



Good afternoon Board Members, Chief Counsel Randy, FTB Attorneys, Attorney Grant and Staff.

Thank you for this opportunity & the prospect to correct this tax assessment error.

It's always the taxpayer's burden and practical reality to have to prove the FTB wrong. Today we will do just that.

This case has been pending before the FTB since the 1990's without final resolution.

This case is about FTB error, so I would like to start by showing a pattern of errors:

Attorneys for the BOE appeals division stated on the first page of the Hearing Summary this past October that last October (2012), the FTB requested that the hearing be postponed.

Because the FTB "Attached and referenced tax returns for years not at issue." Board Members do you remember that? How can the FTB make an elementary mistake like that?

In that same Hearing Summary on page 4, the BOE Attorney wrote "The FTB argues that Regulation 18586.3 (Cal Code of Reg. title 18), *does not address* what constitutes a federal determination or adjustment that necessitates a reporting requirement."

STATE BOARD OF EQUALIZATION



Appeal Name: Applied Companies

Case ID: 593582 ITEM #: 02

Date: 11/19/13 Exhibit No: 11-04

(TP) FTB DEPT PUBLIC COMMENT

As we know, that section , (Cal cod of Reg title 18 sec 18586.3,Sub sec) (E), does define a final determination as “an irrevocable determination or adjustment of taxpayer’s federal tax liability from which there exists no further right of appeal either administratively or judicial.” It’s right in the section. How does FTB get away with this?

The FTB wants to talk about Regulation 19059, (The Successor to Regulation 18586.3), FTB say it offers “guidance.” BUT ITS NOT THE LAW, It was not enacted until 1999, subsequent to this case and is not applicable, and it’s NOT retroactive; it’s disingenuous.

Board Members, please understand from the start by way of FTB’s own admission they NEVER did an independent audit of this case, as would be required.

The FTB has not met its own burden in showing how FTB comes up with a massive liability that does not match.

in any way the IRS final audit position. It is our contention, without conducting an independent FTB audit the FTB cannot make up liabilities using documents from the IRS that the IRS had admitted issued in error and were developed before my client won its IRS appeal.

All this is compounded by the fact that the IRS admits it never issued any final determination report as assumed and claimed by the FTB.

Also, please understand FTB's October 2013, POSITION is that they must rely on insufficient IRS documents because neither the IRS nor Applied Companies, ever provided normal & routine documents to determine California income tax liability. The FTB stated this.

The REASON: The IRS has admitted in writing of the failure of normal intergovernmental protocols that did not allow for the proper documents to get to the FTB. We have this in writing twice once in 2004 and again just this month. -Hold up IRS Officials Affidavit, Read 1

In the FTB October 2013, brief they described their reliance on what the IRS determined as only "*gleaned*" from the original Federal Revenue Agent's Report (RAR) & transcripts at the time (i.e. the audit report).

Furthermore, in the first few pages of the most recent brief by the FTB they shamelessly state that they "*Suspect*"... "that Applied Companies agreement with IRS was memorialized in a written closing agreement." But admit never having seen it.

FTB then bases their liability on a suspicion by using the RARs. This can hardly be believed that the FTB would require a tax payer to pay a liability on a notion of a hunch. But this is exactly what they do by their own written admission.

Then FTB pontificates excessively on legal theories of “excessive compensation,” that they copy and paste from the overturned IRS auditor’s audit notes.

This is self-diminishing and detracts from the authority, reputation and prestige of the FTB. It can hardly be believed that they did this. (I served as a member designee to that Board)

-It can hardly be believed that they did this

FTB only scraped together some peripheral documents from the original IRS audit before my clients won the IRS audit in appeals and reduced ALL 3 audit years to zero liability. That includes the 2 years 1091 & 1993 FTB’s assessment. (The 4th IRS audit year 1990, 5k+ was not related to excess compensation, it was an alternative minimum tax, sub related to an interest deduction).

What FTB admits to using for the FOUNDATION of the California Liability are documents that are not applicable and have been negated by the IRS in the appeal. Which FTB pays no mind to at all.

The former IRS official told me and he swore in his affidavit that after 30 years of service he has never seen a case before without a “Final Federal Determination” until this one. –

-This fact should be paramount to this Board.

Board Members, without conducting an independent FTB audit the FTB cannot make up liabilities using documents from the IRS that the IRS's former officer in charge has acknowledged had been canceled out and "negated" themselves. All this is compounded by the fact that the IRS admits in writing to this Board that it never issued any "Final Federal Determination Report" as erroneously assumed and claimed by the FTB.

Further evidence of FTB error is on page 3 of the FTB's recent October brief where they boldly stated "settlement with the IRS is evidenced by a written closing agreement.

FTB TELLS US :(IRS Form 870AD)" "Respondent (FTB) was unable to obtain a copy of the closing agreement, and appellant (Applied Companies), has not provided a copy to either Respondent (FTB) or the Board" (BOE).

So they admit to not having the IRS settlement Form 870-AD. We could not agree MORE with the FTB. That's why we have already submitted the IRS Form 870-AD and again here today.

Board Members, This is critical, please note that the 870AD is unsigned by the IRS. The law requires it be signed by BOTH party's Remember. Even the FTB has not YET disputed this point. -They are silent

Board Members please take note that the Form 870-AD is not valid unless it's signed by both parties. We won't challenge the FTB to produce the fully executed copy. Why won't we? Because they already admit on the record that they don't have it and have never seen it.

We have recently submitted for the first time:

- 1) Form 870-AD- Unsigned by the IRS.
- 2) Audit Statement IRS form 36013
- 3) Memo of 2004 from IRS
- 4) New Formal & notarized affidavit of IRS Official at the time

These are the very documents and MORE, that what the FTB in its October brief complained they have never seen but need to see. The FTB no longer needs to “glean” or “suspect” things.

In FTB’s recent October 2013 24 page beef they only spent 2 sentences (on page 9) on the fact that they will treat the “Net Operating Loss Carrybacks and Carryforwards” differently than the IRS did.

Today they will tell you that’s all that matters. Where is the FTB AUDIT? Nowhere!

It’s like throwing 24 pages against the wall to see what sticks.

As I told you, the unsigned, IRS Form 870-AD will show Zero liabilities for ALL but one of the IRS audit years in question. And zero for both FTB years.

For year 1990 it will show a \$5,784 change only. Not related to excessive compensation according to IRS Form 5278.

The Excessive Compensation issue before the IRS ended in a victory by my client before the IRS.

(Hold up IRS Official Terry Milne Affidavit)

(Read the Points) 2

With regard to issue 1 - was the FTB time bared? YES it was! The tax gurus of CA will tell you "you can't win a time-bar issue" YES YOU CAN, if the facts are on your side, as there are here.

FTB's position is "According to the only applicable LAW 1998 (pre 1999 law): Section 18622, federal actions must be reported within six months of a final federal determination."

There were not one, but two reasons why there was no final federal determination.

Follow the logic: Since there was no final federal determination, Appellant was under no obligation to report.

Since the Appellant was under no obligation to report, the Notices of Proposed Assessments (NPAs) were, in fact, untimely.

Without timely NPAs, there is no basis for the FTB's assessment.

Here, there was no deficiency assessment adjustment based on Final Federal Determination for tax years 1991 and 1993, therefore, the reporting requirement at that time, cannot be imputed to compel the appellant to do so. Here, there was no deficiency assessment adjustment by the IRS and the FTB never fulfilled their responsibility to conduct an audit.

Tax periods March 1991 and 1993 show no additional tax assessed by examination.

This is definite proof from the IRS showing no excessive compensation or liability for the years in question.

According to the BOE Attorney Mr. Stafford, a key question is whether the taxpayer has substantiated its employee compensation deductions for 1991 and 1993. And if this was an FTB Audit Appeal we would agree. However, it is NOT.

-Board Members, this is a determinate factual issue.

The FTB chose to purposefully not conduct their own audit and instead chose to mirror or echo if you will, the IRS audit. If you going to do that it's incumbent and inescapable to obtain and use the accurate IRS audit and appeal results.

The FTB did not!

Example:

According to the BOE Attorney Stafford, and my team members, the FTB, as Mr. Stafford put it, “The FTB quotes at length from the auditor’s narrative set forth on form 886-A” I think we are in agreement with Mr. Stafford. My staff told me, “The FTB relies absolutely & exclusively on the IRS narrative form 866-A (This is the IRS Doc. Attached to the RAR’s) both are IRS documents overturned on appeal.

Mr. Stafford spends 9 of his 18 pages of his Hearing summary synthesis verifying our contention that the FTB relied only on one source, the overturned IRS audit documents.

(Board Member as you know, Audits are where things begin not end!)

(Hold up Mr. Stafford BOE Brief)

(Read the points starting on page 10, 14). Mr. Stafford is talking about officer compensation.

The FTB should not use what was negated by the IRS later in the subsequent appeal.

(Hold up IRS Terry Milne Affidavit)

(Read the Points) 3.

On the question of employee compensation according to your Attorney Mr. Stafford, it’s a “Question of fact which must be decided on the basis of a review of all of the facts in each particular case.”

The agreed Holy Grail of reasonable compensation is the Ninth Circuit Court of Appeals, Multi-Pak case which lists 5 factors of determination. According to your BOE attorney Mr. Stafford, the FTB concedes the first 2 factors in my clients favor. Can you guess why? Well according to Mr. Stafford (page 14), it's because the IRS, RAR/ 886-A form told them so.

Come on! Again? They have the same bad answer Board members.

The continuing pattern of reliance on the RAR and related documents like the 886-A which has no relationship to the final IRS assessment, is wrong and the IRS official tells us so in writing today. In his sworn affidavit.

I did notice the FTB never mentions the IRS "Appeals Case Memorandum" this is the document that would show the final Narrative results in support of the Form 870-AD findings and is written just before the Final Federal Determining document.

Board Members, since there was a difference between the RAR & the narrative 886-A versus the Appeals settlement methodology, (found in the IRS Appeals Case Memorandum after the winning appeal) , then the burden shifts to the FTB to establish via their own audit the proper amount and reasoning for any adjustments to alleged excessive compensation. They never did that.

Or conversely, the FTB could have just gotten it right.

By relying on the wrong eroded documents, the FTB has ignored all of the following and more:

They have ignored,

- 1) Evidence submitted by the taxpayer that rendered the RAR and 866-A overturned.
- 2) IRS Appeals review of the pertinent case law that supported the taxpayer.
- 3) Other pertinent IRS Revenue rulings.

All of the above are the considerations of the IRS appeals division before rendering a Final Federal Determination.

If FTB was to have conducted an audit they too could have found this also.

- We contend before the IRS that the payments to Mr. Klinger, who was Chairman of the Board, Chief Executive Officer, Chief Engineer, Senior Marketing Officer and Senior Sales Representative was compensated fairly for a man who was working relentlessly in every aspect of this company. He was living the true American dream having started the business from nothing in the 1950's.

During the 2 years in question, Mr. Klinger personally guaranteed up to \$4,500,000 in personal guarantees for loans to the company. The loans were critical to the company survival at the time because of a temporary hold on federal government contracts among other factors. It was part of the strategic plan to weather that temporary hardship.

(CASE: E.J Harrison & Sons Inc. vs. Commissioner (9th cir. 2005) 138 Fed Appx.994), We site this case for the contention that when an individual guarantees loans for a company, then a greater amount of compensation may be found to be reasonable.

His compensation was strategically created to pay him for his increased role to save the company and his previously lower pay to balance this out as catch-up compensation. Board Members he paid tax on that income already both at the federal and state level.

This is not a strategy designed by myself two decades later to explain what happened. This is what the contemporaneous Corporate Board meeting minutes prove to have been the reason for the increased compensation.

Further, Board Members I think you should recall that Mr. Klinger paid both state and federal income tax on this compensation. The FTB already has its tax money. If Board should uphold the FTB's inexcusable actions in this case, they would be granting FTB double taxation.

Board Members Please Reverse and correct this error by voting in favor of our client's request for equalization and refund.

The FTB can't have it both ways first saying they rely on the nonexistent final federal report and in the 11th hr. say that they are just "handling it differently than the IRS."

The regulation was vague and not fitting the UNIQUE facts of this case therefore there was no "duty to report".

Board Members, You might make the argument that this is a unique situation that is very unlikely to happen again. Therefore, if the BOE decides in the TP's favor on this argument, it would not be creating a precedent, but merely recognizing that in this unique set of circumstances that this TP should not be penalized for the mistake of the IRS that seem to have been carried over to the FTB and now to the BOE for final resolution.

Alternatively, the Board should consider a published opinion that will fix this set of facts for this taxpayer and others. The FTB need Guidance Board Members. You of course have this power.

Thank you for your time and consideration.

TIME About 15 min.

END

The MAF Group herein submits the Sworn & Notarized affidavit of Mr. Terry Milne, the former IRS Appeals Officer at the time of this original IRS audit appeal. He later was promoted and became an Appeals Team Case Leader in late 2001 and completed his distinguished career in 2006.

His information is Contemporaneous to the Audit period and not recreated.

Terry Milne's Biography

Terry Milne, EA, holds a BS (Accounting) from California State University Northridge and received a Master of Business Taxation from USC. Terry is an Enrolled Agent and has passed the CPA examination. Over the years he has regularly taught tax classes for Revenue Agents and Appeals Officers at different grade levels and made training and other presentations on Alternative Dispute Resolution (ADR) including some at the Tax Executive Institute. He has also participated in CPE presentations on ADR for a national law firm.

Terry Milne retired from the IRS after more than thirty years of service. He began his career as an Internal Revenue Agent and worked on general corporate business taxation matters and, for several years, with Exempt Organizations. Terry later became a District Technical Reviewer, remaining at that job for several years until an opportunity to move to Appeals arose. Terry was then promoted to Appeals Officer (AO). He finished his time with IRS as an Appeals Team Case Leader (ATCL). As an ATCL, his primary work responsibility was the Large Case Group, often working "Fortune 500" companies. Terry also participated in numerous ADR mediation cases during this period.

In his post-IRS years, he co-authored a textbook entitled "Federal Tax Appeals and Alternative Dispute Resolution...An In-depth Look into the IRS Appeals Process".

Affidavit of Terry Milne, EA

STATEMENT OF FORMER IRS OFFICIAL TERRY MILNE:

All information provided is contemporaneous to the IRS audit:

The purpose of this affidavit is simply to state the facts and not to offer my opinion in this matter, BOE CASE 526527. (Applied Companies), represented by Marcus Allen Frishman of the MAF Group.

IRS file lost:

Upon being contacted by the Taxpayer's accountant in 1998, I attempted to find the IRS file on this case. A colleague of mine who was an expert in finding misplaced files used all of her resources and contacts to try and track down the file. This file was one of the very few files she could never locate. I have been told that Mr. Fred Ferrarin, Appeals Team Manager, made a more recent search this year with the same result.

FTB should not rely on IRS Revenue Agents Report (RAR):

The FTB relied primarily on the original RAR to determine the California tax deficiency. Such reliance is just wrong since there was a subsequent Appeals settlement that resulted in a fairly minimal Federal tax of a few thousand dollars for a different tax year that was examined, and not for any year in question with FTB assessments of years March 31, 1991 & March 31, 1993.

Taxpayer won the IRS audit:

The taxpayer established that a significant portion of the proposed adjustment to excessive compensation was wrong. The proposed tax deficiency was reduced to just a few thousand dollars due to an Alternative Minimum Tax. There was zero due to income taxes for any tax year of the audit.

Clarification of the facts:

I wrote the much-debated IRS FAX Memo Dated 12/15/2004 that has only just been provided to the BOE/FTB by the MAF Group. I stated at that time and again here -"Applied Companies Appeal was successful". This would negate the original RAR that the FTB admits to using to establish the CA State tax Liability. The Board of Equalization can correct this apparent error triggered by faulty IRS documents.

Taxpayer had no closing agreement with IRS:

The Form 870-AD is not a formal Closing Agreement. For the IRS, the Form 870-AD is merely an agreement between the parties whereby the Taxpayer waives his rights to go to court or to file

a claim for refund concerning the years at issue and the particular issues that were considered. In this case, no "Closing Agreement" was entered into by the parties.

There was no Final Federal Determination document issued:

When I wrote in my Memo (12/15/2014), mentioned above, I stated "apparently a final report was never issued". I was referring to the "Final Federal Determination" that was never issued in this matter. I do not know why this standard procedure was not followed. I have never seen a case without a "Final Federal Determination" until this one.

I cannot comment on California Revenue & Taxation Code section 18622 that required appellant to report the 1991 and 1993 federal changes. I can, however, say there was no federal tax liability change to report or change in the Federal gross income to report to the Franchise Tax Board (FTB). I can also understand how they (FTB) became confused or misinformed by relying on the Federal RAR that does not reflect the final outcome in the federal audit.

The above statements are true and correct to the best of my ability under penalty of perjury under the laws of California.

Terry Milne

11/14/2013

Terry Milne

Date

STATE OF CALIFORNIA }
COUNTY OF Los Angeles }

On this 14th day of November, 2013 before me Lisa Lynn Stavich, personally appeared Terry Milne, who proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

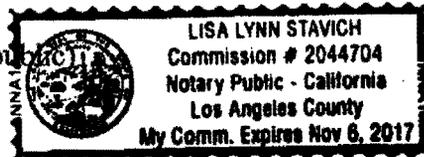
I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature

[Handwritten Signature]

(notary public)



(NOTARY SEAL)