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California Tax Voluntary Disclosure Initiative

BY STEPHEN TURANCHIK & NANCY IREDALE

The State of California has recently enacted a Voluntary Compliance Initiative 2 ("VCI 2") for taxpayers who underreported their California income tax liabilities, through the use of so-called "abusive tax avoidance" transactions or offshore financial arrangements, to amend their tax returns for 2010 and earlier. An "abusive tax avoidance transaction" is defined to include a:

1. Tax shelter;
2. Reportable transaction that is not adequately disclosed;
3. Listed transaction;
4. Gross misstatement; or
5. Transaction to which the California noneconomic substance transaction ("NEST") penalty applies.

The largest incentives for participating taxpayers are the promise of no criminal action and a waiver of most penalties for the taxable years with respect to issues for which the taxpayer participates in the initiative.¹

Taxpayers who choose not to take advantage of this opportunity will face the full range of penalties and interest, which include:

Penalty	Amount
Noneconomic Substance Transaction Understatement	20% or 40% of the understatement
Accuracy Related	20% or 40% of the underpayment
Interest Based	50% or 100% of the interest due on the unpaid tax
Fraud	75% of the underpayment

Taxpayers are eligible for VCI 2 even if they are under audit by the Franchise Tax Board. Taxpayers are ineligible if they are subject of a criminal investigation or if a criminal complaint was filed against them in connection with an abusive tax avoidance transaction or unreported income from the use of an offshore financial arrangement.

Taxpayers who wish to participate in the voluntary disclosure initiative must file the amended income tax returns and pay all tax and interest by October 31, 2011.² If the taxpayer made a deposit of the noneconomic substance transaction understatement penalty associated with an abusive tax avoidance transaction the taxpayer can request a refund of that deposit as part of the VCI 2.

This voluntary disclosure initiative will run from August 1, 2011 until October 31, 2011.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

Nancy Iredale
1.213.683.6232
nancyiredale@paulhastings.com

Stephen Turanchik
1.213.683.6187
stephenturanchik@paulhastings.com

Orange County

Erika Mayshar
1.714.668.6262
erikamayshar@paulhastings.com

Doug Schaaf
1.714.668.6221
dougshaaf@paulhastings.com

¹ Penalties that will remain in place are the large corporate understatement penalty and the penalty for failure to participate in California's 2005 amnesty program.

² Installment plans are authorized to be available so long as final payment is made by June 15, 2012.