



# TAX ALERT

## BULLETIN

February 9, 2005

## CALIFORNIA TAX AMNESTY PROGRAM

### Every California Taxpayer Needs to Consider Its Impact!

On August 16, 2004, the California Legislature enacted into law an ostensibly helpful program for taxpayers: Amnesty. While it is true that, by participating in amnesty, California taxpayers may be relieved of prior tax penalties and not be subject to new Amnesty penalties, the Amnesty program forces taxpayers to participate (which may create an unreasonable financial burden for the taxpayer) or face potentially expensive consequences. It is critical that all California taxpayers are completely informed about this program so they may make an informed decision regarding whether to participate in Amnesty, which decision must be made during a specific period of time from *February 1, 2005 through March 31, 2005*.

#### Who should consider participating in Amnesty?

Any California taxpayer that has, or potentially could be deemed to have, an outstanding tax liability on March 31, 2005 for tax years prior to and including year 2002 should consider participating in Amnesty. This is especially true for California taxpayers who have outstanding disputes with the California taxing authorities, whether civil or criminal. This is also true for California taxpayers who may end up with a tax liability because a California taxing authority disagrees with the taxpayer's position, whether the taxpayer took that position in good faith or not.

There are two separate Amnesty programs: one administered by the California Franchise Tax Board (FTB), which covers corporate franchise taxes, and corporate, individual, estate, and trust income taxes; and one administered by the California State Board of Equalization (SBE), which covers

sales and use taxes. The benefit of participating in Amnesty is that the FTB or SBE will waive prior civil and criminal penalties, and will not pursue additional criminal investigations against a complying taxpayer.

#### What happens if a taxpayer is eligible for Amnesty but does not participate, or participates but fails to fulfill all Amnesty requirements?

If a taxpayer does not participate in Amnesty and fulfill all of the Amnesty requirements, substantial additional new and increased penalties will apply to any unpaid balance that the taxpayer owes as of March 31, 2005 for tax years prior to and including 2002. The FTB Amnesty increases the accuracy related penalty from 20 percent to **40 percent**, and adds a new penalty essentially equal to **50 percent** of the interest on past and future tax liabilities. The SBE Amnesty imposes the foregoing 50 percent penalty and imposes a **double** penalty on non-Amnesty penalties. In addition, the SBE Amnesty program extends the statute of limitation on open tax years to **10 years** after the original due date of the return for that period.

For example, assume that a California "C" corporation has an alleged unpaid income tax liability of \$100,000 on March 31, 2005 for tax years 1977 through 1980. However, the FTB was not able to collect until May 1, 2005. In addition, because it has been over 20 years since the tax liability arose, \$100,000 of penalties and \$2,300,000 of interest raised the outstanding liability to \$2,500,000. If that corporation does not participate in Amnesty, the \$2,500,000 liability will be in-

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creased as follows: the 40 percent accuracy related penalty would add \$1,000,000 to the liability, and the 50 percent of interest penalty would add \$1,150,000 to the liability, for a new total tax liability of **\$4,650,000**. If the corporation were to participate in Amnesty, the tax liability would be **\$2,400,000**.

Amnesty not only applies to “C” corporations and individuals; but it also applies to any type of California taxpayer, including, but not limited to, “S” corporations, limited liability companies, general and limited partnerships, estates, and trusts.

### Who is eligible for Amnesty?

Under both the FTB and SBE programs, a taxpayer must (1) have a tax liability for years prior to and including 2002, and (2) not be the subject of a current criminal investigation, or current criminal court proceeding, for unpaid or underpaid taxes. Additionally, under the FTB Amnesty program, (1) taxpayers may not participate in Amnesty with respect to a tax liability attributable to **tax shelters**, and (2) taxpayers who participate in Amnesty give up their right to appeal or to file a claim for refund for Amnesty related payments. Under the SBE Amnesty program, taxpayers may not file a claim for refund of penalties imposed pursuant to Amnesty.

### How does a taxpayer participate in Amnesty?

A taxpayer has to complete three steps: (1) complete (and sign under penalty of perjury) an Amnesty Application between February 1, 2005 and March 31, 2005; (2) file all unfiled, yet required, tax returns or amended tax returns by May 31, 2005; and (3) pay all outstanding tax liabilities and interest by May 31, 2005. For individual taxpayers, and **possibly** corporate taxpayers, the taxpayer may request to pay the tax liability pursuant to an Amnesty approved installment agreement, under which the liability must be paid in full by **June 30, 2006**. If the Amnesty installment agreement is approved by the FTB or SBE, and if the installment agreement is not later breached by the taxpayer, the taxpayer will have satisfied this Amnesty requirement. Additionally, under the FTB Amnesty program, a taxpayer must remain tax compliant during tax years 2005 and 2006.

### Is there relief for an “innocent” taxpayer?

The SBE Amnesty program includes a so-called “reasonable cause” exception, which, if satisfied, may provide relief to a delinquent taxpayer. However, at the present time, the FTB Amnesty program does **not** provide “reasonable cause” relief, which makes the FTB Amnesty program that much more oppressive to taxpayers.

In summary, every California taxpayer must decide whether to participate in one or both of these Amnesty programs. Taxpayers need to be as confident as possible that they will have no balance due on March 31, 2005 (even a liability that arises **after** March 31, 2005, which is retroactive to March 31, 2005). For example, assume the same corporation that owed the \$2,500,000 tax liability is audited in 2006 for the year 2002, and the final determination is that a tax liability existed as of March 31, 2005, these rules apply!). Since one cannot be sure they will not have a liability covered by the Amnesty rules, the taxpayer **should** consider participating in Amnesty by thoroughly analyzing the law, and that taxpayer’s facts as applied to the law.

### What should you do if you have any questions about Amnesty?

Because the March 31, 2005 deadline is rapidly approaching, at your earliest opportunity, please contact Bradford S. Cohen (the head of the Firm’s Business Tax Department), Michael B. Luftman, David P. Schwartz, Richard A. Luftman, or the attorney at the Firm with whom you normally communicate. ❖