

Frequently Asked Questions: FTB Notice 2023-02 - Resolution of Micro-Captive Insurance Transactions and Syndicated Conservation Easement Transactions

FTB Notice 2023-02 Resolution Program Participation Period was extended to January 31, 2024 as detailed in FTB Notice 2023-03

1. What tax years does FTB Notice 2023-02 cover?

FTB Notice 2023-02 covers all years where you claimed a state tax benefit on an original or amended return from an Eligible Transaction described in the Notice.

2. May I still participate if I am currently under examination by the Franchise Tax Board (FTB) or the Internal Revenue Service (IRS) or in protest or appeal with the FTB regarding my participation in any Eligible Transaction?

Yes. If you and/or one of your related entities is already under examination or is in protest or appeal with FTB or IRS regarding participation in an Eligible Transaction and you and/or your related entity are an Eligible Taxpayer, you may obtain resolution under FTB Notice 2023-02. Please see "Eligible Taxpayers" under FTB Notice 2023-02 for more information.

Notify the FTB staff assigned to the case immediately if you choose to participate and submit a complete and signed FTB Notice 2023-02 Closing Agreement (Closing Agreement), including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024, to the address provided in the Notice.

3. If I entered into an Eligible Transaction but have not yet realized any tax benefits from the transaction, may I participate in FTB Notice 2023-02?

No. If you entered into an Eligible Transaction described in FTB Notice 2023-02 prior to the date of this Notice but you have not yet realized the tax benefits from an Eligible Transaction, you are not eligible to participate in the resolution described in this Notice. Be aware that if you file a return claiming the tax benefits of any Eligible Transaction at a later date, you will be subject to all applicable penalties and all relevant statutes of limitations will apply, including the 12-year statute of limitations provided for in RTC section 19755, subdivision (a)(2).

4. Do I need to complete a Notice 2023-02 Closing Agreement with FTB?

Yes. You must submit a complete and signed Closing Agreement to FTB from July 10, 2023, to January 31, 2024, which concedes all claimed tax benefits (except to the extent specifically allowed as provided in the Notice), relating to the Eligible Transaction(s). A Closing Agreement will not be considered complete unless it also includes Schedule I, II, and II. The Closing Agreement will permanently resolve all tax, penalties, and accrued interest associated with your participation in the Eligible Transaction(s). Subsequent federal adjustments with respect to the Eligible Transaction(s) will have no effect on the terms or finality of an executed Closing Agreement. If the participant in the transaction(s) was a partnership, S corporation, or other pass-through entity, the person or entity that received the tax benefits

from the participant should submit the Closing Agreement. One Closing Agreement should be submitted per taxpayer.

5. If I overpaid the taxes, penalties and accrued interest as agreed upon under the Closing Agreement will I receive a refund?

Yes. As set forth in the Closing Agreement and in Notice 2023-02, under certain circumstances, if an overpayment occurs, FTB will first apply the resulting overpayment to any outstanding balances due and payable for the same or other tax years and may then refund any overpayment if the taxpayer fully complies with the requirements of Notice 2023-02.

6. Do I waive any rights when I participate in FTB Notice 2023-02?

Yes. You waive any statutory right to appeal or otherwise contest the validity of the Eligible Transaction(s) resolved by the Closing Agreement or the amount paid in connection with the Closing Agreement in any forum, whether administrative or judicial.

7. Do I need to File an Election to Participate in FTB Notice 2023-02?

No. You do not have to file an election form to participate in FTB Notice 2023-02. Instead, you must submit a complete and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024, to the address provided in the Notice.

8. Do I need to file a California amended return reversing the transaction(s) for which I am electing to participate in FTB Notice 2023-02?

No. You will not be required to submit an amended return reversing the Eligible Transaction(s). You will be required to submit a complete and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024, to the address provided in the Notice. Schedule III captures the information that would normally be reported on an amended return.

9. Do I have to pay all additional tax, applicable penalties, and accrued interest in order to participate?

Yes. You must pay by January 31, 2024 the self-assessed taxes as shown on Schedule III of the Closing Agreement attributable to the reversal of the tax benefits claimed for the transaction(s), as well as all applicable penalties and interest accrued up to the date of payment, or enter into an installment payment arrangement and pay in full the self-assessed taxes, applicable penalties, and accrued interest over a period not to exceed 12 months.

If you are required to make electronic payments or choose to make payments electronically, select the payment category "Pending Audit Tax Deposit Payment." If you do not choose the proper payment category for electronic payment, your

payment may not be processed properly. In addition, you must make a separate payment for each taxable year at issue covered by the Closing Agreement.

10. Do I have to reverse transaction costs associated with the Eligible Transaction(s) if I participate in FTB Notice 2023-02?

Yes. Except for costs allowed by final federal changes or under a formal IRS settlement initiative agreement, if you elect to participate in FTB Notice 2023-02, you must reverse all associated transaction costs as defined on page 8 of Notice 2023-02.

11. Can I participate if I have been "contacted" by the FTB or IRS with respect to an examination of a return on which I claimed tax benefits from any Eligible Transaction, but have not received a Notice of Proposed Assessment (NPA)?

Yes. You must submit a complete and signed FTB Notice 2023-02 Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024. You must also pay the self-assessed taxes shown on Schedule III, the 20 percent accuracy related penalty, and interest accrued up to the date of payment by January 31, 2024, or enter into an installment payment arrangement. For the definition of "contact," see paragraph 2.C. of Notice 2023-02.

12. Can I participate in FTB Notice 2023-02 if I have received and paid a Notice of Proposed Assessment (NPA) that assessed California tax shelter penalties, including the 40 percent Noneconomic Substance Transaction (NEST) penalty?

Yes. If you received a NPA adjusting the tax benefits claimed from any Eligible Transaction described in FTB Notice 2023-02 and were assessed a NEST penalty that you paid prior to the date of Notice 2023-02, and the taxable year is within the applicable statute of limitations or the amounts you previously paid were paid within the applicable statute of limitations, then if you fully comply with the requirements of Notice 2023-02 the FTB Chief Counsel will reduce the NEST penalty to zero. After first applying the resulting overpayment to any outstanding balances due and payable, including for other taxable years, FTB will then refund any overpayment. Submit the complete and signed FTB Notice 2023-02 Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement, for each Eligible Transaction, from July 10, 2023, to January 31, 2024.

13. Can I participate in FTB Notice 2023-02 if I have received a Notice of Proposed Assessment (NPA) that assessed California tax shelter penalties, including the 40 percent Noneconomic Substance Transaction (NEST) penalty and 100 percent Interest Based Penalty (IBP), but have not paid?

Yes. If you received an NPA adjusting the tax benefits claimed from the Eligible Transaction(s) prior to the date of FTB Notice 2023-02, and have not paid the tax shown on the NPA, you must pay the full amount of tax shown relating to those adjustments plus interest accrued up to the date of payment with the submission of

the completed and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement. If the NPA includes an interest-based penalty under RTC section 19777, you must pay the interest-based penalty. FTB Chief Counsel will reduce the NEST penalty to zero. (Participants who received an NPA from FTB but who have resolved Eligible Transaction(s) through a formal federal settlement initiative may have a different resolution.) The payment and the complete and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement, must be filed with FTB from July 10, 2023, to January 31, 2024.

14. Can I participate in FTB Notice 2023-02 if I have received a Notice of Proposed Assessment (NPA) and resolved my reporting of tax benefits from the Eligible Transaction(s) by participating in a formal IRS settlement initiative?

Yes. You must submit a complete and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024. You must reverse the tax benefits previously claimed on your California tax returns to the same extent the tax benefits from the Eligible Transaction(s) were reversed pursuant to the formal IRS settlement initiative for the same taxable years. Please see paragraph 2.B of FTB Notice 2023-03 for more information.

15. Can I participate in FTB Notice 2023-02 if I resolved Eligible Transaction(s) pursuant to final federal changes other than pursuant to a formal IRS settlement initiative?

Yes. You must submit a complete and signed Closing Agreement, including Schedules I, II, and III, and any other information identified in the Closing Agreement from July 10, 2023, to January 31, 2024. You must reverse the tax benefits previously claimed on your California tax returns to the same extent the tax benefits from the Eligible Transaction(s) were reversed in the final federal changes. Please see paragraph 2.F of FTB Notice 2023-03 for more information.

16. Does interest suspension apply if I participate in FTB Notice 2023-02?

No. If you participate in the resolution described in FTB Notice 2023-02, you are not entitled to any suspension of interest under RTC section 19116.

17. Can I participate in FTB Notice 2023-02 if the transaction I entered into is not the same as one described in the Notice?

No. FTB Notice 2023-02 is only for those taxpayers who participated in an Eligible Transaction as described in the Notice.

18. What penalties may I be subject to if I do not participate in FTB Notice 2023-02?

The following is a summary of penalties and increased interest that may apply to California income and franchise taxpayers involved in abusive tax avoidance transactions:

- **Fraud penalties** (RTC section 19164(c), IRC section 6663): Where an underpayment of tax is due to fraud, the taxpayer is liable for penalties that essentially amount to 75 percent of the increased tax.
- **Reportable Transaction Accuracy Related Penalty** (RTC section 19164.5): Where an understatement of tax is due to a reportable transaction or listed transaction, the taxpayer is liable for penalties of 30 percent of the understatement amount. If the taxpayer adequately disclosed the transaction on the original tax return or qualified amended return, the penalty is reduced to 20 percent.
- **Failure to Disclose Reportable Transaction and Listed Transaction Penalty** (RTC section 19772): Where the taxpayer fails to attach IRS Form 8886, Reportable Transaction Disclosure Statement, to the tax return, or fails to file a complete form disclosing information related to a reportable transaction, the taxpayer is liable for penalties of \$15,000 for reportable transactions other than listed transactions. The penalty for failing to file Form 8886 for listed transactions is \$30,000.
- **Noneconomic Substance Transaction (NEST) Penalty** (RTC section 19774): Where an understatement of tax is due to a transaction that lacks economic substance, the taxpayer is liable for penalties of 40 percent of the understatement amount. If the taxpayer adequately disclosed the transaction on the original tax return or qualified amended return, the penalty is reduced to 20 percent.
- **Interest Based Penalty** (RTC section 19777): Where FTB contacts a taxpayer regarding a reportable transaction, listed transaction, or gross misstatement and assesses a deficiency, the taxpayer is liable for a penalty equal to 100 percent of the interest payable. For taxable years ending on or before December 31, 2004, the Interest Based penalty applies to taxpayers who FTB contacted regarding a potentially abusive tax shelter. See former RTC section 19777.
- **Increased Interest** (RTC section 19778): Where the taxpayer files an amended return reversing the transaction before contact by IRS or FTB, the taxpayer is liable for 150 percent of the interest payable on the understatement of tax related to using a reportable transaction.

19. Can I still participate in FTB Notice 2023-02 if I don't currently have the ability to pay the amount in full?

Yes. If you have a financial hardship, you may request on the Closing Agreement to enter into an installment payment arrangement with the FTB to pay the tax liability, accrued interest and any applicable penalties over a period not to exceed 12 months. FTB will not execute a submitted Closing Agreement absent payment in full or the presence of an acceptable payment arrangement. You must pay in full or apply for payment arrangements by January 31, 2024.

20. Who do I contact if I have a question regarding the requirements for participating in FTB Notice 2023-02 or the amount of accrued interest owing?

Call our FTB Notice 2023-02 hotline at (916) 845-3030, Monday - Friday, 9:00 a.m. to 4:00 p.m. (PT) except for State holidays, or email questions to taxshelter@ftb.ca.gov.
