



California Tax Amnesty . . . Not?

Tax Practice

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On August 16, 2004, Governor Schwarzenegger signed into law S.B. 1100 establishing two tax amnesty programs: the personal and corporate income tax amnesty program and the sales/use tax amnesty program to be administered by the Franchise Tax Board (FTB) and Board of Equalization (BOE), respectively. The BOE and FTB will administer the tax amnesty programs beginning February 1, 2005 and ending on March 31, 2005, inclusive. Both tax amnesty programs will apply to tax liabilities due and payable for tax reporting periods (sales/use tax) and for taxable years (personal/corporate income tax) beginning before January 1, 2003.

The FTB Amnesty Program and the BOE Amnesty Program are in reality nothing more than tax payment acceleration programs to reduce the magnitude of California's budget deficits. With few exceptions, personal and corporate income taxpayers with open tax periods or unpaid liabilities relating to taxable years prior to January 1, 2003—whether or not under audit, in protest, appeal or settlement—must **pay prior to March 31, 2005** any underreported or unpaid outstanding tax liabilities, including interest and penalties, or file an application to participate in the FTB Amnesty Program in order to avoid significant new penalties.¹ Personal and corporate income taxpayers who choose to participate in the FTB Amnesty Program also **waive** their right to file refund claims for amounts paid under the amnesty program.

In general, all personal and corporate income taxpayers should undertake immediately a detailed analysis of their reporting positions on returns for open years and determine the likelihood of success of their various reporting positions taken on returns for periods prior to January 1, 2003 and/or such periods currently under review in audit, protest, appeal and settlement. It appears that most personal/corporate income taxpayers should not avail themselves of the opportunity to participate in the FTB Amnesty Program where genuine disputes exist with the FTB. However, to avoid application of the new penalties such taxpayers should seriously consider paying **tax, interest and any penalties** prior to March 31, 2005 for which they anticipate that their reporting position will not be sustained. This approach will not only avoid some of the new penalties but it preserves the ability of personal/corporate income taxpayers to proceed administratively and judicially regarding all outstanding amounts rather than waiving refund rights for any amounts through participation in the FTB Amnesty Program.

The analysis for sales/use taxpayers differs somewhat because participation in the BOE Amnesty Program—unlike the FTB Amnesty Program—does not foreclose the filing of refund claims for amounts paid through participation in amnesty. Audits, petitions, appeals and matters in settlement

¹ Taxpayers under both amnesty programs are subject to a new 50 percent interest penalty; personal and corporate income taxpayers are also subject to a doubling of the accuracy related penalty from 20% to 40% and applicable sales/use tax penalties are doubled.

apparently will proceed through the normal processes whether or not a taxpayer chooses to participate in amnesty. However, failure to pay by March 31, 2005 **tax**² amounts which are ultimately determined owing will subject taxpayers not only to the new 50 percent interest penalty but the doubling of other applicable penalties. Sales/use taxpayers should undertake an analysis of their reporting positions and matters currently in audit, petition, appeal, settlement as well as those years subject to the expanded statute of limitations and determine the strengths and weaknesses of the reporting positions and their likelihood of success.³ For certain matters it will be prudent to pay certain liabilities, whether through participation in amnesty or by March 31, 2005, in order to avoid the new interest penalty and the doubling of other penalties. Finally, an expanded ten-year statute of limitations for all open periods as of August 16, 2004 replaces the three-year statute of limitations for assessments (but not refunds) irrespective of whether a taxpayer participates in the BOE Amnesty Program.

I. Amnesty Overview

Benefits. The apparent benefits of participating in amnesty are as follows:

- The BOE must waive all unpaid penalties and the FTB must waive all unpaid penalties and fees relating to the nonreporting or underreporting of tax liabilities or the nonpayment of tax.
- In general, no criminal action will be brought against the taxpayer, for the tax reporting periods/taxable years, for which tax amnesty is requested, for the nonreporting or underreporting of tax liabilities or the nonpayment of tax.⁴ The “no criminal action” amnesty does not cover taxpayers who as of February 1, 2005 are under—or are on notice of a—criminal investigation or are the subject of a court proceeding for nonreporting, underreporting or nonpayment of pre-2003 tax liabilities.

Requirements. To participate in the amnesty programs, an eligible taxpayer must file an amnesty application with the relevant agency and within 60 days⁵ of the end of the amnesty period do all of the following:

- File completed tax returns for all tax reporting periods/taxable years for which the taxpayer has not previously filed a tax return or files completed amended returns for all tax reporting periods for which the taxpayer underreported its tax liability.

² As explained in more detail later, the BOE has stated taxpayers under audit, petition or appeal who do not wish to participate need only paid tax, not also interest and penalties, to avoid the 50 percent interest penalty. However, taxpayers with final amounts in collection are required to pay both tax and interest to avoid the penalty. Taxpayers should be aware of the differences in BOE and FTB interpretations.

³ If already audited, the BOE does not intend to go back and reaudit unless it becomes aware of an issue from some other source.

⁴ To the extent a taxpayer pays less than the full amount due under amnesty, criminal action may be brought only with respect to the difference between the amount shown on the return and the correct amount of tax, or the amount of unreported or underreported tax, whichever the case may be.

⁵ For FTB purposes, a taxpayer paying in full any taxes and interest due within 15 days of receiving a notice from the FTB (“15-day cure” provision) shall be treated as paid during the amnesty period.

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- Pay in full the taxes and interest due for all periods/taxable years for which amnesty is requested, or apply for an installment agreement.⁶
- Pay in full the taxes and interest due for each period for that portion of the proposed determination for each period for which amnesty is requested or apply for an installment payment agreement. For FTB purposes, taxpayers who have not paid in full any taxes previously proposed to be assessed must pay in full the taxes and interest due for that portion of the proposed assessment for each taxable year for which amnesty is requested or apply for an installment payment agreement.

The application must be in the form and manner specified by the BOE and FTB, but in no case will a mere payment of any taxes and interest due, in whole or in part, for any reporting period/taxable year otherwise eligible for amnesty, be deemed to constitute an acceptable amnesty application. For purposes of the preceding sentence, the application of a refund from one reporting period/taxable year to offset a tax liability for another reporting period/taxable year otherwise eligible for amnesty will not be allowed without the filing of an amnesty application.⁷ Failure of the taxpayer to fully comply with the terms of an installment payment agreement renders the waiver of penalties null and void, unless the failure was due to reasonable cause, and the total amount of tax, interest, and all penalties will be immediately due and payable.⁸

Restrictions. The FTB Amnesty Program will not apply to any nonreported or underreported tax liability attributable to tax shelter items that could have been reported under either the Voluntary Compliance Initiative or the Internal Revenue Service's Offshore Voluntary Compliance Initiative described in Revenue Procedure 2003-11. In addition, taxpayers who have filed for bankruptcy protection under Title 11 of the United States Code, must obtain a court order in order to be eligible to participate in the amnesty programs.

Limitations on Refunds. Personal or corporate income taxpayers may not file a claim for refund or credit for any amounts paid in connection with the FTB Amnesty Program. The amnesty legislation does not contain a similar prohibition against refunds of sales/use tax amounts paid under amnesty. Personal/corporate income or sales/use taxpayers may not use the amnesty program to seek a refund of any penalties or fees paid prior to the amnesty period.

II. New Amnesty Penalties

New penalties will be imposed for taxpayers who fail to participate in the FTB or BOE Amnesty Programs.

⁶ An acceptable installment payment agreement, which should include interest on the outstanding amount due at the rate prescribed by law, must have a final payment due no later than June 30, 2006.

⁷ The BOE is reviewing this position and may permit offsets between reporting periods and only apply the relevant provisions to any net amounts owing as of March 31, 2005.

⁸ According to the BOE, the 50 percent interest penalty would not apply.

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50 Percent Interest Penalty. Except for taxpayers who have entered into an installment payment agreement and except for certain tax shelter items, there will be added to the tax for each period for which amnesty could have been requested a 50 percent interest penalty as provided below:

- For amounts that are due and payable on March 31, 2005, a penalty equal to 50 percent of the accrued interest payable under the applicable statute for the period beginning on the date in which the tax was due and ending on March 31, 2005.
- For amounts that become due and payable after March 31, 2005, a penalty equal to 50 percent of the applicable interest on any final amount, including final deficiencies and self-assessed amounts, for the period beginning on the date in which the tax was due and ending on March 31, 2005.

The 50 percent interest penalty is in addition to any other penalty imposed under the relevant tax provisions. Taxpayers may not file a claim for refund for any amounts paid in connection with the 50 percent interest penalty.⁹ The usual provisions relating to determinations and deficiency assessments will not apply with respect to the assessment or collection of the fifty percent interest penalty.

Doubling of BOE Penalties. If, subsequent to the amnesty period, the BOE issues a deficiency determination upon a return filed pursuant to the amnesty program, or upon any other nonreporting or underreporting of tax liability by any person who was eligible for amnesty, the BOE will impose penalties at the rate that is double the rate of penalties prescribed by law and criminal action may be brought under this part only with respect to the difference between the amount shown on that return and the correct amount of tax, or the amount of unreported or underreported tax, whichever the case may be.¹⁰ This action may not invalidate any waivers granted under the amnesty program.

Increased Accuracy Related Penalty (ARP). Except for understatements relating to tax shelter items, which already are subject to enhanced ARP, and taxable years of a taxpayer in audit, protest, appeal, settlement, or litigation as of February 1, 2005, in the case of a proposed deficiency assessment issued after March 31, 2005 for any taxable year beginning prior to January 1, 2003, the ARP will be computed by substituting “40 percent” for “20 percent.”

Failure to Pay Tax for Taxable Years 2005 and 2006. In the case of any taxpayer who participates in the tax amnesty program, receives a waiver of all penalties and fees, and subsequently fails to pay any amount of tax (including penalties, fees and other amounts) for the 2005 or 2006 taxable year, which failure results in the imposition of a collection recovery fee, then the previous waiver of the penalties

⁹ The FTB on its website under “Amnesty: Payments, penalties, and miscellaneous” states in response to Question 4 that a taxpayer may get a refund of the 50 percent interest penalty paid by a taxpayer if the underlying interest amount decreases due to a redetermination of the correct tax liability for the year. The FTB notes that the penalty will necessarily be recomputed to reflect the change. The stated rationale is that a taxpayer may claim a refund of amounts paid in excess of the proper penalty, but cannot claim a refund of the penalty itself. The BOE has not yet adopted this interpretation but should specifically address it in the future on its website under its Q & A discussions. Irrespective of such interpretations, it would seem advisable that a taxpayer not pay any 50 percent interest penalty if it intends to challenge the underlying tax.

¹⁰ The BOE at its Informational Meeting on the Amnesty Program stated that the 50 percent interest penalty does not double under this provision.

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and fees under the tax amnesty program will be rendered null and void, and all penalties, fees, and associated interest shall be immediately due and payable. The usual provisions relating to deficiency assessments will not apply with respect to the assessment or collection of any penalty, fee, or interest imposed pursuant the aforementioned provision. Further, a taxpayer may not file a claim for refund or credit for any amounts paid in connection with any such penalty, fee, or interest.

III. Post-Amnesty Deficiencies and Statute of Limitations

Upon conclusion of the tax amnesty program period, the FTB may propose a deficiency upon any return filed pursuant to the amnesty program, impose penalties and fees, or initiate criminal action under this part with respect to the differences between the amount shown on that return and the correct amount of tax. The FTB has 180 days to refund amounts resulting from overpaid amnesty liabilities—such as that which might result from an amended return changing a filing enforcement (FE) assessment or from withholding being applied—before interest on such overpayment must be paid.

If the BOE issues a deficiency determination after March 31, 2005 with respect to a return filed under amnesty or any nonreporting or underreporting of tax liability for which amnesty could have been requested, the BOE may issue that deficiency determination within ten years from the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.¹¹

IV. Whether or Not to Participate in the FTB Amnesty Program?

Reasons for Participation in FTB Amnesty

Participants in the FTB Amnesty Program avoid the 50 percent interest penalty, doubling of any accuracy related penalty (ARP increase does not apply to a taxpayer in audit, protest, appeal, settlement or litigation at the start of amnesty), most penalties and fees and criminal prosecution. However, participants waive their rights to claims for refund or credit for amounts paid in connection with amnesty and must be compliant for subsequent years 2005 and 2006 in filing and paying any amount of tax, including penalties and fees, for 2005 and 2006 taxable years.

Taxpayers with eligible periods currently under audit should recognize that participation in the FTB Amnesty Program basically precludes any further protest, appeal or litigation concerning any amounts paid thereunder. In addition to filing an application to participate, the FTB will require the filing of

¹¹ It was explained at the BOE's Informational Meeting that the expanded statute of limitations applies to open periods even if a final audit determination has been fully paid and is not being contested for such periods and irrespective of whether a taxpayer participates in the amnesty program. That is, if a period was open for assessment on August 16, 2004, such period technically is open for further assessment (but not refund) under the expanded statute of limitations. For example, if an audit for the period fourth quarter 1999 through the fourth quarter 2002 was completed and fully resolved and even paid as of August 16, 2004, the period still open under the three-year statute of limitations as of August 16, 2004 would encompass the quarterly periods from July 1, 2001 through December 31, 2002—and the previously applicable three year statute of limitations is now expanded to ten years. Thus, taxpayers need to be aware that even matters purportedly closed by audit may still be open for further assessment.

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an amended return along with payment of the outstanding amounts of tax and interest by May 31, 2005.

Taxpayers may apply for partial amnesty. Taxpayers may request amnesty only for a portion of a proposed assessment amount while continuing to protest or appeal the remaining disputed portion. If a taxpayer does not choose full amnesty participation, the taxpayer will be subject to amnesty penalties on any portion remaining after March 31, 2005.¹² Taxpayers who have received a Notice of Proposed Assessment (NPA) which includes proposed penalties should consider this approach where their position on certain issues may be weak but stronger on others. Again, an application and an amended return would need to be filed along with payment of the outstanding amounts by May 31, 2005. The FTB has advised that under partial amnesty a taxpayer does not concede issues but only the amount paid which will not be subject to refund. Partial amnesty will preserve the ability of the taxpayer to protest, appeal and possibly litigate all issues in dispute. Of course, if the taxpayer fails to prevail it will be subject to the imposition of the applicable penalties discussed above, but if it wins all issues the taxpayer will have lost the ability for a refund on the amounts paid under amnesty.¹³

No Participation in FTB Amnesty

Unless a taxpayer is a nonfiler, has outstanding final liabilities and/or has criminal or a significant penalty exposure, amnesty is not an attractive option. Instead, most personal and corporate income taxpayers should consider making payment by March 31, 2005 of all or a part of disputed tax and interest amounts for taxable years before January 1, 2003 outside of the amnesty program. Taxpayers should undertake an analysis of each open taxable year prior to January 1, 2003 and determine the strengths and weaknesses of their respective California reporting positions issue by issue. Taxpayers will also need to do a similar review of their federal reporting positions and audits in order to determine potential federal RAR adjustment issues. Taxpayers can then determine whether it would be beneficial to pay tax and corresponding interest on certain issues that may be weaker than others. This approach will preserve the ability of the taxpayer to pursue its administrative and judicial remedies on all issues while at the same time minimizing the taxpayer's exposure to the 50 percent interest penalty (and if relevant, the increase in the accuracy related penalty) on at least that portion of tax amounts and interest paid by the taxpayer prior to March 31, 2005.

Taxpayers should file claims for refund for the amounts paid to preserve said amounts in the event they are ultimately successful. The claims generally must be filed within one year of payment.

¹² See FTB website under "Administrative Protest, Appeal, Settlement, and Litigation Amnesty Procedures," response to Question 8.

¹³ The FTB initially advised that partial amnesty required taxpayers to concede issues but most recently now advises that taxpayers are only conceding (waiving) their ability to receive a refund of amounts paid under amnesty. FTB amnesty website, Question 8, provides that taxpayers may request amnesty only for a "portion" of a proposed assessment amount. This is now interpreted by the FTB to mean only dollar amounts are being conceded, and not issues.

Payment of protested tax during the pendency of a protest or appeal converts the protest to a claim for refund and the appeal into an appeal from the denial of a claim for refund.¹⁴

The 50 percent interest penalty is imposed on net amounts owed with respect to a taxable year. Offsets between taxable years will not preclude imposition of applicable penalties for the taxable year where an assessment is issued—that is, the fact an audit may reflect a refund that is not final for one taxable year and a proposed assessment for another will not avoid or lower the penalty amount as such penalty is imposed separately with respect to each taxable year.¹⁵

Practical Considerations Depending on the Taxpayer's Procedural Situation with FTB

1. Years under FTB Audit or Not Yet Audited

Taxpayers under audit by the FTB who do not have any significant penalty exposure generally should not consider amnesty but should assess whether they will have a deficiency for a particular year and, if so, in what amount. They should then consider making payment of the projected tax and interest before March 31, 2005 outside amnesty and file immediate claims for refund or amended returns. A similar approach should be taken for years not yet under audit. The claim for refund or amended return should indicate what changes are being made from the original return. If the FTB was unaware of the issue at the time of payment, such payment may cause the FTB to examine said issue more carefully.

2. Matters under Protest or Appeal

Taxpayers in protest or appeal who have no penalties at issue generally should not consider amnesty. Rather, they should perform an analysis of the merits of the issues and attempt to determine on a year-by-year basis whether they will ultimately have a deficiency for that year. They should then consider making payment of the projected tax and interest before March 31, 2005. As noted above, claims for refund or amended returns should be filed. To the extent a taxpayer's exposure relates to a recently issued NPA or matters in protest, appeal or settlement, it appears that the taxpayer will not be required to identify any payments with any particular issue if less than full payment is being made. This approach should protect the taxpayer from specifically identifying any issues associated with the payment and providing the FTB with a roadmap as to which issues the taxpayer believes are weaker and thus keep the taxpayer in a better position of arguing all of its issues during the administrative and judicial processes.

¹⁴ The conversion of a protest to a claim means the grounds set forth in the protest are now the grounds for the claim. Taxpayers should consider filing an additional claim within the one year period setting forth all the grounds which may go beyond those set forth in the original protest.

¹⁵ The FTB on its website under "Amnesty: Payments, penalties, and miscellaneous," Question 6 indicates that the general rule is that a credit of an overpayment from one year to satisfy the liability of another year is effective on the date the credit is actually made by the government agency. Therefore, if the overpayment is credited before March 31, 2005, it will reduce the final balance upon which the penalty is based.

3. Matters in Settlement

It appears that unless matters in settlement are resolved prior to March 31, 2005, all the above-discussed amnesty penalties will be applicable to unpaid amounts. The FTB has stated that it will not compromise the amnesty penalties. Thus, for matters in settlement that are not fully paid and that are ultimately resolved after March 31, 2005, penalties will apply to any amounts agreed to be paid under the settlement. The FTB currently indicates that it will not impose the 50 percent interest penalty on the full unpaid amount in settlement but only on the amount that is ultimately agreed upon for settlement.

The FTB Settlement Bureau has advised that taxpayers currently in settlement who reach a settlement which is approved by FTB Chief Counsel prior to March 31, 2005, will not be subject to any enhanced penalties even if the settlement amount has not been paid by March 31, 2005. This is similar to the treatment afforded to existing installment payment agreements under the amnesty legislation.

With respect to taxpayers currently in settlement with no expectation of finalizing the process by March 31, 2005, the FTB Settlement Bureau advises that the taxpayer pay by March 31, 2005 the full NPA amount with interest. The Bureau indicated that, despite perceptions to the contrary, the Bureau does not apply different standards depending on whether the taxpayer is in a payment or refund posture.

The FTB Settlement Bureau also indicated that partial payments made prior to March 31, 2005 may reduce a taxpayer's potential exposure to the new amnesty penalties. For example, if the taxpayer decides to gamble that a matter will be settled on a certain basis (e.g., 50-50) and pays only 50 percent of the balance prior to March 31, 2005, but the matter ultimately settles on the basis of the taxpayer paying 60 percent, then the enhanced penalties will apply only to the 10 percent differential, not the entire assessment.

Finally, the FTB Settlement Bureau advises that if a taxpayer expects the issuance of an NPA and is considering the transfer of the matter into settlement, the taxpayer should pay by March 31, 2005 to avoid the application of the enhanced penalties.

4. Federal RAR Adjustments

Federal RAR adjustments will be treated similar to the situation where the taxpayer receives future deficiency assessments for taxable years that were eligible for amnesty—that is, the applicable penalties will apply to any unpaid amounts. If an RAR adjustment was favorable to a taxpayer (i.e., a refund) but the taxpayer participated in the amnesty program, the taxpayer will not be entitled to a California refund for that taxable year. To the extent a taxpayer is aware of potential RAR adjustments for taxable years eligible for amnesty, the same analysis as discussed above for audits, protests and appeals should be undertaken. As previously indicated, offsets of tax and non-final refunds/credits between taxable years will not be recognized to reduce or avoid the new amnesty penalties.

V. Whether or Not to Participate in the BOE Amnesty Program?

Reasons for Participation in BOE Amnesty

Participants in the BOE Amnesty Program avoid the 50 percent interest penalty, other penalties, doubling of existing penalties, and criminal prosecution. Unlike the FTB Amnesty Program, participants in the BOE Amnesty Program **do not waive** their rights to claims for refund or credit for amounts paid in connection with amnesty. However, it appears the major disincentive for taxpayers to participate in the BOE Amnesty Program is the requirement of prepayment of both **tax and interest**. Another difference is that, in addition to the 50 percent interest penalty applicable under both programs, existing BOE penalties are doubled for determinations issued following the amnesty period for relevant reporting periods. The expanded BOE statute of limitations does not reopen tax-reporting periods that are already closed. However, a notice of determination issued by the BOE on or after April 1, 2005, may be issued within ten years from the due date of the tax for those open periods prior to January 1, 2003, including periods open under existing waivers.¹⁶

1. Eligible Periods Currently under Audit

Participation in the BOE Amnesty Program for eligible reporting periods requires filing an application to participate by March 31, 2005 and the filing of an amended return(s) (which may consist of audit schedules provided during the audit) labeled “tax amnesty” along with payment by May 31, 2005 of the outstanding amounts of tax and interest for which amnesty is being sought.¹⁷

Partial participation for amnesty will be permitted by the BOE in that a taxpayer can choose to participate with respect to less than all amounts owed for a particular reporting period. Taxpayers should consider this approach where their position on certain issues may be weak but stronger on others. Again, an application would need to be filed by March 31, 2005 and an amended return or separate statement identifying the specific liabilities (tax amounts, not necessarily issues for which amnesty is being requested) would need to be filed along with payment of the outstanding amounts of tax and interest by May 31, 2005.¹⁸

To the extent a taxpayer participates in the BOE Amnesty Program but does not concede the amounts paid, a refund claim should be filed within the applicable statute of limitations.¹⁹

Offsets within a reporting period will be recognized in that imposed penalties relate to net amounts owed by reporting period—generally quarterly. Offsets between reporting periods within an audit period (generally three years) apparently should not preclude imposition of applicable penalties for the reporting period where an amount due is owing—that is, the fact an audit may reflect a refund or

¹⁶ See November 19, 2004 letter to Tax Professionals, p.5.

¹⁷ See BOE Q & A, nos. 53 and 60.

¹⁸ See BOE Q & A, no. 15.

¹⁹ The BOE advises that any refund claim must be filed within three years from the due date of the return on which tax was reported, or six months from the date of the overpayment. See BOE Q & A, no. 29.

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credit for one reporting period and an assessment for another may not avoid or lower the 50 percent interest penalty amount as such penalty is imposed by reporting period.²⁰

Participation in amnesty by a taxpayer under audit generally will require payment in advance of the issuance of a determination. The BOE has indicated that notwithstanding an amnesty application and payment, audits, petitions and appeals will proceed as in the past unless the taxpayer otherwise concedes the matter. Taxpayers should be cognizant of the need to file timely refund claims in an ongoing audit situation as the issue paid will not be affirmatively assessed (because payment has already been made) in the audit as amended returns will have been filed. Thus, to preserve the ability to contest an issue, the taxpayer's only avenue would be through the refund process. To the extent a taxpayer ultimately prevails, it will avoid the increased penalties but will receive a much lower interest rate on any refund as compared to the interest rate on assessments.

2. Matters under Petition or Appeal

As mentioned above, the BOE has indicated that matters under petition and appeal will proceed as usual. As with any determination, taxpayers can make prepayments of tax to stop the interest from running and, similarly under the amnesty program, can make payments of tax and interest to avoid the penalties described above. The BOE advises that taxpayers do not need to file protective **refund claims** at the time of payment as RTC section 6902 provides for a statute of limitations to file refund claims concerning petitioned matters of six months from the date the determination becomes final or after six months from the date of overpayment, whichever period expires the later. In addition to filing an application to participate, the BOE will require payment of the outstanding petitioned amounts (tax and interest) or the entering into a installment payment agreement by May 31, 2005.

Partial participation for amnesty will be permitted by the BOE for matters under petition or appeal in that a taxpayer can choose to participate for particular reporting periods and/or with respect to less than the entire determined tax amounts for a reporting period. Taxpayers should consider this approach where their position on certain issues may be weak but stronger on others for which it does not wish to prepay. An application, but apparently not amended returns,²¹ would need to be filed by March 31, 2005 along with payment of the amounts for which amnesty is being requested by May 31, 2005.

²⁰ The BOE at its Informational Meeting indicated that it is leaning toward allowing such offsets and says it could do so under the amended language of RTC section 6592 if needed. BOE is still examining this issue and should have something on its website in the future.

²¹ BOE Q & A, no. 15 provides with respect to nonpayers that if you request amnesty for less than all of your liabilities for a particular reporting period, you must also identify the specific liabilities for which you are requesting amnesty on your amnesty application, or on returns or amended returns, or on a separate statement submitted to the BOE by May 31, 2005. The BOE has recently advised that the aforementioned only relates to non-final amounts. Taxpayers with final amounts (effectively in collection status) who choose to participate in amnesty must pay all outstanding tax and interest and will not be permitted to seek amnesty on selected issues. However, it should be noted again that refund claims can be filed for amounts paid to the BOE under amnesty.

3. Matters in Settlement

To date the BOE has not provided any information regarding how it intends to proceed with settlement matters in the context of the amnesty program. However, BOE Settlement has indicated that it will try to complete the settlement process of pending matters by March 31, 2005 and to the extent payment has not been made to set up installment payment agreements permitted under the legislation which will avoid application of the enhanced penalties. With respect to taxpayers still negotiating settlement terms or contemplating entering settlement, it is advised that taxpayers pay at least the tax prior to March 31, 2005 to avoid the enhanced penalties. BOE Settlement currently is of the opinion that the enhanced penalties will apply to settlements finalized after the amnesty period but only as to amounts remaining to be paid—that is, the enhanced penalty will not be based on the original full determination amount.

No participation in BOE Amnesty, but Pay “Tax” Amounts by March 31, 2005

Unless a taxpayer is a nonfiler, has outstanding final liabilities and/or criminal or significant penalty exposure, amnesty may not be an attractive option. Instead, an alternative to participation in the BOE Amnesty Program for matters in audit, petition, appeal or settlement is to make payment of the disputed “tax” or portions thereof by March 31, 2005. The BOE apparently does not require payment of outstanding interest²² prior to March 31, 2005 in order to avoid the 50 percent interest penalty. Taxpayers should indicate that amounts paid should be applied to tax and identify the reporting period related thereto.

As mentioned above, taxpayers participating in the BOE Amnesty Program are permitted to file refund claims for amounts paid in amnesty. Similarly, taxpayers paying outside of amnesty can file refund claims. Thus, it would seem the most significant benefit for taxpayers in not participating in the BOE Amnesty Program is to avoid the prepayment of interest where the taxpayer has disputed issues it intends to pursue.

VI. Conclusion

Personal and corporate income taxpayers who choose to participate in the FTB Amnesty Program **waive** their right to file refund claims for amounts paid under the amnesty program. For this reason most personal and corporate income taxpayers should not participate in the FTB Amnesty Program, especially where the taxpayer has, or potentially will have, issues of genuine dispute with the FTB. Instead, personal and corporate income taxpayers should undertake a detailed analysis of their reporting positions on returns for open years and determine the likelihood of success of their various reporting positions taken on returns for periods prior to January 1, 2003 and/or such periods currently under review in audit, protest, appeal and settlement. To avoid application of the new amnesty penalties such taxpayers should seriously consider paying prior to March 31, 2005 and outside of the amnesty program, amounts of **tax, interest and any penalties** for which they anticipate that their reporting position will not be sustained. This approach will not only avoid some penalties but also

²² This is a significant variation from FTB’s interpretation. See BOE’s website Q & A nos. 12 ,27, 40, 43 and 61 where it is stated that the 50 percent penalty is assessed on the unpaid tax amount as of March 31, 2005.

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preserves the ability of taxpayers to proceed administratively and judicially regarding all outstanding amounts.

The analysis for sales/use taxpayers differs somewhat because participation in the BOE Amnesty Program does not foreclose the filing of refund claims for amounts paid through participation in the program. Audits, petitions, appeals and matters in settlement apparently will proceed through the normal processes whether or not a taxpayer chooses to participate in amnesty. However, failure to pay by March 31, 2005 **tax** amounts which are ultimately determined owing will subject taxpayers not only to the new 50 percent interest penalty but the doubling of other applicable penalties. Sales/use taxpayers should undertake an analysis of their reporting positions and matters currently in audit, petition, appeal, settlement and those years subject to the expanded statute of limitations and determine the strengths and weaknesses of the reporting positions and their likelihood of success. For certain matters it will be prudent to pay certain liabilities, whether through participation in amnesty or by March 31, 2005, in order to avoid the 50 percent interest penalty and the doubling of other penalties.

Both the FTB and BOE are determining or reevaluating their respective interpretation and positions concerning the matters discussed above. The BOE has a website (www.boe.ca.gov) containing questions and answers concerning the BOE Amnesty Program. On December 6, 2004, the FTB posted questions and answers concerning the FTB Amnesty Program on its website (www.ftb.ca.gov). Both websites should be periodically visited for any changes or updates.

We will also update this summary when further information is provided by the FTB or BOE. If you would like a copy of any future updates or have any questions regarding the FTB and BOE Amnesty Programs please contact Jeffrey M. Vesely (415.983.1075, jvesely@pillsburywinthrop.com), Kerne H. O. Matsubara (415.983.1233, kmatsubara@pillsburywinthrop.com), Richard E. Nielsen (415.983.1964, rnielsen@pillsburywinthrop.com) or Annie H. Huang (415.983.1979, ahuang@pillsburywinthrop.com).

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