



June 2009

Dear ,

This issue of the WKBK&Y newsletter addresses:

1. Board of Equalization Proposes Legislation to Limit Attorneys' Fees;
2. Refresher: Report of Foreign Bank and Financial Accounts; and
3. IRS Issues Interim Guidance Regarding Tax Return Preparer Standards

**1. Board of Equalization Proposes Legislation to Limit Attorneys' Fees**

*Introduction*

On the tail of *Parmer v. California State Board of Equalization* in which an award of attorney's fees greatly exceeded the amount in dispute, the California State Board of Equalization (the Board) in a 3-2 vote proposed legislation to limit the awards of attorneys' fees in cases dealing with the special tax and fee programs which the Board administers.

*Background*

Generally, California Code of Civil Procedure Section 1021.5 allows a court to award attorneys' fees to a party in an action which results "in the enforcement of an important right affecting the public interest" if, *inter alia*, a significant benefit has been conferred on the general public or a large group of people. For approximately 20 years, attorneys' fees in connection with litigation dealing with the sales and use tax law have been limited, such as by a required showing that the Board's position was not substantially justified and by limiting attorneys' fees to a per hour maximum.

*Proposed Law*

On June 9, 2009, the Board voted 3-2 approving legislation that would add provisions, similar to the present provision limiting attorneys' fees in sales and use tax cases, to limit attorneys' fees in actions dealing with property taxes and the special tax and fee programs

administered by the Board. Such added provisions would include a requirement that the Board's position in the action was not substantially justified.

The Board approved the proposal after removing a provision in the original proposal which would have made the law retroactive to the extent allowable under the California Constitution as well as limiting any awards of attorneys' fees to \$75 per hour (the proposal as approved by the Board would allow attorneys' fees of approximately \$150 per hour, as adjusted for inflation).

### *WKBKY Takeaway*

The proposed legislation will likely not have a substantial impact upon most taxpayers since actions against the Board involving "a significant benefit [that] has been conferred on the general public" are infrequent. However, the unavailability of attorneys' fees may potentially chill legal actions against the Board in connection with certain property tax and special tax and fee programs that do not result in high tax assessments.

## **2. Refresher: Report of Foreign Bank and Financial Accounts**

### *Introduction*

Corresponding with the Internal Revenue Service's (IRS) amnesty program regarding unreported offshore income (see our April 2009 newsletter for more information), the IRS has announced that it will be less lenient with those who do not voluntarily report themselves, including those who are not in compliance with their Report of Foreign Bank and Financial Accounts (FBAR) reporting requirements and are exposed to the potentially massive penalties for such non-compliance.

### *Background*

The FBAR requirement was put in place to help combat overseas tax evasion. However, it was not until the IRS was delegated the responsibility to enforce the FBAR in 2003 that enforcement of the FBAR began to have teeth. The penalty for a willful violation of the FBAR is the higher of \$100,000 or 50% of the balance in the account at the time the violation occurred; while non-willful violations can be as high as \$10,000 per violation. In addition, a criminal violation of the FBAR may result in up to 5 years in prison plus a fine.

### *Refresher*

The FBAR needs to be filed no later than June 30 in any year that a United States person has "a financial interest in or signature authority, or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year". The definition of a United States person is broad and includes "a citizen or resident of the United States, or a person in and doing business in the United States." The FBAR is completed on Treasury Form TD F 90-22.1. It is important to remember that the June 30 filing deadline cannot be extended.

As part of the IRS' amnesty program regarding unreported offshore income, the IRS has also stated that taxpayers who have not properly submitted FBARs but have reported all taxable income, including foreign income, and paid all related taxes will be able to file their FBARs late without any penalization. To do so, a taxpayer will need to send their delinquent FBARs to the Philadelphia Offshore Identification Unit along with a statement discussing why the FBAR is being filed late. In addition, taxpayers should include a copy of their tax returns corresponding to the delinquent FBAR(s). The IRS' amnesty program ends on September 23, 2009.

#### *WKBKY Takeaway*

Compliance with the FBAR reporting requirement is easy to do and can avoid costly penalties. Taxpayers who do not have unreported offshore income, but did not file FBARs in past years should take advantage of the IRS' offer and file delinquent FBARs by September 23, 2009.

### **3. IRS Issues Interim Guidance Regarding Tax Return Preparer Standards**

Last year Public Law 110-343 retroactively changed the standard for tax return preparers effective May 25, 2007. The effect was to toss out the "more likely than not" standard, except for "tax shelters" and certain "reportable transactions". The tax return preparer standard for return reporting positions applicable to these types of transactions remains more likely than not. The IRS recently issued Notice 2009-5, providing interim guidance to clarify the effect of interim guidance from prior years, an explanation of the "substantial authority" standards, and providing interim rules regard tax shelters.

#### *Summary of Penalty Standard*

The following is a recap of existing law with respect to tax return preparer penalty standards of confidence:

1. If a position is disclosed under Section 6662(d)(2)(ii), then the taxpayer need merely have a reasonable basis for the position.
2. If the position is not disclosed, then there must be substantial authority for the position.
3. Effective October 3, 2008, for Tax Shelters and Reportable Transactions, return preparers must take positions that will "more likely than not be sustained on its merits", or they will be subject to preparer penalties under IRC section 6694.
4. Relief for reasonable cause will continue to be allowed where the tax return preparer acted in good faith (e.g., relied on a third party opinion, relied on facts provided by taxpayer - proven wrong, etc.).

### *Substantial Authority Defined*

The IRS defined substantial authority by reference to the definition found in Regs. Section 1.6662-4(d)(2) (taxpayer understatement penalties). Under this definition, the weight of authorities supporting the tax treatment must be substantial in relation to the authority supporting contrary positions. The relative weights of the authorities are determined in light of the pertinent facts and circumstances, and there may be substantial authority for more than one position with respect to the same item. Generally, “substantial authority” is considered to be approximately a 1/3 likelihood of success on the merits. The Notice states that the substantial authority standards will be identical “until further guidance is issued,” but there is little doubt that the standard will differ at all once final regulatory guidance is issued under 6694.

### *Tax Shelters*

As stated above, return preparers are required to reasonably believe that a tax position representing a “tax shelter” or a “reportable transaction” (if tax avoidance is a significant purpose of the reportable transaction) are more likely than not correct to be free from penalties under 6694. A tax shelter is defined any partnership, transaction or arrangement, the principal purpose of which is to avoid or evade federal income tax, other than a reportable transaction. A reportable transaction is any one of six transactions identified by the IRS in Regs. section 1.6011-4(b).

Notice 2009-5 specifies that with respect to tax shelters, a tax return preparer can avoid having the “more likely than not” standard apply with respect to tax shelters if the return preparer advises the client of the nature of the understatement penalties, advises the client to disclose the tax return position on the client’s income tax return, and documents the advice contemporaneously. In such a case, the substantial authority standard will apply to the tax return preparer. Again, this provision applies “until further guidance is issued.”

### *WKBKY Takeaway*

Notice 2009-5 does not do much that we were not already familiar with as practitioners. The most important piece of the Notice is actually what was left out—there is no safe harbor for reportable transactions as there is for tax shelters. This means that for reportable transactions, a practitioner’s advice to the client regarding disclosure will mean nothing in terms of the preparer’s penalty exposure. In fact, actual disclosure has no effect on the penalty standard at all. The IRS has simply carved out a safe harbor in the narrow instance of a tax shelter. But since no safe harbor exists with respect to reportable transactions, preparers must be aware of this nuance.

Practitioners are advised to familiarize themselves with reportable transactions so that they are aware of potential penalty exposure—both for the sake of the client and practitioner. Another important point to keep in mind is that some reportable transactions may not have a substantial tax avoidance purpose. In this case, the enhanced standard of confidence is not applicable, and so the substantial authority standard is going to apply if the position is disclosed.

*We hope that you find these items of interest to you. If you need further information or would like to discuss a particular issue, feel free to call any one of the lawyers listed below. We will get you to the right person.*

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