STATE OF CALIFORNIA
**FRANCHISE TAX BOARD**
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**FTB NOTICE 2006-1** **January 11, 2006**

**SUBJECT: California Tax Shelter Resolution Initiative – California's Program for Participants in Internal Revenue Service (IRS) Settlement Initiative.**

The purpose of this Notice is to provide guidance to those California taxpayers participating, or intending to participate, in the Internal Revenue Service (IRS) Settlement Initiative – Announcement 2005-80 (IRS Initiative), as to how they may obtain analogous tax treatment from the State of California.

Eligibility to participate in the California Tax Shelter Resolution Initiative (California Initiative) is limited to those taxpayers eligible to participate in, and who fully complete the requirements of, the IRS Initiative.

Like its federal counterpart, the California Initiative requires the taxpayer to sign a closing agreement with the Franchise Tax Board (FTB), permanently resolving all tax, interest, and penalty consequences associated with the taxpayer's participation in any transaction listed in Announcement 2005-80. The California closing agreement will provide that the resolution of the transaction(s) specified therein is final and cannot thereafter be the subject of any claim for refund or offset, and that the taxpayer waives all rights to contest/appeal in any forum, whether administrative, judicial, or otherwise, the validity of the transaction(s) described therein or the amounts to be paid thereunder. Taxpayers choosing to participate in the California Initiative must file with the FTB an irrevocable election to do so no later than March 31, 2006.

## IRS Initiative (Announcement 2005-80)

The IRS Initiative identifies 21 transactions eligible for resolution under the terms contained within Announcement 2005-80. Under the federal program, participants are required to pay 100 percent of the taxes owed, interest, and the applicable accuracy related penalty (ARP). Depending on the transaction, the ARP can range from 5 percent to 20 percent of the underpayment. Taxpayers can claim transaction costs paid, including professional and promoter fees, as an ordinary loss, provided the promoter did not previously refund these amounts to the taxpayer. The period within which taxpayers may elect to participate in the IRS Initiative runs from October 27, 2005, to January 23, 2006.

**California Initiative**

By satisfying all requirements of the IRS Initiative and the California Initiative, a California taxpayer can avoid all penalty assessments, including the non-economic substance transaction understatement penalty (Revenue and Taxation Code (RTC) section 19774), except the ARP, which will be assessed at the percentage rate specified in section 3 of Announcement 2005-80. If the taxpayer has other unreported income, adjustments, or improper transactions, applicable penalties may be imposed.

Complete performance of the IRS Settlement Initiative and the California Initiative is mandatory for a California taxpayer to receive the treatment described in the preceding paragraph. If, for example, a California taxpayer participates in the IRS Initiative, and then merely files an amended California return claiming the same tax treatment as that obtained under the IRS Initiative, as opposed to participating fully in the California Initiative, that taxpayer will be subject to all penalties otherwise applicable to the transaction, without further reduction or compromise. The same consequences would occur in a situation where a taxpayer fails to sign the closing agreement required by either Initiative, or fails to provide information required to be disclosed under either Initiative. The penalties that could be assessed in such situations include, but are not limited to, reportable transaction penalties (RTC § 19772 and former § 19773[1]), the noneconomic substance transaction understatement penalty (RTC § 19774), increased interest assessments (RTC §§ 19777, 19778), and the full ARP. In addition, taxpayers will not be allowed a deduction for promoter fees and transaction costs in such situations.

**Interaction with California VCI Program (2004)**

Taxpayers that participated in the Voluntary Compliance Initiative (VCI) pursuant to RTC section 19752, subdivision (b), have a statutory right to appeal and file a claim for refund. In the event that a taxpayer participates in the IRS Initiative with respect to that transaction, the taxpayer may also, if timely requested, participate in this California Initiative. Any VCI taxpayer electing to participate in this California Initiative will be deemed to have abandoned any rights to file an appeal or a claim for refund under RTC section 19752, subdivision (b), with respect to that transaction.

**Procedures for Participation in California Initiative**

To participate in the California Initiative and avail themselves of the penalty waivers described herein, the reduced ARP, and the deductibility of promoter fees and transaction costs, taxpayers must do all of the following:

[1] Pursuant to section 15, subdivision (b), of SB 614 (Stats. 2003, ch. 656) and AB 1601 (Stats. 2003, ch. 654), RTC section 19773 was operative for taxable years beginning on or after January 1, 2003. AB 115 (Stats. 2005, ch. 691, §§ 50.3 and 50.4) repealed RTC section 19773 for taxable years beginning on or after January 1, 2005.

A. File with the FTB an irrevocable election to participate in the California Initiative (Form 638) no later than March 31, 2006. Completed forms should be sent to:

**Tax Shelter Resolution Initiative**
Franchise Tax Board
PO Box 1673
Sacramento CA 95812-1673

**Private carrier services, mail to:**

**Tax Shelter Resolution Initiative**
Franchise Tax Board
Sacramento CA 95827

B. Provide FTB with requested information and documents. The election requires information necessary to process the election and determine the proper tax liabilities. The FTB may request additional information and documents relating to the transaction, such as marketing materials, tax opinion letters, and documentation of fees and costs incurred and paid by the taxpayer in connection with the transaction that is the subject of the California Initiative. All requested information must be submitted under penalties of perjury to the FTB within 30 days of the date of mailing of the request for additional information by the FTB. FTB may grant an extension for good cause to persons who request additional time within the 30-day period. The FTB will treat a person who fails to provide the required information within the applicable time period as having withdrawn from the California Initiative.

C. Provide FTB with a copy of the signed IRS closing agreement within 30 days of the date the agreement was signed by both the taxpayer and the IRS. Failure to provide this item within the specified time period will be treated as a withdrawal from the California Initiative.

D. Sign a separate closing agreement with the FTB, which, among other things, will memorialize the finality of the resolution, the inability of the taxpayer to thereafter claim a refund or offset of amounts paid under the Initiative, and the taxpayer's waiver of any rights to contest/appeal the validity of the transaction(s) resolved under the California Initiative.

E. Fully pay all taxes, interest and penalties under the terms of the closing agreement at the time the closing agreement signed by the taxpayer is returned to FTB. Any taxpayer unable to make full payment at that time may submit a request to enter into a payment arrangement with FTB. Any such request must be accompanied by a complete and current financial statement. Requests to enter a payment arrangement with FTB will be considered on a case-by-case basis. FTB will not sign closing agreements absent payment in full or the presence of an acceptable payment arrangement.

The principal authors of this notice are William Hilson and David Gemmingen of the Franchise Tax Board Legal Department. For further information regarding this notice, contact Mr. Hilson or Mr. Gemmingen at the Franchise Tax Board, Legal Department, P.O. Box 1720, Rancho Cordova, CA 95741-1720.