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IRS & CALIFORNIA FTB EXCHANGE AUDIT DATA

By Victor Sy, CPA, MBA

After surviving a harrowing IRS audit, you probably think it's over. Well, it's not quite over. You went through a federal audit by the IRS who will provide audit results to its State counterpart - the California Franchise Tax Board (FTB for short). Let's discuss how these two government agencies exchange audit information and how to deal with them for damage control.

FROM FEDERAL IRS TO CALIFORNIA FTB:

The federal IRS provides the following assessment reports to the California FTB:

1. Weekly paper Revenue Agent Reports (RAR),
2. Monthly electronic RARs, and
3. Quarterly assessments based on CP-2000.

TIP: Because it takes the State agency many months to bill you, it makes sense to provide results of the IRS audit to the FTB promptly and voluntarily. This will help you save interest and penalties. This will also put a closure to your misery. Believe me; you don't want the same type of experience many months after your initial relief of closing an IRS audit.

If a case is disputed, the IRS indicates on its report to the FTB that files your case in a "pending federal" file. Your case is kept there until the IRS provides a final determination letter. There are a couple of potential problems:

Problem 1: What if you did not respond, protest, or appeal? The federal assessment becomes final and the State issues its own assessment. You now have to deal with two agencies. Your initial reaction is to get upset at the FTB for issuing a wrong bill. Tough luck. The State assessment is presumed correct. You, the taxpayer, bear the burden of proving the error. The State will not budge from this position. You want it corrected? Go to the IRS and take care of it there. Until then, the assessment stays. Sorry.

Problem 2: If you still do not act on the state bill, FTB imposes "cost recovery fees" for tax filing enforcement and collection enforcement. Both fees become final even if you prove them wrong at the end. It is upsetting but there is some logic to these fees - costs were incurred because you did not respond timely; therefore, the FTB wants you to reimburse the State for its costs. The fees are cost-driven with no relation to the tax issues on hand.

FROM CALIFORNIA FTB TO FEDERAL IRS:

1. The State provides Notice of Proposed Assessments (NPAs) to the IRS.
Problem 3: The State does not wait for the assessments to go final before sharing them with the IRS. The IRS will therefore proceed against you on a state notice that may be erroneous. You end up with an unnecessary headache that could have been avoided if you had merely taken care of business.
2. The State does not yet share non-filer information with the IRS.