Client Alert.

March 30, 2011

California Adopts Tax Amnesty Covering, Among Other Things, Income From Previously Unreported Foreign Bank Accounts.

By Joseph K. Fletcher, III and Eugene Illovsky

On March 24, 2011, Governor Jerry Brown signed SB 86 into law. SB 86 creates a window of opportunity from August 1, 2011 to October 31, 2011, during which taxpayers can opt into a voluntary disclosure program. This program will permit taxpayers to report many types of unreported income without penalty, including income from previously unreported bank accounts. The new voluntary disclosure program also covers certain abusive tax avoidance transactions, unlike the Federal 2011 Offshore Voluntary Disclosure Initiative ("OVDI"). Under the California program, taxpayers would file amended returns, including the income from unreported bank accounts or eliminating deductions generated by abusive tax avoidance transactions.

The new California voluntary disclosure program provides that no criminal action will be brought against any taxpayer who participates in the program, provided that as of July 31, 2011: (i) no criminal complaint has been filed against the taxpayer in connection with the issues disclosed, and (ii) the taxpayer is not the subject of a criminal investigation in connection with the issues disclosed. Further, the new voluntary disclosure program will eliminate penalties other than the penalty under Section 19138 of the California Revenue and Taxation Code for large understatements of income by corporations, and the penalty under Section 19777.5 for failing to participate in the prior amnesty period, which ended on April 15, 2004.

Taxpayers who face federal as well as California issues (as most will) will want to coordinate any voluntary disclosure, as there is information sharing between the IRS and California's tax authorities, including the Franchise Tax Board. While the reporting of previously unreported income from foreign bank accounts could be coordinated with the OVDI, there is no special federal voluntary disclosure program covering abusive tax avoidance transactions. As such, the taxpayer would need to develop a strategy with his or her tax advisor as to how to coordinate California and federal disclosure of abusive tax avoidance transactions. Of course, the IRS has a general voluntary disclosure program, as set forth in Section 9.5.11.9 of the Internal Revenue Manual, subject to certain eligibility requirements.

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