file, in red.** This should be done in addition to placing the Form 7805 on top of the audit file as well as storing the files in a locked drawer or cabinet.
- **Retain a copy of Form 8796-A in your audit file and maintain a log sheet to track FTI received/destroyed.** All FTI uploaded to your PASS case unit should be kept together in a separate issue folder. Refer to MAP 28.7, Recording Federal Tax Information in PASS, for additional information. The issue folder should contain a log sheet, which is used to track the date FTI was requested, the date FTI was received, and the date FTI was destroyed. Refer to MAP 16.2.7, Disposal and Destruction of Federal Tax Information, for information pertaining to the destruction of FTI.
- **If you receive, create or handle FTI that is not tracked in PASS, you will need to set up local FTI tracking procedures** and use the Enterprise FTI tracking logs and procedures to track FTI. Contact the FTB IRS Safeguards Program for assistance with local FTI tracking procedures.
- Never email FTI outside of the department, encrypted or not.
- Never email FTI internally without a valid FTB business need, or without 7-zip encryption.
- Never store FTI on a flash drive.
- Never store FTI on a C: or a P: drive.
- Never save the hardcopy FTI Tracking Log with the case file.

For further information regarding FTI tracking, see the FTI Tracking Enterprise Procedures page.

If you have any questions or need further information, you may contact the IRS Coordinator/Liaison or the Disclosure Office.

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16.2.7 Disposal and Destruction of Federal Tax Information (FTI)

Upon completion of use of Federal Tax Information (FTI), state agencies must ensure that the FTI is destroyed in accordance with the guidelines contained under IRC §6103(p)(4)(F).

If you used any IRS information to substantiate an audit determination, retain the documents in the audit file. However, if you no longer need the IRS information or if you uploaded the IRS information to PASS, then the documents provided by the IRS will need to be destroyed.

- **Disposal/Destruction of FTI Furnished in Paper Format**

Place all paper documents containing FTI into **LOCKED CONFIDENTIAL DESTRUCT BINS** or shred them immediately.

- **Disposal/Destruction of Removable Media containing FTI**

Route all USB drives, disks, CDs, DVDs, or other removable media containing FTI to the IRS Coordinator/Liaison for proper destruction. Please include a copy of the original Form 8796-A request.

REMINDER: Be sure to record the date the FTI was destroyed and the method used to destroy the FTI (i.e. deleted, shredded, routed to IRS Coordinator/Liaison for destruction, etc.) in the log sheet. The log sheet should be retained and included in your audit file or PASS case unit.

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16.3 INCORPORATING THE RAR WITH THE TAXPAYER'S FILE

MAP 16.3.1 Incorporating the RAR for PIT and General Corporations

MAP 16.3.2 Incorporating the RAR for Apportioning Corporations

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16.3.1 Incorporating the RAR for PIT and General Corporations

To determine if a federal audit is in progress, you should contact the Federal/State Special Audit Section (FSSAS). If during the course of an examination, you determine that federal activity is occurring, or has occurred, follow these:

Revenue Agent Reports (from IRS) on Years Under Examination

- Federal Audit in Progress - If there are no state issues for audit, forward the case to the FSSAS Unit in Central Office (see the mail stops listed below). Secure a copy of the IRS request for information, and a federal waiver if applicable. If there are state issues, continue the examination of the state only audit issues.

- Federal Audit Complete -
 1. If you receive a federal No Change letter and there are no state issues, attach the letter to the back of the return to which it applies and treat as a survey case. Otherwise, continue the examination of the state only audit issues.

 2. If federal adjustments are made and there are no state issues, get a copy of the RAR and forward it to the FSSAS Unit in Central Office (see the mail stops listed below).

 3. If you are going to work the RAR with the state adjustments, you must notify the FSSAS Unit at the time you receive the RAR. This is especially important because you may not complete the audit for the state issues for some time. By coordinating with the FSSAS Unit, the case can be put on the RAR PIT or Corporation Local Area Network with comments. When the RAR comes in through normal channels, the FSSAS Unit will not issue a Notice of Proposed Assessment inadvertently. If the FSSAS Unit receives an RAR and finds that the case is assigned to an auditor, the staff in the FSSAS Unit will contact you before taking any action. Note: If federal adjustments are based upon the lack of substantiation, give the taxpayer an opportunity to submit substantiation before closing the examination.

- Federal Audit Protest - If an RAR is being protested or appealed, get a copy of the RAR and forward it to the FSSAS Unit in Central Office (see the mail stops listed below). Note: If the state does not conform to the federal statute, or has a different statute, you may make a state adjustment without regard to the federal decision.
 1. If federal adjustments are made and there are no state issues, get a copy of the RAR and forward it to the FSSAS Unit in Central Office (see

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the mail stops listed below).

2. If you are going to work the RAR with the state adjustments, you must notify the FSSAS Unit at the time you receive the RAR. This is especially important because you may not complete the audit for the state issues for some time. By coordinating with the FSSAS Unit, you can put the case on the RAR PIT or Corporation Local Area Network with comments. When the RAR comes in through normal channels, the FSSAS Unit will not issue an NPA inadvertently. If the FSSAS Unit receives an RAR and finds that the case is assigned to you, the staff in the FSSAS Unit will contact you before taking any action. Note: If federal adjustments are based upon the lack of substantiation, you should give the taxpayer an opportunity to submit substantiation before closing the examination.

RAR on Years Not Under Examination

- Federal Audit in Progress - Forward the federal information to the FSSAS Unit in Central Office (see the mail stops listed below). Secure a copy of the IRS request for information, and a federal waiver if applicable.
- Federal Audit Complete - Get a copy of the RAR and forward it to the FSSAS Unit in Central Office (see the mail stops listed below).
- Federal Audit Protest - Get a copy of the RAR and forward it to the FSSAS Unit in Central Office (see the mail stops listed below).

Upon receipt of an RAR, you should write across the top of the RAR in red, Voluntary the date received, and your initials. Forward the RAR to:

PIT

FSSAS Unit - Pending Federal
Voluntary Team
Mail stop: F310

Pending Federal (PF). The GTA RAR Unit keeps a file for audit cases where a protest or written correspondence is received from taxpayers in response to a Notice of Proposed Assessment indicating the case is still open with the IRS because of ongoing litigation. The RAR unit will withhold finalizing a protested NPA or withhold collection activity until the IRS makes a final determination.

GENERAL C-CORP

FSSAS - ADF Unit
General Corporation Revenue Agent Reports
Mail stop: F310

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Audit Determination File (ADF) The FSSAS Unit keeps a file for audit cases where taxpayers informs us that the IRS is conducting an audit at the same time we began our state audit. Files held without payments are called ADF files. When the taxpayer anticipates owing additional tax and has made a pre-payment, we call the cases NPA cases. We hold these payments in suspense and hold all cases until IRS makes a final determination.

Check RAR Pend - FSSAS on the Audit Report - Form FTB 6430 when routing. For additional routing instructions, see MAP 7.8.4 Routing the Physical & Electronic Files.

For PIT and General Corporation taxpayers, if the FSSAS Unit receives an RAR and finds that the case is assigned to you, they will contact you before taking any action.

If an RAR is received for apportioning and/or combined taxpayers and there is already an audit in progress, the RAR will be sent to the office currently working it.

If you have any questions, please contact the FSSAS Unit at 916.845.3304.

SOL for RARs

It is important that cases based on Revenue Agent Reports receive special handling due to the shorter statute of limitations.

- **Assessments** – Assessments based on federal changes must be issued within two years from the date of notification, provided the taxpayer or IRS notified the FTB of the federal changes within six months of the final federal determination date.

If notification (from the taxpayer or IRS) of the federal changes occurred after the six-month timeframe, then the FTB has four years from the notification date to issue an assessment.

Regardless of when notification takes place, it is important to note that the normal statute of limitations date (four years from the date the original return was filed, or as last modified by a state or federal waiver) will prevail if it is later than either of the assessment SOLs described above.

- **Refunds** – The taxpayer must file a claim for refund based on the federal changes within two years of the final federal determination date. If the taxpayer does not file a claim, and FTB is going to issue an overassessment based on the federal adjustments, then the refund must be issued within two years from the date of final federal determination.

It is important to note that the normal statute of limitations date (four years from the date the original return was filed, one year from the date of the overpayment, or as last modified by a state or federal waiver) will prevail if it is later than the refund SOL described above.

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Final federal determinations dated on or after January 1, 2000 were impacted by changes to R&TC Section 18622:

- **Notification of final federal determinations dated before January 1, 2000** - When **any written notification** is received within the six months following a final federal determination dated before January 1, 2000, the statute of limitations for assessment is the later of two years from the date of notification or the normal statute of limitations date.

If notification is received after the six-month period following the final federal determination date, the statute of limitations is the later of four years from the date of notification or the normal statute of limitations date.

- **Notification of final federal determinations dated on or after January 1, 2000** - For final federal determinations dated on or after January 1, 2000, the notification must be **sufficiently detailed** to allow computation of the resulting California change before the statute of limitation period begins. If the required documentation is received within six months following the final federal determination date, the statute of limitations is the later of two years from the date of notification by the taxpayer or IRS, or the normal statute of limitations date.

If notification is received after the six-month period following the final federal determination date, the statute of limitations is the later of four years from the date of notification or the normal statute of limitations date.

- **"Final Federal Determination Date" definition revised** – For final federal determinations dated on or after January 1, 2000, the term "final federal determination date" is defined to be the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to IRC Section 6203.

If the normal statute of limitations has expired, then the RAR SOLs are limited to assessments and refunds resulting from federal adjustments. However, taxpayers often report federal adjustments with offsetting non-RAR adjustments; or auditors may want to examine non-RAR issues to offset refunds resulting from federal adjustments.

- For more guidance on rules for offsetting federal adjustments, especially when the offsetting adjustments are state issues that are otherwise barred by the normal statute of limitations, refer to the this document aid.

Also See MAP 4.1 Statute of Limitations and MAP 4.2 Statute of Limitations Charts, for additional information.

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<p>16.3.2 Incorporating the RAR for Apportioning Corporations</p>	<p>Upon receiving RARs from the IRS, Audit Support in Central Office will sort the RARs, request the BMF, and send the report to the appropriate office to be processed. The auditor assigned the RAR must first review the taxpayer's file to determine an appropriate action based upon the following steps:</p> <p>VERY IMPORTANT: The first page of all audit files containing IRS information must be stamped with the following, FILE CONTAINS CONFIDENTIAL IRS INFORMATION.</p> <ol style="list-style-type: none">1. Determine if an NPA has been issued for each taxable year covered by the RAR. Review the BETS conversation **** to make this determination. Also, check to see if an amended return has been filed reporting the RAR changes.2. If an NPA has been issued, determine the extent, if any, that the RAR issues were adjusted. The RAR adjustments may have been incorporated with a previous FTB Field Audit NPA or an NPA reflecting the RAR adjustments may have already been issued. Review the Narrative Report to determine this. The auditor must take care not to duplicate RAR adjustments that have previously been made.3. If a copy of the RAR is in the file and has already been issued or reported in an amended return, the auditor may either destroy the RAR or write duplicate/already worked in red on the RAR and place it into the file.4. If the NPA does not include the RAR adjustment, issue an NPA using the prior NPA or last return accepted as the starting basis for your NPA. This includes combination in a manner consistent with that of the audit determination, as well as using the apportionment percentage per the audit determination. If the RAR years were settled by the Settlement Bureau, the settlement agreement may contain the apportionment percentage for future RAR adjustments.5. If no NPA has been issued, the auditor should determine if the returns are in the field. If the RAR years are under current audit by the field, route the RAR to the appropriate program office using form FTB 7024. If only some of the returns are in the field, send a copy of the RAR with a notation to inform the field auditor what years will be issued by central office. If the RAR is on PASS, the auditor
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must correctly transfer the case to the appropriate Program Office or responsible owner.

If none of the above steps apply, audit the RAR as discussed in MATM 5310.

SOL for RARs

It is important that cases based on Revenue Agent Reports receive special handling due to the shorter statute of limitations.

- **Assessments** – Assessments based on federal changes must be issued within two years from the date of notification, provided the taxpayer or IRS notified the FTB of the federal changes within six months of the final federal determination date.

If notification (from the taxpayer or IRS) of the federal changes occurred after the six-month timeframe, then the FTB has four years from the notification date to issue an assessment.

Regardless of when notification takes place, it is important to note that the normal statute of limitations date (four years from the date the original return was filed, or as last modified by a state or federal waiver) will prevail if it is later than either of the assessment SOLs described above.

- **Refunds** – The taxpayer must file a claim for refund based on the federal changes within two years of the final federal determination date. If the taxpayer does not file a claim, and FTB is going to issue an overassessment based on the federal adjustments, then the refund must be issued within two years from the date of final federal determination.

It is important to note that the normal statute of limitations date (four years from the date the original return was filed, one year from the date of the overpayment, or as last modified by a state or federal waiver) will prevail if it is later than the refund SOL described above.

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Final federal determinations dated on or after January 1, 2000 were impacted by changes to R&TC Section 18622:

- **Notification of final federal determinations dated before January 1, 2000** - When **any written notification** is received within the six months following a final federal determination dated before January 1, 2000, the statute of limitations for assessment is the later of two years from the date of notification or the normal statute of limitations date.

If notification is received after the six-month period following the final federal determination date, the statute of limitations is the later of four years from the date of notification or the normal statute of limitations date.

- **Notification of final federal determinations dated on or after January 1, 2000** - For final federal determinations dated on or after January 1, 2000, the notification must be **sufficiently detailed** to allow computation of the resulting California change before the statute of limitation period begins. If the required documentation is received within six months following the final federal determination date, the statute of limitations is the later of two years from the date of notification by the taxpayer or IRS, or the normal statute of limitations date.

If notification is received after the six-month period following the final federal determination date, the statute of limitations is the later of four years from the date of notification or the normal statute of limitations date.

- **"Final Federal Determination Date" definition revised** – For final federal determinations dated on or after January 1, 2000, the term "final federal determination date" is defined to be the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to IRC Section 6203.

If the normal statute of limitations has expired, then the RAR SOLs are limited to assessments and refunds resulting from federal adjustments. However, taxpayers often report federal adjustments with offsetting non-RAR adjustments; or auditors may want to examine non-RAR issues to offset refunds resulting from federal adjustments.

- For more guidance on rules for offsetting federal adjustments, especially when the offsetting adjustments are state issues that are otherwise barred by the normal statute of limitations, refer to the this document aid.

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	<p>Also See MAP 4.1 Statute of Limitations and MAP 4.2 Statute of Limitations Charts, for additional information.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.4 FEDERAL ADJ WITH A CALIFORNIA TAX EFFECT IN DIFFERENT YEARS</p>	<p>The tax effect of a Revenue Agent Report adjustment may apply to different years for California purposes than federal purposes for such issues as net operating losses, tax credits or other carryover items. For example, a taxpayer incurs research and development expenses in 2004 and claims a federal research and development credit. The amount of the federal credit exceeds the federal tax in 2004, so the excess credit carries forward to 2005 and 2006. While the federal statute of limitations is open for 2005 and 2006, the Internal Revenue Service examines the carry forward credits claimed for those years and makes a final federal determination that the original expenses claimed on the 2004 return were excessive. The expense adjustments have no net federal tax effect for 2004, but reduce the amount of the federal credit carry forward to 2005 and 2006. This results in federal assessments of additional federal tax for those years, based on the disallowance of expenses originally claimed on the 2004 federal return.</p> <p>A taxpayer claims a California research and development credit that is fully used in 2004. Assume the normal California statute of limitations has expired for assessments of additional California tax for 2004. Under these circumstances, an NPA would be issued for 2004 reflecting the federal disallowance of 2004 expenses that gave rise to the federal changes actually made for federal purposes to the 2005 and 2006 federal tax years.</p> <p>R&TC Section 18622(a) and (b) require the taxpayer to report federal changes for any year that increases California tax for any year. Although changes only need to be reported by individuals if they increase the amount of California tax for any year, the statute was specifically amended in 1993 to clarify that due to state and federal differences in carryovers and credits, a federal adjustment for one year could result in a California tax change in a different year.</p> <p>R&TC Sections 19059 and 19060 authorize the Franchise Tax Board to issue a Notice of Proposed Assessment resulting from federal adjustments required to be reported under R&TC Section 18622(a) and (b). Nothing within R&TC Section 19059 or 19060 requires the Notice of Proposed Assessment be issued for the same year as the federal tax adjustment resulting from the final federal determination of a change to income,</p>

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deductions, or credit amounts. They allow assessments for all adjustments that **result from** the federal determination.

Similarly, R&TC Section 19311 uses the same **resulting from** language when granting the taxpayer the right to file a claim for refund within two years of the final federal determination; therefore, the same rationale would apply when allowing claims for refund. A taxpayer can claim a refund for a different year than a federal refund was allowed if the California tax effect is in a different year due to the application of carry forwards or other state-federal differences.

Therefore, although the normal California statute of limitations had expired for 1996, we would issue a NPA when applying Revenue Agent Report adjustments where the change to income, deductions, or credits was to a federal year that had no net tax effect from the change.

EXAMPLE

Taxpayer claims a \$100,000 loss on its Year 1 federal return and then has income of \$20,000 in each of the next six years, using up the federal NOL in Year 6. Due to federal and state tax law differences, no loss is incurred for California tax purposes during Year 1. Consequently, the taxpayer does not have a loss carry forward available to offset future year California income. The taxpayer must pay tax on any California income for each Year 2 through 7.

Later, the Internal Revenue Service audits Year 6 and determines the Year 2 income was actually \$40,000. Recalculation of the federal NOL carry forward results in using up the NOL in Year 5, thereby causing a Year 6 deficiency. By this time, California's statute of limitations has expired for Year 2.

The Franchise Tax Board can propose an assessment for Year 2 based on the federal determination of additional income for Year 2. However, the Franchise Tax Board is limited to the issue adjusted by the Internal Revenue Service.

Similarly, if the Internal Revenue Service determines the Year 2 income was actually zero and gives a refund for Year 7, the taxpayer can claim a California refund for Year 2, limited to the adjustment to income allowed by the Internal Revenue Service.

The reason an assessment could be issued in the above example is twofold: First, the taxpayer had a reporting requirement under R&TC Section 18622 which is the basis for reopening the statute of limitations under R&TC Section 19059 or 19060 for issuing

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deficiencies. Second, R&TC Sections 19059 or 19060 do not limit the California adjustments to the same year as the federal assessments.

Although R&TC Sections 19059 and 19060 authorize the Franchise Tax Board to issue a Notice of Proposed Assessment **resulting from** federal adjustments, this does not apply to a year in which the federal statute of limitations to assess the tax resulting from the change barred the corresponding federal assessment resulting from the change. In that case, there is no federal determination within the meaning of R&TC Section 18622, so no California change may be made.

EXAMPLE

The Internal Revenue Service issues a Revenue Agent Report for Year one, proposing an increase to income of \$10,000. Taxpayer successfully argues the Internal Revenue Service assessment notice was mailed to the wrong address and so is invalid. In this case, California may not propose an assessment because there was no federal determination since there was never an actual assessment based on the federal Revenue Agent Report.

If you have any questions or concerns, please contact a Federal Action (RAR) TRS Subject Matter Contact.

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**16.5 UNAGREED
RARS AND PENDING
FEDERAL**

Unagreed RAR

Prior to 1/1/2000, a final federal determination was defined as an irrevocable determination or adjustment of a taxpayer's federal tax liability from which there exists no further right of appeal either administrative or judicial. In other words, there was only one final federal determination per year. After 1/1/2000, the law changed and the date of each final federal determination is the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to IRC Section 6203. In other words, there can be more than one federal determination per year. The easiest way to identify the final federal determination date is the date the assessment posts to the Business Master File (BMF).

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After 1/1/2000, the auditor should determine if the assessment is final vs. whether the taxpayer agrees or not. It is possible the taxpayer could allow the RAR to finalize, pay the assessment, and file a claim for refund. If we delay issuing the assessment until a decision is issued on the claim, we may find the statute expired to issue the assessment.

If the taxpayer files a claim based on a federal report that is not final, the auditor has the option to forward the claim along with all related material (original return, prior amended returns, field audit reports, protest reports, etc) to the following, if there are no current state issues:

MSA – Pending Federal Coordinator

GTA – Pending Federal Coordinator for PIT

GTA – Pending Federal Coordinator for Corporations

Pending Federal – Audit in Process

If during an audit, you are notified by the taxpayer or representative that the Internal Revenue Service is auditing the same or different years, the case should be classified as a pending federal case if the federal examination is not complete.

When a taxpayer protests an NPA on the basis of pending federal action, it is considered to be a **Pending Federal (PF)** case. (Designated PFI for general corporations.) The taxpayer will generally file a protest with the department requesting that no further action be taken on the NPAs pending the final federal settlement.

You should advise the taxpayer that when the federal audit is finalized, a complete copy of the revenue agent's report should be mailed to:

For Apportioning Corporations:

FRANCHISE TAX BOARD

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MS F360

PO BOX 1468

SACRAMENTO CA 95812-1468

For apportioning corporations, Pending Federal cases will be held by the NBA Sac Region until IRS resolution and then routed to the appropriate office for final determination.

For PIT and C-Corporations:

FRANCHISE TAX BOARD

MS F310

PO BOX 1468

SACRAMENTO CA 95812-1468

Follow-up activity on **pending federal** cases is performed by GTA FSSAS Unit at Central Office for PIT taxpayers, and Non Apportioning C or S corporations. Transfer all PIT, and Non-apportioning C or S corporation physical files to Audit Business Support who will route the physical file to the RAR Unit. Transfer the PASS files to the 389 Audit/Support/GTA Review group worklist. Make sure to put a sticky note in the PASS file indicating where the case needs to go. To facilitate follow-up, make sure the name and phone number of the IRS contact is in the file. In addition, mark the box on FTB Form 6430 to indicate an IRS examination is in process and provide a workpaper reference on the workpaper reference line.

Note: Apportioning S Corps, all LLCs or Partnerships (whether Apportioning or Non-Apportioning), or Estate and Trust cases will be worked by their respective areas according to local procedures.

Required Action – Pending Federal Cases

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	<ul style="list-style-type: none"> • Determine that an IRS audit is in process by gathering substantiation from the taxpayer, (for example, scheduling information or any type of audit contact), and an NPA has been issued, for an unagreed RAR. • Contact the taxpayer by telephone or by letter to inform them that the case is being referred to Pending Federal. • Change the initials on inventory listing to PF and refer the case to the Pending Federal desk. The auditor should make all necessary transfers or updates on PASS. <p>Annually the Pending Federal desk will send a follow up letter to determine the status of the IRS action. If the taxpayer replies that IRS action is still in process, the pending federal desk will change the inventory list for a follow up to the next year. If no reply is received or after the case has been in Pending Federal for three years, the Pending Federal desk will complete Form 8796-A, requesting a BMF transcript to determine if the IRS has closed the case. Once the BMF transcript is received, the case will be referred to an auditor for analysis.</p> <p>No action is taken on a Pending Federal case until the final federal determination has been made. Pending Federal cases are sent to Data Services and held for one year. A letter is then sent to the taxpayer requesting the status of the Internal Revenue Service audit. When the taxpayer responds to our request with a final federal determination the case is pulled from Data Services and sent to the initiating auditor to be worked.</p> <p style="text-align: right;">Rev. 2/19</p>
<p>16.6 CORPORATE TAXPAYER NOT IDENTIFIED</p>	<p>Occasionally, Audit receives an RAR on a corporation for which no record can be found. In those cases, the FEIN and alpha cross-reference files should be checked on BETS (****). If the corporation is not found, send special letter Form FTB 4841 to the corporation. If no reply is received, the case is referred to the unit supervisor for final determination and disposition. The supervisor may close the file or refer it to the appropriate field office, filing enforcement, etc.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.7 RECORDING RAR REVENUE</p>	<p>Only one revenue code may be used to record revenue from an NPA. The additional assessment cannot be split to credit a portion to RAR and a portion to another audit program. When making assessments that contain both RAR and other audit adjustments, credit the revenue to the audit program that generates the revenue.</p>

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	<p>For example, while reviewing an amended return requesting a \$2,000 refund based on an RAR, the auditor noticed a non-RAR adjustment resulting in additional tax of \$1,000. In this case, the RAR revenue code would be used, since the revenue was found under the RAR audit program.</p> <p style="text-align: right;">Rev. 7/17</p>
16.8 RAR INDICATOR CODES	<p>The sixth digit of the seven-digit revenue code is used as an IRS Indicator Code to identify adjustments based on RAR. See MAP 13.4.10 Revenue Codes.</p> <p style="text-align: right;">Rev. 7/17</p>
16.9 FEDERAL ADJUSTMENTS BASED ON COPIES OF FRANCHISE TAX BOARD NPAS	<p>If the RAR was the direct result of the federal government receiving a copy of our NPA and the adjustments are the same, place the RAR in the folder and return the case to files.</p> <p>However, if the adjustments are not the same, complete as follows:</p> <ul style="list-style-type: none">• Original NPA was issued by the Audit division and not protested. Make all changes applicable to conform to the RAR.• Original NPA was issued by Technical Resource Section protested and notices of action issued. Discuss with the unit supervisor.• Original NPA issued by field auditor and not protested. Allow field audit adjustments to stand if such adjustments are similar to those on the RAR. If different, discuss with the unit supervisor for possible adjustment or re referral to field for determination.• Original NPA issued by field auditor, NPA protested and notice of action issued. Discuss with the unit supervisor. <p style="text-align: right;">Rev. 7/17</p>
16.10 FEDERAL AMENDED RETURNS	<p>If you receive a federal amended return before completing your audit, follow the procedures listed below:</p> <ul style="list-style-type: none">• If a federal examination of the amended return is pending or incomplete, contact the Federal/State Examination Unit to verify the examination. If the amended issues are the same as the state audit issues, advise the taxpayer to file amended returns with us. We will process the state amended returns when the taxpayer tells us about the final IRS action on the federal amended returns,

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	<p>see MAP 8.1.4 Informal Claims for Refund for additional Protective Claims information.</p> <ul style="list-style-type: none">• If the amended issues are not the same as the state audit issues, you should request a copy of the Notice of Refund, RAR, etc., from the Federal/State Examination Unit, once the final action is taken on the federal amended returns. Consider the amended return adjustments at audit, to the extent applicable for California purposes.• If a federal examination of the amended return is complete, you should seek proof of the examination (Notice of Refund, RAR, etc.), and consider the amended return adjustments at audit, to the extent that they apply to California purposes.• If there has been no federal examination of the amended return, and there is no sign that a federal examination is pending, address the issues in the same way as any other position a taxpayer might raise at audit. That the IRS issued a refund without examination does not control a state audit. Depending upon the adjustment, you may need to audit the issues raised on the amended returns unless the federal amended return treatment is clearly appropriate for California purposes. <p style="text-align: right;">Rev. 7/17</p>
<p>16.11 SENATE FINANCE COMMITTEE AND INTERNAL REVENUE SERVICE SPECIAL TASK FORCE REVIEW</p>	<p>During an examination, taxpayers may tell us that the Senate Finance Committee (SFC) or the Internal Revenue Special Task Force (ISTF) is reviewing their case. The Commissioner of the Internal Revenue Service has established a special task force to resolve cases brought before the SFC. These cases involve taxpayers that have written letters to the SFC with unresolved issues with the IRS in at least one tax year. The SFC reviews these letters and asks taxpayers to sign a waiver authorizing the committee to forward the cases to the ISTF in Washington D.C. for resolution. The ISTF assigns the cases, through the IRS Advocate's Office, to a Problem Resolution Officer in a District Office or a Service Center near the taxpayer's home.</p> <p>Once assigned, the IRS will review these cases and actively seek to resolve all potential issues, including issues the taxpayer has not raised. At the end of the examination, the taxpayer receives a notice of tax change or a closing letter.</p> <p>Cases scheduled for review by the ISTF will not show as reopened cases on the Individual Master File transcript. Consequently, statements by a taxpayer that a case is in review by ISTF cannot be verified with an IMF transcript.</p> <p>The IRS has an internal control database that lists the cases under ISTF review. We can get information on specific cases by contacting the IRS. We have made arrangements to fax the Request for Federal Tax Information - Form 8796-A to the Fresno Service Center. The IRS will fax a response showing:</p>

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	<ul style="list-style-type: none">• If the case has been referred by the SFC.• To whom it has been assigned. <p>To verify IRS or SFC involvement, contact the Federal/State Examination Unit.</p> <p style="text-align: right;">Rev. 7/17</p>
16.12 RARS RECEIVED IN THE FIELD	<p>PIT and General C-Corporation RARS received by the field offices should be forwarded to the GTA FSSAS Unit. When RAR and field audit years coincide, federal adjustments applicable for state purposes should be incorporated into the audit.</p> <p>For apportioning corporations if the RAR is received in the field the federal adjustments should be incorporated into the audit with a clear indication (Federal Exam Folder in PASS, event logged in the Event Log, etc.) that the RAR was received by the department.</p> <p>RARs received in the field after an audit has been completed should be forwarded to the GTA FSSAS Unit for PIT and C-Corp taxpayers. If the GTA FSSAS Unit is unable to process the RAR for any reason, they may return it to the field for assistance. See MAP 16.3.1 Incorporating the RAR for Personal Income Tax and General Corporations and MAP 16.3.2 Incorporating the RAR for Apportioning Corporations regarding statute of limitations for RARs.</p> <p>If an RAR is received by a field office for an apportioning corporation, and that office has an open audit on that corporation or has audited that corporation in the past, then that office should review the RAR and take the appropriate action.</p> <p>When a RAR is received in the field from a taxpayer or representative, the auditor should write across the top of the RAR in red Voluntary, date received, and initial to prevent the loss of the statute of limitations, since special statutes apply when RARs are received within six months of final determination.</p> <p>This same procedure also applies to partial RARs. Sometimes the taxpayer or representative will provide only a page, or a few pages, of the RAR. This may be</p>

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	<p>sufficient if the RAR information provided contains enough information to compute the adjustment. If not, the taxpayer should be notified that they have not met their legal requirements and that the entire RAR, or portions necessary to compute the adjustment, must be furnished for the special statutes to apply. This also prevents the representative from claiming the RAR was furnished timely when it was actually submitted after the required period.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.13 INFORMATION COPIES TO IRS</p>	<p>An auditor making an adjustment that applies for federal purposes and is within the federal statute should code the NPA to forward a copy to the IRS.</p> <p>Consideration should be given to undisclosed income that may extend the statute beyond the normal three-year Federal limitation period.</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.14 ABATEMENT REFUND MEMO</p>	<p>For information regarding Abatement Refund Memos, see MAP 13.4.2 Abatement Refund Memo (Form FTB 6163).</p> <p style="text-align: right;">Rev. 7/17</p>
<p>16.15 COMPLIANCE ASSURANCE PROCESS (CAP)</p>	<p>Background</p> <p>In 2005, the IRS started the CAP program as a pilot for large corporate taxpayers. On March 31, 2011, they announced that CAP would be a permanent program based on results during the pilot period. This development prompted inquiries to TRSB regarding CAP and how this process may impact FTB audits in progress and if there would be different procedures that staff should follow when a taxpayer under audit is participating in the CAP program.</p> <p>Recommendations are outlined below.</p> <p>Description of CAP (Internal Revenue Manual 4.51.8)</p> <p>CAP is covered in the <u>Internal Revenue Manual (IRM) section 4.51.8</u>.</p> <p>CAP is a method of identifying and resolving tax issues through open, cooperative, and transparent interaction between the Internal Revenue Service (IRS) and Large Business and International (LB&I) taxpayers prior to the filing of a return. Through the CAP</p>

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program, the taxpayer should achieve tax certainty sooner and with less administrative burden than conventional examinations.

The CAP program was initiated as a pilot for large business taxpayers in 2005. Based on reviews and results of CAP pilot cases, the IRS announced on March 31, 2011 that the CAP would become permanent, effective immediately. According to a February 2012 report, there were 160 participants in the federal program, which was an increase from 17 participants since the program's inception in the 2005 tax year.

The CAP Program (the Program) consists of three phases: Pre-CAP, CAP, and Compliance Maintenance.

The Program fosters compliance by helping the IRS achieve its goal of reducing overall examination cycle time and increasing currency for participating taxpayers while enhancing the accurate, efficient, and timely resolution of complex tax issues. In addition, the Program assists in increasing audit coverage by providing a more efficient use of audit resources.

The Program does not provide taxpayers with guidance on, or resolution of, prospective or incomplete transactions outside of existing procedures.

See Exhibit 1 - Overview of CAP Plan for an illustration of the different phases and eligibility criteria.

Recommendations

1. If a taxpayer is part of the CAP program, does California accept their federal return as audited?

Participation in CAPS is not synonymous with an IRS audit. Staff should continue to verify items where there is non-conformity between state and federal treatment.

Refer to the following MAP Sections for more information on federal audits:

- MAP 16.1
- MAP 16.5

Exceptions: Staff should review the CAP plan to get an understanding of what was reviewed during the CAP. There are instances where taxpayers who participated in the CAP are subject to the normal post-filing examination procedures. In particular where:

- Items were not reported on the return as agreed,
- New items or issues are identified on the return, or
- IRS issued a partial acceptance letter.

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Staff should obtain the results of this post-file examination from the TP or IRS. (See [FAQ 9](#))

2. Will an AIC be issued to communicate audit procedures to be applied when taxpayers have participated in the CAPS?

Since there aren't special processing procedures for taxpayers that participate in CAP, an AIC will not be issued. Staff should follow procedures in MAP 16.1, 16.5, and 16.15 (*this section*).

3. What information should staff request from the TP (or IRS) related to the CAP?

Staff should review the IRS planning, CAPs and post-filing documents to determine how it impacts the state audit. Staff should request the following information from the Taxpayer or IRS (as applicable):

- CAP Plan
- Issue Resolution Agreement
- Closing Agreements
- Full Acceptance Letter or Partial Acceptance Letter
- No Change Letter and Post-filing determination letter. In some cases, the IRS will examine issues through the traditional examination process resulting in an RAR.

See Exhibit 2 – Definitions for additional information regarding the above terms.

4. What instructions should auditors have on items that have NOT been reviewed by the IRS? For example, IRS doesn't review a capital loss.

Staff should follow normal audit procedures. Similar to question 1, auditors should determine what impact this area may have on the state audit.

5. Would we direct auditors to request a copy of the "No Change" letter to verify the taxpayer's full participation in the CAP?

Yes. However, even in No Change situations, auditors should examine the federal return to determine if there are areas of non-conformity that would require state follow-up.

State Level Program

1. Is FTB considering implementing a similar CAPs program at the state level?

Based on initial discussions with the IRS, the anticipated benefits for CA appear to be minimal. Additionally, based on the number of participants at the federal level (see note

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below), the volume of CA-filers does not appear to support implementation of a CA program. Therefore, at this time, a CA program is not being pursued further.

If pursued in the future, the following steps would be recommended:

- Check with other states to see if any other states had started a similar program
- Shadow process with the IRS
- GC approval
- IPM or other forum to obtain input on how to determine application of CAP to CA
- Tax News Article & Audit Communiqué
- Other implementation efforts, such as forms development, etc.

Note: As mentioned above, according to a February 2012 report, there were 160 participants at the federal level. Although this was an increase from 17 participants since the program's inception in 2005, the volume is still not high relative to the number of filers. We recently inquired with our IRS liaison who indicated the IRS currently has 14 CAP participants (we are in the process of seeing if they are willing to share TP information). To date, CAP has only been mentioned in a handful of audits.

Contact Information

For more information regarding CAP, contact the TRS CAP Subject Matter Contact.

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