

CALIFORNIA TAX "AMNESTY": It's A Tricky Business

By William Truax

The State of California has approved a tax amnesty which will apply to both income taxes (handled by the Franchise Tax Board) and sales taxes (handled by the State Board of Equalization). Each agency will run its own tax amnesty program from February 1, 2005 through March 31, 2005.

However, a far more important element to all this is that starting April 1, 2005, all penalties for past-due taxes will double.

California has been under financial strain for some time, and this new amnesty is part of its solution. The amnesty waives a relatively small amount of debt currently due in order to provide an incentive for individuals and businesses to come forward and pay immediately. However, this amnesty program is not as generous as its name suggests. Yes, there will be relief from penalties and fees for taxpayers who come forward under this amnesty. However, a far more important element to all this is that starting April 1, 2005, all penalties for past-due taxes will *double*. This extremely harsh measure is the far greater incentive.

There will be individuals who should but won't step forward. Some will have understandable reason for that (for example, they didn't think a debt was due). The new penalties will still apply. We'll discuss those in a moment.

Who Is Eligible

Amnesty is available for pre-2003 taxable years and is open to individuals, businesses, estates, and trusts that meet the following criteria:

- ◆ Didn't file required California tax returns
- ◆ Didn't pay taxes on time
- ◆ Underreported taxes on one or more previously-filed tax returns

Taxpayers who fall into any of the following categories aren't eligible for the amnesty:

- ◆ Is involved in a criminal court proceeding
- ◆ Is under criminal investigation or prosecution on a tax-related matter
- ◆ Is involved in abusive tax-sheltered transactions that were eligible for relief under the California Voluntary Compliance initiative

Taxpayers currently in bankruptcy need approval from the Federal Bankruptcy Court to participate in the amnesty program.

Continued Eligibility

Amnesty applicants will be forgiven all civil and criminal penalties (but *not the taxes due or interest*) for taxable years prior to January 1, 2003, if:

- ◆ they remain in compliance with tax law by paying their taxes, penalties, and fees for 2005 and 2006;
- ◆ they stay in compliance with the any amnesty installment agreement they may work out.

Those failing to meet the requirements will have their penalties and fees reinstated, and will also be assessed the new amnesty penalties.

New Penalties

Beginning April 1, 2005, substantial new penalties can be imposed by the FTB and BOE on taxpayers who were qualified, but chose not to participate in the amnesty. The penalties will be imposed on all amnesty-eligible years and reporting periods, *including those closed by statute of limitations*.

- ◆ There will now be a 40% (instead of 20%) accuracy-related penalty on new audit-related assessments for pre-2003 taxable years (FTB only). This penalty can be assessed for negligence or disregard of rules and regulations, any substantial underpayment of tax, and other reasons. The increased penalty does not apply for taxpayers currently in audit, protest, appeal, or settlement status, or who have a pending court action as of February 1, 2005.
- ◆ For amounts that are due and payable on March 31, 2005, a penalty equal to 50% of the interest due up to March 31, 2005 will apply to liabilities that are eligible for amnesty.
- ◆ For amounts that will become due and payable after March 31, 2005, a penalty equal to 50% of the interest computed from the original due date of the return up to March 31, 2005 will apply to liabilities which are eligible for amnesty.

Starting April 1, 2005, the BOE will also impose double the amount of existing penalty when issuing an audit-related determination on a return filed under amnesty or on any other non-reporting or underreporting of tax liability by a taxpayer who could have participated in the amnesty. The BOE may also bring criminal action against the taxpayer 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.

The new amnesty penalties do not apply to taxpayers who have established an amnesty installment agreement by May 31, 2005, or who have an existing installment agreement as of February 1, 2005.

Although you might consider that "due and payable" means billable or collectible, the FTB has indicated that they will take a much harder line and will interpret this phrase to include unprotested notices of potential assessment and other non-final or non-billable amounts which become final after April 1, 2005. Using the FTB's interpretation, it will make no difference whether a taxpayer disputes a notice of proposed assessment or doesn't; the penalty will be the same.

This can raise a big question if you are in the midst of a tax dispute with the FTB. Should you pay the disputed tax during the amnesty period in order to take advantage of the amnesty provisions and avoid the subsequent huge penalties, or should you carry on with your dispute in the hope and trust that you will eventually prevail?

Obviously, the purpose of the new penalties is to make it substantially more expensive to wait until after amnesty to file an amended return or receive an assessment, as opposed to paying a potentially disputed amount or self-assessing amended return during amnesty.

How and When To Apply

To participate in the FTB program, taxpayers must complete and file a signed amnesty application during the amnesty period, which runs from February 1, 2005, through March 31, 2005 (although the FTB will accept applications postmarked April 1, 2005). Amnesty participants must (1) file an application during the amnesty period; (2) file any tax returns, including amended returns, on or before May 31, 2005; and (3) on or before May 31, 2005, pay any taxes and interest or enter into an amnesty installment agreement to pay off the tax in full by June 30, 2006.

Refund Rights

If you participate in the amnesty, you give up the right to appeal or to file a claim for refund for amnesty-related payments. So, if you file an amnesty application and make payments on it, that money is gone, and you no longer have the right to any sort of appeal or refund regarding those tax years or monies. Amnesty participants can get back money — usually overpayments — they paid as withholding or as estimated tax, paid with an original return, or paid after the original return was filed but before they applied for amnesty.

Existing Installment Agreements

If you have an existing installment agreement, you must continue in compliance with it until the amnesty period begins. Upon applying for amnesty, the FTB or BOE will cancel your current agreement and establish a new one forgiving unpaid penalties, fees, and related interest. The FTB or BOE will first apply installment payments received before June 30, 2006, to amnesty-related liabilities, then to other liabilities.

IRS Assessments

It's important to realize that the FTB and BOE have an information exchange agreement with the IRS. They will notify the IRS of any amnesty-related tax increases, and if the federal statute of limitations is still running, amnesty participants will likely receive an IRS assessment.

Summary

There are many elements and details to this amnesty. Further consideration as to an individual's or company's unique situation is, obviously, beyond the scope of this article. If in doubt, seek competent advice.

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