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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeal of:) **HEARING SUMMARY²**
11) **PERSONAL INCOME TAX APPEAL**
12 **PETER ST. GEME AND**) Case No. 693089
13 **POLLY PLUMER ST. GEME¹**)
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24 ¹ Appellants filed this appeal from an address in San Francisco County.

25 ² This appeal was originally scheduled for the April 22-23, 2014 Board meeting. Appellants requested and received a
26 postponement to prepare for the hearing. Accordingly, this appeal was rescheduled for the July 17-18, 2014 Board meeting
27 at appellants' request. Prior to appellants' request for a postponement, the Appeals Division received a Board Member
28 Inquiry. Respondent submitted a supplemental brief addressing the inquiry, which is found in the Contentions section of
the hearing summary. This appeal was then rescheduled for the September 23-24, 2014 Board meeting, but was deferred at
the Appeals Division's request to conduct further briefing in response to appellants' additional brief submitted on
August 3, 2014, which raised a new issue. The additional briefing concluded on December 3, 2014, and this appeal was
scheduled for the March 25, 2015 Board meeting.

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Year³
2000

Amount
at Issue
\$914,847, plus interest⁴

Representing the Parties:

For Appellants: Peter St. Geme and Polly Plumer St. Geme

For Franchise Tax Board: David Muradyan, Tax Counsel

QUESTIONS: (1) Whether respondent's proposed assessment was timely;
(2) Whether appellants have shown error in respondent's proposed assessment of tax which was based on a federal adjustment; and
(3) Whether appellants have shown that they are entitled to further interest abatement.

HEARING SUMMARY

This appeal involves an amount in controversy that is \$500,000 or more and thus is covered by Revenue and Taxation Code (R&TC) section 40. Please see Staff Comments below for details.

Background

Appellants timely filed their California income tax return for the 2000 tax year. On the return, appellants reported California AGI of \$3,858,379 and claimed total deductions of \$3,299,624,

³ The length of time between the year at issue and the filing of appellants' appeal is due to a federal audit in 2006 and appellants' protest of respondent's proposed assessment prior to this appeal.

⁴ According to the Notice of Action, the amount of interest that accrued on the underlying tax liability through November 28, 2012, is \$839,731. Respondent indicated that it would abate interest from May 27, 2009 through August 6, 2012. In addition, respondent has indicated that it will allow interest suspension from September 14, 2007 through September 25, 2008.

According to respondent's calculations, appellants' tax liability for 2000, after accounting for the interest abatement and interest suspension, is \$1,496,880.97 (\$914,847.00 in tax + \$582,033.97 in interest) as of July 17, 2014. After crediting the overpayments and interest on those overpayments totaling \$1,182,242.36 (i.e., \$433,641.59 + \$25,912.20 + \$722,688.57), the remaining deficiency balance for the 2000 tax year is \$314,638.61 as of July 17, 2014. At the oral hearing, respondent should be prepared to provide an updated deficiency balance and the current amount of interest that has accrued in this matter.

1 resulting in a taxable income of \$558,755. Appellants reported a self-assessed tax of \$48,455. After
2 applying withholding credits of \$17 and accounting for estimated tax payments of \$35,255, appellants
3 reported a balance due of \$13,183, which they remitted with their return. (Resp. Op. Br., p. 1, Exhs. A
4 & B.)

5 The Internal Revenue Service (IRS) subsequently audited appellants' federal 2000 tax
6 year account.⁵ The federal adjustments included a capital gain of \$9,533,451, and disallowed itemized
7 deductions of \$346,738. As a result of these adjustments, the federal taxable income increased by
8 \$9,880,189 (from \$376,243 to \$10,256,432) for the 2000 tax year. The IRS assessed a deficiency of
9 \$2,348,462, plus interest. A review of appellants' federal Account Transcript, dated May 30, 2013,
10 reflects that appellants did not dispute the additional federal tax liability and the additional federal
11 liability was satisfied with payments transferred from other tax years. According to respondent,
12 appellants submitted a copy of the Revenue Agent Report (RAR) to respondent on September 13, 2006.
13 On November 30, 2006, the IRS also informed respondent of the federal adjustments through the
14 submission of a FEDSTAR IRS Data Sheet (FEDSTAR).⁶ On or about July 13, 2007, respondent
15 issued a letter to appellants acknowledge that their representative provided respondent with the federal
16 information on August 17, 2006.⁷ (Resp. Op. Br., p. 2, Exhs. C, D, E, & K.)

17 Based on the federal information, respondent examined appellants' 2000 tax account and
18 issued a Notice of Proposed Assessment (NPA) for the 2000 tax year on September 10, 2008. On the
19 NPA, respondent followed the federal capital gain adjustment of \$9,533,451, and disallowed itemized
20 deductions of \$303,609. These adjustments increased appellants' California taxable income by
21 \$9,837,060 (from \$558,755 to \$10,395,815), resulting in a proposed assessment of additional tax of
22 \$914,847. The NPA also imposed a Noneconomic Substance Transaction Understatement (NEST)

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24 ⁵ The IRS audited and adjusted appellants' income for the 1997, 2000, 2001, 2002, and 2003 tax years. The adjustments
25 resulted in additional tax for the 2000 tax year and refunds for the subsequent years.

26 ⁶ The adjustments on the FEDSTAR received from the IRS are consistent with the adjustments listed on the RAR provided
27 by appellants. The only difference between the FEDSTAR and the RAR was that the FEDSTAR indicated that appellants
28 were involved in an abusive tax avoidance transaction (ATAT). The FEDSTAR also reflected that the IRS did not impose
penalties against appellants related to the ATAT.

⁷ According to respondent, the August 17, 2006 date is incorrect and was due to an oversight.

1 Penalty of \$365,939.00⁸ and an Interest Based Penalty (IBP) of \$552,699.54,⁹ plus interest. (Resp. Op.
2 Br., p. 2, Exh. F.)

3 Appellants protested the NPA by a letter dated October 17, 2008, disputing the
4 imposition of the NEST penalty and the IBP. Appellants argued that these penalties were erroneous,
5 improper, and unreasonable in light of the fact that the IRS had not assessed any federal penalties for
6 the 2000 tax year. Appellants contended that respondent did not initiate an audit to determine whether
7 appellants engaged in a transaction that lacked economic substance. Appellants also contended that
8 they never received a position letter from respondent specifically explaining the reasons that appellants'
9 transaction as reported on the RAR lacked substance. (Resp. Op. Br., p. 2, Exh. G.)

10 Respondent confirmed the receipt of appellants' protest by a letter dated October 22,
11 2008. On November 19, 2008, respondent sent a letter to appellants, informing them that the protest
12 had been forwarded to respondent's protest unit for resolution. On December 2, 2008, respondent sent
13 a letter to appellants informing them that their protest was assigned to a Protest Hearing Officer (PHO).
14 (Resp. Op. Br., p. 6, Exhs. M, N, & O.)

15 On March 11, 2009, respondent sent an initial contact letter, setting forth what was at
16 issue in the protest and requesting that appellants provide specific documents. On March 16, 2009,
17 respondent received a letter from appellants' representative at Ernst & Young stating that
18 Ernst & Young would no longer be representing appellants. Respondent then sent a letter similar to the
19 March 11, 2009 letter directly to appellants rather than their representatives. On May 5, 2009,
20 appellants sent a facsimile to respondent, stating that they were having difficulties obtaining some of
21 the requested documents, including the federal Form 886-A, Explanations of Items, for the 2000 tax
22 year. Respondent states that, on May 27, 2009, appellants requested additional time to respond to the
23 information request. Respondent also requested and waited for appellants' Individual Master File
24 (IMF) for the 2000 tax year from the IRS on October 28, 2009 and November 5, 2009. Respondent
25 states that, from May 27, 2009, to July 26, 2010, respondent reviewed, analyzed, and researched facts
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27 ⁸ This penalty was imposed pursuant to R&TC section 19774, and was later removed by the FTB.

28 ⁹ This penalty was imposed pursuant to R&TC section 19777, and was later removed by the FTB.

1 and issues relevant to the protest. (Resp. Op. Br., p. 7, Exhs. P, Q, R, & S.)

2 On August 6, 2012, respondent sent appellants its preliminary determination letter.
3 Respondent informed appellants that the additional tax and interest were assessed properly.
4 Respondent also informed appellants that it removed the IBP and that respondent's Chief Counsel
5 removed the NEST penalty. On September 5, 2012, respondent issued an Interest Computation letter,
6 computing the interest for the 2000 tax year after taking into account the overpayments from the 2001
7 through 2003 tax years. (Resp. Op. Br., p. 2, Exhs. H & T; App. Op. Br., p. 1, Exh. B.)

8 On November 28, 2012, respondent issued a Notice of Action (NOA) for the 2000 tax
9 year which made revisions to the NPA. The NOA affirmed the assessment of additional tax of
10 \$914,847, but removed the IBP and NEST penalty. The NOA also reflected that interest would be
11 partially abated under R&TC section 19104 for the period, July 26, 2010 to July 22, 2011. Appellants
12 then filed this timely appeal. (Resp. Op. Br., p. 3, Exh. I; App. Op. Br., Exh. A.)

13 Contentions

14 Appellants' Opening Brief

15 Appellants first contend that they have yet to receive refunds for the overpayments made
16 to the FTB for the 2001, 2002, and 2003 tax years. Appellants contend that the IRS audited their 1997,
17 2000, 2001, 2002, and 2003 tax years which resulted in a net federal refund of \$97,797.¹⁰ Appellants
18 further contend that they provided timely notice of the federal changes to the FTB. Appellants contend
19 that the NPA reflected the imposition of the NEST penalty and the IBP, but did not state the basis for
20 the imposition of those penalties. Appellants contend that the four years it took for the FTB to remove
21 the penalties was unreasonable, particularly since the IRS did not impose any federal penalties.
22 Appellants argue that the egregious amount of time that it took the FTB to eliminate the penalties was
23 detrimental to appellants as interest continued to compound. (App. Op. Br., pp. 1-2, Exhs. A & B.)

24 Appellants contend that the NPA assessing additional tax and the penalties was
25 erroneous. Appellants contend that the federal adjustment to capital losses in the 2000 tax year was
26 simply a timing issue and those losses were allowed by the IRS in subsequent years. As such,
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28 ¹⁰ This amount includes the following: an overpayment of \$110,566 for 1997; additional tax of \$2,348,462 for 2000; an
overpayment of \$1,088,554 for 2001; an overpayment of \$35,015 for 2002; and an overpayment of \$1,212,124 for 2003.

1 appellants contend that the application of the NEST penalty was unreasonable. Appellants further point
2 out that the IRS did not impose penalties for any of the years audited and, therefore, respondent's
3 original assessment of the NEST penalty was unfair. Appellants also argue that the FTB wasted
4 valuable taxpayer time when it improperly assessed the IBP without providing them with a position
5 letter or any other written or verbal explanation. Appellants contend that the four years between the
6 NPA and the NOA caused interest to accumulate to their detriment. Appellants argue that this
7 egregious amount of time combined with appellants' subsequent compliance in filing returns for 2004
8 through 2012, and their claimed overpayments for 2001, 2002, and 2003, are more than enough
9 evidence to vacate the proposed assessment. (App. Op. Br., p. 2, Exh. C.)

10 Appellants contend that they suffered enough from respondent's erroneous imposition of
11 the penalties and the severe financial hardship caused by the FTB and the economic uncertainty due to
12 the four-year protest. Appellants contend that they possess virtually no assets, are part of a
13 five-member household, and do not possess the liquidity or assets to make payments on the assessment.
14 Appellants allege that they lost their home to foreclosure in June 2009 and were evicted from their
15 home in June 2011 and that their economic prospects are dim. (App. Op. Br., p. 3.)

16 Respondent's Opening Brief

17 With regard to the additional tax, respondent contends that appellants have not made any
18 arguments or submitted any evidence to show that there are errors in the federal changes or
19 respondent's proposed assessment based on those changes. Respondent contends that R&TC
20 section 18622, subdivision (a), requires taxpayers to either concede the accuracy of the federal
21 determination or to prove that the federal changes are erroneous. Respondent contends that it follows
22 federal adjustments to the extent allowable under California law, but is not necessarily bound to follow
23 a federal action, citing the Board's decision in the *Appeal of Der Weinerschnitzel International, Inc.*,
24 79-SBE-063, decided on April 10, 1979.¹¹ Respondent contends that it proposed additional California
25 tax by following the federal adjustment to capital gain indicated on the federal audit report for the 2000
26 tax year. Respondent contends that itemized deductions were disallowed in a slightly different amount,
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28 ¹¹ Board of Equalization cases may be viewed on the Board's website (www.boe.ca.gov).

1 due to the differences between governing state and federal laws. Respondent further contends,
2 according to appellants' federal Account Transcript for the 2000 tax year, on May 30, 2006, the IRS
3 assessed a deficiency of \$2,348,462, which is the same amount as shown on the federal audit report for
4 the 2000 tax year. Respondent notes that the federal Account Transcript does not show that the IRS
5 subsequently revised or revoked the assessment of additional tax or the existence of any pending action
6 by the IRS. Respondent contends that, while appellants merely state that the assessment of additional
7 tax and interest is "unfair and unreasonable," a deficiency assessment based on a federal audit report is
8 presumptively correct and appellants' unsupported assertions will not satisfy their burden of proof in
9 showing error in the assessment. (Resp. Op. Br., pp. 3-4, Exhs. C, D, F, and K.)

10 With regard to interest abatement, respondent contends that R&TC section 19101
11 requires respondent to charge appellants interest on the balance due. Respondent notes that it may
12 abate interest pursuant to R&TC section 19104 to the extent that interest is attributable in whole or in
13 part to any unreasonable error or delay by respondent in performing a ministerial or managerial act.
14 Respondent notes that the NOA already reflects that respondent will abate interest for the period of
15 July 26, 2010 to July 22, 2011, due to a delay in the performance of a ministerial act during the protest
16 period. Respondent contends that the remaining interest is not attributable to unreasonable error or
17 delay by respondent in performing a ministerial or managerial act. (Resp. Op. Br., p. 4.)

18 Respondent contends that, while appellants assert that the imposition of the NEST
19 penalty and the IBP was an unreasonable error which caused an unreasonable delay, it was not
20 unreasonable to impose these penalties where appellants previously excluded \$9,533,452 in capital
21 gains from taxation. Citing Example 12 in Treasury Regulation section 301.6404-2(c), respondent
22 contends that its determination to impose the penalties and to examine the propriety of the penalties at
23 protest is not a managerial or ministerial act and, therefore, not a basis for the abatement of interest.
24 (Resp. Op. Br., pp. 4-6.)

25 Respondent further contends that, while appellants assert that there was an unreasonable
26 delay by respondent due to the four-year period between the issuance of the NPA and the NOA, a
27 thorough review of the protest period reveals that, with the exception of the period that respondent
28 already agreed to abate interest, the protest was worked in due course considering workload constraints.

1 Respondent notes that the period between its receipt of appellants' protest on or about October 17,
2 2008, and the issuance of the NOA on November 28, 2012, with the exception of the period between
3 July 26, 2010 to July 22, 2011, was due to its examination of the disputed issues, preparing
4 correspondence, waiting for responses from the taxpayers and the IRS, workload constraints and other
5 activities typically performed during the protest period. Respondent contends that none of these
6 reasons provide a basis for an abatement of additional interest in this matter. (Resp. Op. Br., p. 6,
7 Exh. G.)

8 With regard to the period between September 10, 2008, the date respondent issued the
9 NPA, and December 2, 2008, the date respondent notified appellants that the protest was assigned to a
10 PHO, respondent contends that there was no unreasonable delay in processing appellants' protest and
11 assigning the case to the PHO. Respondent further contends that the period between December 2, 2008
12 and March 11, 2009, was attributable to workload constraints, reviewing the protest, and preparing the
13 initial contact letter. Respondent contends that workload constraints are not a basis for an abatement of
14 interest, citing *Leffert v. Comm'r*, T.C. Memo. 2001-23, and *Strang v. Comm'r*, T.C. Memo. 2001-104.
15 (Resp. Op. Br., pp. 6-7.)

16 Respondent contends that the next period, March 16, 2009 to July 26, 2010, consisted of
17 the review and consideration of appellants' protest, some workload constraints in addition to the
18 examination of the propriety of the penalties, which included the application of tax law, drafting
19 correspondence, and awaiting responses from the taxpayer and the IRS.¹² Respondent contends that,
20 during this time period, its PHO worked on appellants' protest and there was no unreasonable error or
21 delay. Respondent further contends that the examination of appellants' protest during this period and
22 intermittent workload constraints are not a basis for an abatement of interest. (Resp. Op. Br., p. 7.)

23 Respondent acknowledges that interest for the period, July 26, 2010 to July 22, 2011,
24 will be abated due to unreasonable delay. Respondent contends that, during the following period,
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27 ¹² Respondent notes that, although it requested IRS Forms 886-A, Explanations of Items, and 4549-A, Income Tax
28 Discrepancy Adjustments, several times from both the IRS and appellants, respondent never received these forms.
Respondent contends that these forms are important because the documents would have provided an explanation of
appellants' transaction and a breakdown of the amounts assessed against appellants. Respondent notes that, instead,
appellants obtained and provided respondent with the closing agreement and RAR report for the 2000 tax year.

1 July 22, 2011 to August 6, 2012, respondent reviewed, analyzed, and researched the facts and issues
2 relevant to the protest, and issued a Determination Letter on August 6, 2012.¹³ (Resp. Op. Br., p. 7.)

3 Respondent contends that the period, September 5, 2012, when respondent issued the
4 Interest Computation Letter, to November 28, 2012, when respondent issued the NOA, consisted of
5 clerical acts of closing the protest and issuing the NOA. Respondent contends that, during this period,
6 it ensured that the NOA properly reflected the PHO's determinations, as well as abating interest from
7 July 26, 2010 to July 22, 2011. As such, respondent contends that there was no unreasonable delay in
8 performing those functions. (Resp. Op. Br., p. 8.)

9 Respondent contends that, aside from the period for which interest was already abated,
10 there were no irregularities in the treatment of appellants' case in the issuance of the NPA and during
11 the protest period. Respondent contends that appellants' case proceeded under the normal course of
12 business without any anomaly. Respondent cites *Denny's Auto Sales*, T.C. Memo. 2002-266, for
13 support of its argument that interest cannot be abated based on a general allegation of a lengthy time
14 period. As such, respondent contends that interest may not be abated for (1) delays due to workload
15 constraints because such actions are neither ministerial or managerial acts or (2) alleged error due to the
16 decision in this case to impose penalties prior to the issuance of the NPA because such a decision was a
17 reasonable general administrative decision and did not involve a ministerial or managerial act.

18 Respondent further contends that, other than the conceded delay, the time period spent examining the
19 issues during the protest, drafting correspondence, and waiting for documentation are also not grounds
20 for the abatement of interest. (Resp. Op. Br., pp. 8-9.)

21 Respondent further contends that R&TC section 19104, subdivision (b)(1), precludes the
22 abatement of interest accrued before respondent contacted the taxpayers about the liability. Respondent
23 notes that the first written contact here regarding the liability occurred when respondent issued the NPA
24 on September 10, 2008, and, therefore, respondent does not have the discretion to abate interest that
25 accrued prior to September 10, 2008. Respondent also notes that appellants appear to argue that, had
26 respondent not imposed the NEST penalty and the IBP, appellants would have paid the assessment and
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28 ¹³ Respondent subsequently abated interest for this period.

1 applicable interest during the protest stage. Respondent points out that appellants could have paid the
2 assessment of additional tax and interest during the protest stage and still protested the two penalties.
3 Respondent also contends that the Board's review of interest abatement is limited to a determination of
4 whether the FTB's failure to abate interest was an abuse of discretion, citing R&TC section 19104,
5 subdivision (b)(2)(B). Respondent contends that, where an administrative decision is supported by
6 substantial evidence, it cannot be successfully attacked as arbitrary, unreasonable, or capricious, citing
7 *McDonough v. Goodcell* (1939) 13 Cal.App.2d 254. (Resp. Op. Br., p. 9.)

8 With regard to appellants' allegation that it is unreasonable and unfair that respondent
9 failed to credit or refund appellants for the overpayments made for the 2001, 2002, and 2003 tax years,
10 respondent contends that, once the 2000 tax year liability is final, either by the appeal being dismissed
11 or by the Board rendering its decision, respondent will credit overpayments for the 2001, 2002, and
12 2003 tax years against the 2000 tax year in accordance with R&TC section 19301,¹⁴ as outlined in
13 respondent's September 5, 2012 letter. (Resp. Op. Br., p. 10.)

14 Appellants' First Reply Brief

15 Appellants contend that, at this point, the additional interest that has accrued on the tax
16 assessment is nearly the same amount as the originally-proposed NEST penalty of \$365,939.
17 Appellants contend that, while respondent asserts that the NPA was based on federal adjustments, the
18 federal adjustments did not include the NEST penalty or the IBP. Appellants contend that they had to
19 wait four years before respondent admitted its error and withdrew these penalties. Appellants contend
20 that, during this period, interest of \$290,000 accrued on the additional tax assessment, "effectively
21 sterilizing the withdrawal of the NEST Penalty." Appellants contend that respondent's withdrawal of
22 the penalties shows an unreasonable error because respondent did not follow the federal adjustments
23 when it initially imposed the penalties and respondent confirmed that the penalties were inconsistent
24 with California law. Appellants also contend that respondent did not follow the federal adjustments, as
25 appellants allege that the IRS did not charge interest on the additional federal tax liability for the 2000
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28 ¹⁴ R&TC section 19301, subdivision (a), provides "If the Franchise Tax Board or the board, as the case may be, finds that there has been an overpayment of any liability . . . by a taxpayer for any year for any reason, the amount of the overpayment may be credited against any amount then due from the taxpayer and the balance shall be refunded to the taxpayer."

1 tax year. Appellants contend that this behavior is an abuse of discretion and law. Appellants contend
2 that respondent assumed that there was an abusive tax avoidance transaction and, had respondent
3 reviewed the RAR or FEDSTAR report when these documents were provided to respondent in the fall
4 of 2006, respondent could have concluded that there was nothing in the reports that would trigger the
5 imposition of the two penalties. Appellants reiterate that the IRS would not have issued a refund to
6 appellants if they were involved in an abusive tax avoidance transaction. Appellants argue that
7 respondent, by only partially following the federal adjustments, increased the potential cost to
8 appellants and, because of the FTB's conduct, included interest and accounting fees in the tens of
9 thousands of dollars. Appellants argue that, based on this conduct, the FTB's NOA should be denied in
10 its entirety and economic compensation should be awarded to appellants. (App. Reply Br., pp. 1-4.)

11 Appellants argue that respondent's conduct between September 2006 and
12 November 2012 was factually erroneous, arbitrary, unreasonable, capricious, and unsupported.
13 Appellants contend that, while respondent has agreed to abate a portion of the interest, the remaining
14 interest has accrued \$290,000 more than the amount that accrued as of September 2008, which is
15 almost equivalent to the amount of the NEST penalty originally imposed. Appellants also contend that
16 respondent's behavior violated R&TC section 19104. Appellants further contend that, just because the
17 amount of tax for the 2000 tax year is relatively large, does not mean that appellants were involved in
18 any abusive tax avoidance transaction. Appellants contend that to come to that conclusion would be
19 discriminatory and inconsistent with the law. Appellants further argue that the IRS did not charge
20 appellants any penalties or interest. (App. Reply Br., p. 4.)

21 Appellants further contend that respondent cannot claim that the FTB was required to
22 interpret any complex provisions of federal tax law pertaining to the 2000 tax year. Appellants assert
23 that the IRS fully and comprehensively examined appellants' 2000 tax year within the context of full
24 compliance with federal law. Appellants argue that the FTB cannot argue that the IRS charged
25 penalties or interest for the 2000 tax year or any other tax year that the IRS examined. Appellants
26 assert that they never received the Forms 886-A and 4549-A from the IRS and, therefore, the FTB's
27 argument that appellants failed to provide these forms to respondent is of no avail. Appellants assert
28 that these forms are not applicable because they never participated in any abusive tax avoidance

1 strategies. With regard to respondent's contention that its workload and time constraints prevented it
2 from reviewing appellants' matter in a more timely manner, appellants assert that their protest of the
3 proposed assessment for the 2000 tax year should not have been included in respondent's workload.
4 With regard to respondent's reliance on *Denny's Auto Sales, supra*, appellants contend that the IRS
5 already examined appellants' 2000 tax year and respondent received the RAR on September 13, 2006,
6 and the FEDSTAR report on November 30, 2006. Appellants contend that these two reports show no
7 penalties or interest were charged to appellants. Appellants contend that respondent cannot
8 successfully argue that it was reasonable for it to spend six years deliberating its reasoning on the
9 imposition of the penalties. As such, appellants contend that the entire assessment of tax and remaining
10 interest should be abated. (App. Reply Br., p. 5-6.)

11 Respondent's First Reply Brief

12 With regard to appellants' contention that the IRS did not charge interest on appellants'
13 2000 tax liability, respondent contends that the IRS did charge interest and, while the IRS removed a
14 portion of the interest, the remaining amount of interest of \$218,103.67 was charged to appellants'
15 2000 federal tax account. Respondent notes that appellants' federal Account Transcript for the 2000
16 tax year reflects that the federal audit resulted in an assessment of tax of \$2,348,462.00 and the IRS
17 initially charged interest of \$785,656.61. The federal Account Transcript further reflects that the IRS
18 abated interest on June 30, 2008, and July 21, 2008, of \$214,580.10 and \$352,972.84, respectively.¹⁵
19 Respondent contends that, while the IRS abated interest of \$567,552.94 (i.e., \$214,580.10 +
20 \$352,972.84), appellants were still charged with federal interest charges of \$218,103.67 (i.e.,
21 \$785,656.61 - \$567,552.94), which appellants satisfied through credits from appellants' other tax year
22 accounts. (Resp. Reply Br., pp. 1-2; Resp. Op. Br., Exh. K.)

23 Respondent notes that, under R&TC section 19104, subdivision (a)(3), respondent will
24 follow a federal determination to abate interest based on IRS errors or delays in the performance of
25 ministerial or managerial acts. Respondent contends that appellants must demonstrate that they meet
26 the following four requirements: (1) the interest accrued and was abated by the IRS under IRC
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28 ¹⁵ Staff notes that the federal Account Transcript reflects that the IRS reduced or removed interest originally charged for a late payment of tax, consistent with the IRS reducing or removing the late payment penalty. (Resp. Op. Br., p. 4, Exh. K.)

1 section 6404(e); (2) the error or delay must have occurred on or before the IRS issued a final
2 determination of tax; (3) the deficiency upon which the federal interest abatement was allowed must be
3 related to the state deficiency; and (4) the interest can only be abated for the same time period that the
4 IRS abated interest. Respondent contends that, if appellants can provide additional documentation
5 demonstrating that interest was abated under IRC section 6404(e) and the period of the abatement,
6 respondent will follow the federal action if the other requirements are met. (Resp. Reply Br., p. 2.)

7 Appellants' Supplemental Brief

8 Appellants contend that the IRS issued its final RAR in May 2006 in which the IRS
9 indicated a total tax owed of negative \$97,797 for all the years audited. Appellants point out that they
10 received a refund of \$97,797 from the IRS. Appellants contend that there is no ambiguity as to the
11 balance due or overpayments for the audit years excluding interest and penalties based on the IRS cover
12 letter and RAR.¹⁶ Appellants contend that, if respondent's claim that they were charged interest of
13 \$218,103.67, then appellants would not have received a refund from the IRS, but would have owed
14 \$120,306.67. (App. Supp. Br., p. 1, Exhs. A & B.)

15 Respondent's Supplemental Brief

16 Prior to the July 2014 postponement of this appeal, the Appeals Division received a
17 Board Member Inquiry directed at respondent, which resulted in respondent's supplemental brief.

- 18 1. Respondent was requested to provide a copy of the federal information showing the tax shelter
19 adjustments made as referenced in respondent's Exhibit G.

20 Respondent states that there were two sources of federal information which reflected
21 that appellants' return was selected by the IRS for further examination of a tax shelter issue and
22 included in the IRS Tax Shelter Program. Respondent states that the FEDSTAR IRS Data Sheet, under
23 the heading "Report Information," noted the phrase "Tax Shelter Program" under "Source Code."
24 Respondent explains that this notation means that the FEDSTAR IRS Data Sheet is from the IRS Tax
25 Shelter Program. In addition, respondent states that appellants' IMF reflects that appellants' account
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27 _____
28 ¹⁶ Staff notes that page 2 of the RAR reflects that appellants were charged interest of \$251,948.03 for the 2000 tax year. It
is unclear to staff why there is a discrepancy in the amount of interest charged per the RAR and per the federal Account
Transcript (\$218,103.67). The parties may wish to clarify this discrepancy. (App. Supp. Br., Exh. B.)

1 was selected for exam (Transaction Code 420)¹⁷ under the Tax Shelter Program (Source Code 17) on
2 February 5, 2004. Respondent states that Source Code 17 is defined by the Internal Revenue Manual as
3 “All returns selected for examination of a tax shelter issue and included in the Tax Shelter Program.”
4 Respondent further notes that the IMF also reflects a Transaction Code 425 and Source Code 17 on
5 January 28, 2004. (Resp. Supp. Br., pp. 1-2, Exh. A; Resp. Op. Br., Exh. D.)

- 6 2. Respondent was requested to discuss its opening brief reference to IRS Form 4849-A and when
7 respondent requested this form from appellants.

8 Respondent states that Form 4549-A, Income Tax Discrepancy Adjustments, and not the
9 mistakenly referenced Form 4849-A, is used by the IRS to show subsequent IRS adjustments to its
10 initial audit assessment. Respondent states that it never received Form 4549-A for the 2000 tax year.
11 Respondent states that appellant provided Form 4549-A for the 2001 and 2002 tax years on August 31,
12 2009. Respondent states that it did receive Form 4549, Income Tax Examination Changes, for the
13 1997, 2000, 2001, and 2002 tax years, which were attached in its opening brief. Respondent states that
14 it did not receive, for any tax year, the Form 886-A, Explanation of Adjustments. (Resp. Supp. Br.,
15 p. 2, Exh. B; Resp. Op. Br., Exh. C.)

16 Respondent states that it requested a complete copy of the final RAR, including all
17 schedules, on February 20, 2008. Respondent states that it requested Form 886-A on numerous
18 occasions, including March 11, 2009, and April 16, 2009. Respondent further states that, as to the
19 closing agreement, respondent received an Examination Closing Record for the 2001 tax year, and not
20 the 2000 tax year. Accordingly, respondent acknowledges that it mistakenly referenced a closing
21 agreement for 2000 in its opening brief, when it was an Examination Closing Record for the 2001 tax
22 year. (Resp. Supp. Br., pp. 2-3, Exh. C.)

- 23 3. Respondent was requested to explain and document the review and research that took place
24 during the following periods: (1) May 27, 2009 through July 26, 2010; and (2) July 22, 2011
25 through August 6, 2012.

26 Respondent states that, upon further review, it has determined to abate interest for these
27

28 ¹⁷ An explanation of the transaction codes may be found on the IRS website: http://www.irs.gov/pub/irs-utl/transaction_codes_pocket_guide.pdf.

1 two periods. (Resp. Supp. Br., p. 3.)

2 4. Respondent was requested to discuss whether interest suspension under R&TC section 19116 is
3 applicable to this appeal.

4 Respondent notes that R&TC section 19116, subdivision (f), provides, for notices sent
5 after January 1, 2004, R&TC section 19116 does not apply if the taxpayer has taxable income greater
6 than \$200,000 and were contacted by respondent regarding the use of a potentially abusive tax shelter.
7 Respondent contends that appellants' income for 2000 exceeded \$200,000 and the notice for the 2000
8 tax year was issued on September 1, 2008. Respondent also contends that appellants were contacted by
9 respondent regarding the use of a potentially abusive tax shelter as evidenced by the NPA and various
10 letters from respondent to appellants. As such, respondent contends that interest suspension under
11 R&TC section 19116 is not applicable.¹⁸ (Resp. Supp. Br., p. 3.)

12 Appellants' Supplemental Information

13 By letter dated August 3, 2014, appellants contend that the September 10, 2008 NPA
14 was issued untimely and is barred by the statute of limitations. Appellants contend that the statute of
15 limitations expired on August 17, 2008, 23 days prior to date of the NPA. Appellant contends that the
16 FTB received the federal information from them within six months of the final federal determination.
17 Appellants contend that the FTB received the RAR from the taxpayers on August 17, 2006.¹⁹
18 Appellant contends that, pursuant to R&TC section 19059, the two-year period in which the FTB may
19 issue an assessment expired on August 17, 2008. Appellants rely on a letter dated July 13, 2007, from
20 the FTB which stated that the FTB received the federal information from appellant's representative on
21 August 17, 2006. Appellant also relies on the fax header information found at the top of the RAR
22 which reflects that appellant's former representative faxed the RAR on August 17, 2006 at 1:57 p.m.

23 ///

24 ///

25 ///

26 _____
27 ¹⁸ As previously noted, the FTB has subsequently allowed interest suspension.

28 ¹⁹ According to respondent's audit worksheet, appellants' representative provided the RAR to respondent on September 13, 2006. (App. Supp. Info., Exh. A.)

1 from the representative's fax number.²⁰ (App.Supp. Info., pp. 1-2, Exhs. A , B, C, & D.)

2 Appellants also contend that the FTB reneged on its "written promise" that it would send
3 appellants a refund within 60-to-90 days of the FTB's letter dated September 11, 2008. Appellants rely
4 on the letters respondent issued on September 11, 2008, for the 2001, 2002, and 2003 tax years, in
5 which respondent indicated that "If you have a credit balance, we will send you a refund of tax and any
6 interest within 60 to 90 days." Appellants point out that they are due overpayments of \$234,218,
7 \$14,892, and \$441,121, for the 2001, 2002, and 2003 tax years, respectively. (App.Supp. Info., pp. 2-3,
8 Exh. E.)

9 Appellants' Additional Evidence²¹

10 By letter dated September 29, 2014, appellants contend there was no transaction to
11 describe in response to the Appeals Division's request for an explanation of the transaction which
12 caused the federal adjustments. Appellant contends that they agreed to the federal adjustments made to
13 their federal 1997, 2000, 2001, 2002, and 2003 tax years which resulted in a net refund of \$97,797.
14 Appellants reiterate their arguments that the FTB received the RAR on August 17, 2006 based on the
15 fax information and the FTB's July 13, 2007 letter. Appellants contend that the FTB received another
16 copy of the RAR from appellants' representative on or about July 29, 2008. Appellants provide a letter
17 dated July 29, 2008 from appellant's former representative to the FTB which states that, in response to
18 the FTB's letter dated July 15, 2008, the representative is enclosing a copy of the final federal audit
19 adjustments and supporting schedules used in making the final federal determination for the 2000
20 through 2002 tax years. Appellants assert that this July 29, 2008 letter is important because it was
21 provided within the two-year statute of limitations period ending on August 17, 2008. Appellants
22 contend that the FTB never asked them for any additional information. (App. Addl. Ev., pp. 1-2,
23 Exhs. A, B, C & D.)

24 _____
25 ²⁰ It appears that there is no information in the fax header as to the recipient of the fax. Although appellant claims that this
26 RAR came from respondent's files, it appears that there is a discrepancy as respondent's copy of this document includes a
27 stamped receipt date of September 13, 2006 on the first page which is missing from appellant's copy of this document.
(Resp. Op. Br., Exh. E; App. Supp. Info., Exh. C.)

28 ²¹ Appellant also addressed the interest suspension issue in this submission. As the FTB has now allowed the interest
suspension, this issue will not be addressed further.

1 In response to the request for all federal audit correspondence, appellants point to the
2 Form 4549-A, which respondent received a copy, and state that Form 886-A does not exist. Appellants
3 contend that appellant-husband confirmed with the IRS office in San Francisco and their former
4 representative that the Form 886-A did not exist. Appellants also submitted correspondence from the
5 IRS discussing the federal adjustments. (App. Addl. Ev., pp. 1-2, Exhs. E, F & G.)

6 Appellants also submitted additional evidence to support their contention that they have
7 fully cooperated with the FTB. Appellants point out that the FTB's audit file shows that the FTB
8 received numerous documents directly from the IRS. Appellants contend that the FTB has not
9 submitted any evidence to contradict appellants' position that the FTB received the federal information
10 on August 17, 2006. Appellants contend that, although the FTB's audit work papers state that the FTB
11 received the federal information on September 13, 2006, the FTB's auditor used the incorrect date as
12 the correct date is reflected in the fax header information and the FTB's July 13, 2007 letter. (App.
13 Addl. Ev., pp. 3-4, Exhs. I, J, K, L, M, N, O & P.)²²

14 Respondent's Second Reply Brief

15 By letter dated October 29, 2014, respondent first contends that appellants' statute of
16 limitations arguments are incorrect. Respondent contends that the NPA was timely issued within
17 two years of respondent's receipt of the federal information as provided by R&TC section 19059.
18 Respondent states that its July 13, 2007 letter mistakenly referenced August 17, 2006, as the date of
19 receipt of the federal information. Respondent contends that this is the only document to reference that
20 inaccurate date, and it was "simply an oversight error by respondent which is contradicted by the dearth
21 of evidence in this matter." Respondent points out that the federal information contains a date stamp
22 which demonstrates that the federal information was received by respondent on September 13, 2006.
23 Respondent further provides an affidavit dated October 24, 2014, from Kenneth Bonton, in which
24 Mr. Bonton attests that the document in question was received by the FTB on September 13, 2006, at
25 its Central Office or Sacramento District Office based on the date stamp. Mr. Bonton further attests
26 that a document with such a date stamp indicates that the document was received by mail in
27

28 ²² Appellants also submitted additional correspondence dated August 17, 2014, to the Board which reiterates appellants' arguments regarding the date that the FTB received the RAR as being August 17, 2006. (App. Addl. Ev., Exh. Q.)

1 respondent's Central Office in Sacramento or hand delivered in person to respondent's District Office
2 in Sacramento. Mr. Bonton further attests that a document with such a date stamp means that it was not
3 sent by facsimile to respondent, as respondent only places this date stamp on documents that are either
4 received by mail in its Central Office or in person at its District Office. (Resp. 2nd Reply Br., pp. 1-2,
5 Exh. A.)

6 Respondent also contends that there is additional evidence which support respondent's
7 position. Respondent notes that the facsimile heading merely shows that the document was faxed on
8 August 17, 2006, from Ernst and Young LLP. Respondent points out that this information does not
9 identify the recipient of the facsimile. Respondent also contends that appellants acknowledged that the
10 FTB received the federal information on the September 13, 2006 date in their reply brief. Respondent
11 further contends that appellants attached a copy of the FTB's internal memo entitled "AUDIT ISSUE
12 SECTION" which clearly states that the taxpayers' representative provided the RARs on September 13,
13 2006 and that the statute of limitations based on the federal information expired on September 13,
14 2008. Respondent also points out that appellants omitted the first page of the federal information with
15 their additional evidence submission. Respondent notes that the first page of the federal information
16 includes the date stamp. (Resp. 2nd Reply Br., pp. 2-3; App. Reply Br., Exh. A & C; App.Supp. Info.,
17 Exh. A.)

18 Respondent contends that the official government records (the date stamped federal
19 information) is supported by the affidavit and demonstrates that respondent received the federal
20 information on September 13, 2006. Respondent analogizes this matter to the burden of proof required
21 to establish a proof of mailing in statute of limitations cases and the taxpayer's responsibility to show
22 that a claim for refund was timely filed. Here, respondent contends that it is appellants' responsibility
23 to show that the federal information was timely filed. Respondent contends that, if there is no
24 convincing evidence that a return or refund claim was actually mailed on or before the expiration of the
25 statute of limitations, a taxpayer's unsupported allegations do not overcome respondent's official
26 government records showing an untimely filing. Respondent contends that, where an appellant claims
27 that the federal information was faxed before a statutory deadline, the appellant must offer compelling
28 proof, such as a fax confirmation page, showing that the document was timely faxed. In support,

1 respondent cites Government Code section 11003, Internal Revenue Code section 7502, and its
2 regulations. Respondent contends that the fact that the facsimile may have been prepared prior to the
3 due date does not, in itself, prove a timely filing of the document, citing the Board's decision in the
4 *Appeal of La Salle Hotel Co.*, 66-SBE-071, decided on November 23, 1966. Respondent contends that,
5 with the exception of the FTB's letter mistakenly identifying the August 17, 2006 date, appellant have
6 not provided any credible evidence showing that the federal information was faxed to the FTB on
7 August 17, 2006. As such, respondent contends that the record, including the date stamped RAR,
8 affidavit, respondent's internal memorandum, and appellants' own reply brief, reflects that the FTB
9 received the federal information on September 13, 2006. (Resp. 2nd Reply Br., pp. 3-4.)

10 As to whether there is "an abusive tax avoidance transaction" in this matter, respondent
11 contends that the NEST penalty and the IBP were initially assessed on the NPA because of two sources
12 of federal information showing that appellants' tax return was selected by the IRS for further
13 examination of a tax shelter issue and included in the IRS Tax Shelter Program. The FTB contends that
14 this was reflected in the FEDSTAR IRS Data Sheet and the IMF which reflected a "Source Code 17."²³
15 Respondent notes that it ultimately abated these penalties upon further review. (Resp. 2nd Reply Br.,
16 p. 5.)

17 As to appellants' argument that respondent "renege" on its written promise dated
18 September 11, 2008, to issue a refund of tax and interest, respondent contends that it has not done so.
19 Respondent explains that it previously acknowledged the overpayments in its opening brief and the
20 interest computation letter. Respondent explains that, pursuant to R&TC section 19301, subdivision
21 (a), respondent will credit the overpayments from 2001, 2002, and 2003 against the amount due for
22 2000, and the balance, if any, shall be refunded to appellants. Respondent also submitted a
23 Computation Sheet, detailing the overpayments, and allowed interest abatement and allowed interest
24 suspension. (Resp. 2nd Reply Br., pp. 5-6, Exh. C.)

25 As to the issue of whether appellants are entitled to interest suspension, respondent notes
26 that it has now determined that interest suspension is permitted in this matter and will suspend interest
27

28 ²³ This code is defined as "All returns selected for examination of a tax shelter issue and included in the Tax Shelter Program."

1 for the period, September 14, 2007 through September 25, 2008. (Resp. 2nd Reply Br., pp. 6-7.)

2 As to the interest computation through July 17, 2014, respondent calculates appellants'
3 2000 tax liability (tax and interest), after accounting for the periods of interest abatement and interest
4 suspension, as \$1,496,880.97. Respondent notes that, after crediting the overpayments (including
5 interest on the overpayments), the remaining deficiency balance as of July 17, 2014 is \$314,638.31.
6 (Resp. 2nd Reply Br., pp. 7-8.)

7 Appellants' Second Reply Brief

8 Appellants contend that the NOA is unenforceable. Appellants maintain that the NPA is
9 time-barred. Appellants note that the July 13, 2007 letter from the FTB is an official government
10 record, citing Government Code section 6252, subdivision (e), and Government Code section 6204,
11 subdivision (a)(2). Appellants maintain that, as the July 13, 2007 letter indicated that the FTB received
12 the federal information on August 17, 2006, the statute of limitations for the FTB to issue an NPA
13 expired on August 17, 2006. Appellants argue that the letter is uncontradicted, convincing, credible
14 evidence that the two-year statute of limitations began on August 17, 2006, and ended on August 17,
15 2008. (App. 2nd Reply Br., pp.1-2, Exh. C.)

16 Appellants note that they agreed to the federal adjustments on April 6, 2006. Appellants
17 further note that the IRS confirmed the adjustments and issued a refund on May 19, 2006. Appellants
18 argue that the FTB's July 13, 2007 letter demonstrates that respondent received the federal information
19 on August 17, 2006. As to respondent's argument that there is a "dearth of evidence contradicting" its
20 July 13, 2007 letter," appellants agree and argue that the evidence does not exist. Appellants argue that
21 respondent has not denied or modified the July 13, 2007 letter since the date of that letter until
22 October 29, 2014, when raised by appellants. Appellants assert that the FTB "had the opportunity to
23 deny or modify the date it received appellants' federal information" during protest and the FTB did not
24 do so. Appellants claim that respondent did not "deny or modify" the following information in
25 appellants' protest letter: the taxpayers received "a letter dated July 13, 2007 acknowledging receipt of
26 the federal information." Appellants contend that this shows that respondent agreed with the
27 information in the July 13, 2007 letter. Appellants further contend that the July 13, 2007 letter was
28 written eleven months after respondent received appellants' federal information and that should be

1 sufficient time for respondent to be accurate in its disclosure to appellants. (App. 2nd Reply Br.,
2 pp. 3-4, Exhs. A, B, C & F.)

3 Appellants further argue that they relied on the July 13, 2007 letter. Appellants assert
4 that they presumed documents and correspondence they received from respondent were correct.
5 Appellants contend that respondent never provided them with information that prevented appellants
6 from relying on the information in the July 13, 2007 letter. As such, appellants contend that, as the
7 FTB issued the NPA on September 10, 2008, the NPA was untimely. Appellants also contend that
8 “knowing the beginning and end of the Statute of Limitations is critical for *both* parties.” Appellants
9 further argue that there is no equity when appellants rely on one date based on an official government
10 record while respondent relies on another date which was “negligently hidden” from appellants.

11 Appellants argue that respondent cannot assert the safe harbor that it is presumed correct
12 on the one hand, yet on the other hand, negligently claim a mistake whenever the facts are unfavorable.
13 Appellants assert that, if the September 13, 2006 date was the correct date, respondent would have
14 included it in the July 13, 2007 letter. Appellants further assert that respondent violated the California
15 Taxpayer’s Bill of Rights by “hiding” the date respondent was using. Appellants also assert that it can
16 raise the statute of limitations issue during this appeal because this appeal is based on an NOA and
17 appellants contend that the NOA is unenforceable. (App. 2nd Reply Br., pp. 4-5, Exhs. C, F, G & E.)

18 As to respondent’s argument regarding the date stamp, appellants first contend that the
19 date stamp is illegible. Appellants assert that “[n]o human being, including Affiant Kenneth Bonton,
20 knows beyond a reasonable doubt that ‘September 13, 2006’ is the date of the ‘date stamp’ . . .”
21 Appellants assert that the “date stamp” cannot be hidden from appellants or supersede the July 13, 2007
22 letter, an official government record. Appellants further maintain that, if the federal information was
23 received on September 13, 2006, respondent would have included that date in the July 13, 2007 letter as
24 the date stamp “would have been staring Respondent right in the face.” Appellants claim that it would
25 be impossible for respondent to overlook the date stamp one year later. Appellants further claim that
26 the last digit in the year of the date stamp is not legible and Mr. Bonton cannot claim “beyond a
27 reasonable doubt” that the digit is a “6” or an “8.” Appellants contend that the date stamp is illegible,
28 contradicted, and lacks credibility, and, as such, is not convincing evidence. (App. 2nd Reply Br.,

1 pp. 5-6.)

2 Appellants further contend that respondent ignored appellant's Exhibit Q, which is
3 appellants' additional correspondence dated August 17, 2014, to the Board discussing appellants'
4 arguments that the FTB received the RAR on August 17, 2006. Appellants contend that the fact they
5 raised the statute of limitations issue on August 3, 2014, is not evidence that respondent received
6 appellants' federal information on September 13, 2006. Appellants maintain that they may raise this
7 issue prior to the hearing. Appellants also point out that respondent avoids discussing the Board's
8 inquiry into the underlying transaction which resulted in the initial imposition of the NEST and
9 interest-based penalties. Appellants contend that this circumstance was another mistake made by the
10 FTB. Appellants contend that respondent negligently alleged that appellants were engaged in an
11 abusive tax avoidance transaction without any evidence and then discovered, after four years of protest,
12 that respondent made a "mistake" and withdrew the penalties. Appellants assert that they made an error
13 in their prior briefs when appellants stated that respondent received the RAR on September 13, 2006.
14 Appellants contend that, while they have graduate degrees, they are not tax experts and it took them
15 considerable time to review and understand the documents in this matter. (App. 2nd Reply Br.,
16 pp. 6-7.)

17 Appellants also contend that the interest abatement allowed by respondent pales in
18 significance to the larger issues. Appellants assert that the interest abatement concessions of
19 39 months do not address respondent's "vast negligence." Appellants contend that "respondent ignores
20 that it never provided appellants with a 'position letter' prior to issuing a time-barred, erroneous and
21 non-existent NPA which was based upon a negligent fantasy that Appellants engaged in an Abusive
22 Tax Avoidance Transaction which negligence cause appellants to spend valuable resources and time
23 protesting." Appellants note that respondent continues to charge interest from September 25, 2008
24 through May 27, 2009. Appellants point out that the interest abatement concessions have been offset
25 by the 28 months of interest accrued since August 6, 2012, which continues to accrue to the present.
26 Appellants contend that the interest abatement concessions made by the FTB make no dent in
27 respondent's original NOA deficiency of \$1,754,578.12, which includes 89 months of interest levied
28 from April 15, 2001 through September 14, 2007. Appellants claim that respondent has the legal

1 authority to abate 100 percent of the interest charged to appellants. Appellants further contend that the
2 overpayment letters dated September 11, 2008, did not include the qualifications provided by R&TC
3 section 19301, subdivision (a). Appellants reiterate that the three letters merely stated that “If you have
4 a credit balance, we will send you a refund of tax and any interest within 60 to 90 days.” (App. 2nd
5 Reply Br., pp. 6-8.)

6 Applicable Law

7 Burden of Proof

8 The FTB’s determination is presumed correct and an appellant has the burden of proving
9 it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
10 2001-SBE-001, May 31, 2001.) In the absence of uncontradicted, credible, competent, and relevant
11 evidence showing an error in the FTB’s determinations, respondent’s determinations will be upheld.
12 (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

13 Federal Assessment

14 R&TC section 18622, subdivision (a), provides, in pertinent part, that if the IRS makes
15 any changes or corrections to a taxpayer’s federal return that would increase a taxpayer’s California tax
16 liability, that taxpayer is required to report each change or correction within six months after the final
17 federal determination of the change or correction and concede the accuracy of the determination or state
18 why it is erroneous. R&TC section 19059, subdivision (a), provides a two-year statute of limitations
19 for the FTB to issue a deficiency when a taxpayer reports federal changes to the FTB as required by
20 R&TC section 18622 within six months of the final federal determination or the IRS reports the federal
21 changes to the FTB within six months of the final federal determination.

22 It is well-settled that a deficiency assessment based on a federal audit report is
23 presumptively correct and that the appellant bears the burden of proving that the determination is
24 erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18, 1986; *Todd v.*
25 *McColgan, supra*.) Unsupported assertions are not sufficient to satisfy the appellant’s burden of proof.
26 (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

27 Interest Abatement

28 Interest is not a penalty but is merely compensation for the taxpayer’s use of the money.

1 (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977;
2 *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) To obtain interest abatement, an appellant
3 must qualify under one of the following three statutes: R&TC sections 19104, 19112, or 21012.²⁴

4 Under R&TC section 19104, subdivision (a)(1), respondent may abate all or a part of
5 any interest on a deficiency to the extent that interest is attributable in whole or in part to any
6 unreasonable error or delay committed by respondent in the performance of a ministerial or managerial
7 act. (Rev. & Tax. Code, § 19104, subd. (a)(1).) An error or delay can only be considered when no
8 significant aspect of the error or delay is attributable to an appellant and after respondent has contacted
9 the appellant in writing with respect to the deficiency or payment. (Rev. & Tax. Code, § 19104,
10 subd. (b)(1).) There is no reasonable cause exception to the imposition of interest. (*Appeal of*
11 *Audrey C. Jaegle, supra.*)

12 Under R&TC section 19104, subdivision (a)(3), respondent may abate all or any part of
13 any interest accruing from a deficiency based on a final federal determination of tax, for the same
14 period that interest was abated on the related deficiency amount under IRC section 6404(e),²⁵ and the
15 error or delay occurred on or before the issuance of the final federal determination. (Rev. & Tax. Code,
16 § 19104, subd. (a)(3).)

17 In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29,
18 1999, the Board adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a
19 “ministerial act” as:

20 [A] procedural or mechanical act that does not involve the exercise of judgment or
21 discretion, and that occurs during the processing of a taxpayer’s case after all
22 prerequisites to the act, such as conferences and review by supervisors, have taken place.
23 A decision concerning the proper application of federal tax law (or other federal or state
24 law) is not a ministerial act.

24 ²⁴ It does not appear that R&TC section 21012 is applicable because there has been no reliance on any written advice
25 requested of respondent. Under R&TC section 19112, interest may be waived for any period for which respondent
26 determines that an individual or fiduciary demonstrates an inability to pay that interest solely because of extreme financial
27 hardship caused by a significant disability or other catastrophic circumstance. It appears that this statute does not provide
28 any authority for the Board to review the FTB’s determination whether to abate interest for extreme financial hardship.

²⁵ IRC section 6404(e) provides that the IRS can abate interest on any deficiency attributable to an unreasonable error and
delay by an officer or employee of the IRS in performing a ministerial or managerial act and the error and delay shall be
taken into account if no significant aspect of such error or delay can be attributable to the taxpayer, and after the IRS
contacted the taxpayer in writing with respect to the deficiency or payment.

1 When a California statute is substantially identical to a federal statute (such as with the
2 interest abatement statute in this case),²⁶ the Board may consider federal law interpreting the federal
3 statute as highly persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of*
4 *California* (1942) 48 Cal.App.2d 835.) In this regard, Treasury Regulation section 301.6404-2(b)(1)
5 defines a “managerial act” as:

6 [A]n administrative act that occurs during the processing of a taxpayer’s case involving
7 the temporary or permanent loss of records or the exercise of judgment or discretion
8 relating to management of personnel. A decision concerning the proper application of
9 federal tax law (or other federal or state law) is not a managerial act.

9 Generally, respondent’s decisions relating to the organization and prioritizing for the
10 processing of tax returns involve general administrative decisions, which do not provide a basis for
11 interest abatement. For example:

12 A taxpayer claims a loss on the taxpayer’s income tax return and is notified that the IRS
13 intends to examine the return. However, a decision is made not to commence the
14 examination of the taxpayer’s return until the processing of another return, for which the
15 statute of limitations is about to expire, is completed. The decision on how to prioritize
16 the processing of returns based on the expiration of the statute of limitations is a general
17 administrative decision. Consequently, interest attributable to a delay caused by this
18 decision cannot be abated under paragraph (a) of this section.

17 (Treas. Reg., § 301.6404-2(c), example 8.)

18 Examples of a ministerial act that provides a basis for interest abatement include the
19 following circumstances:

20 A taxpayer contacts an IRS employee and requests information with respect to the
21 amount due to satisfy the taxpayer’s income tax liability for a particular taxable year.
22 Because the employee fails to access the most recent data, the employee gives the
23 taxpayer an incorrect amount due. As a result, the taxpayer pays less than the amount
24 required to satisfy the tax liability. Accessing the most recent data is a ministerial act.

24 (Treas. Reg., § 301.6404-2(c), example 11.)

25 An examination of a taxpayer’s income tax return reveals a deficiency with respect to
26 which a notice of deficiency will be issued. The taxpayer and the IRS identify all agreed
27 and unagreed issues, the notice is prepared and reviewed (including review by
28 _____

²⁶ R&TC section 19104, subdivisions (a) and (b)(2)(B), are substantially identical to IRC sections 6404 (e) and (h).

1 District Counsel, if necessary), and other relevant prerequisites are completed. The
2 issuance of the notice of deficiency is a ministerial act.

3 (Treas. Reg., § 301.6404-2(c), example 2.)

4 Decisions regarding personnel and case assignments, in addition to the misplacing of
5 files, can be considered managerial acts, which can also provide a basis for interest abatement. For
6 example:

7 A revenue agent is sent to a training course for an extended period of time, and the
8 agent's supervisor decides not to reassign the agent's cases. During the training course,
9 no work is done on the cases assigned to the agent. The decision to send the revenue
10 agent to the training course and the decision not to reassign the agent's cases are not
11 ministerial acts; however, both decisions are managerial acts.

12 (Treas. Reg., § 301.6404-2(c), example 3.) (See also, e.g., Treas. Reg., § 301.6404-2(c), examples 4,
13 5, 6, & 10.)

14 A decision concerning the proper application of federal tax law, or other federal or state
15 laws, to the facts and circumstances surrounding a taxpayer's tax liability is not a ministerial or
16 managerial act. (Treas. Reg., § 301.6404-2(b); *Bucaro v. Comm'r*, T.C. Memo. 2009-247.)

17 For example:

18 During the examination of an income tax return, there is disagreement between the
19 taxpayer and the revenue agent regarding certain itemized deductions claimed by the
20 taxpayer on the return. To resolve the issue, advice is requested in a timely manner from
21 the Office of Chief Counsel on a substantive issue of federal tax law. The decision to
22 request advice is a decision concerning the proper application of federal tax law; it is
23 neither a ministerial nor a managerial act. Consequently, interest attributable to a delay
24 resulting from the decision to request advice cannot be abated under paragraph (a) of
25 this section.

26 (Treas. Reg., § 301.6404-2(c), example 9.) In addition, Example 12 provides:

27 A taxpayer contacts an IRS employee and requests information with respect to the
28 amount due to satisfy the taxpayer's income tax liability for a particular taxable year.
To determine the current amount due, the employee must interpret complex provisions
of federal tax law involving net operating loss carrybacks and foreign tax credits.
Because the employee incorrectly interprets these provisions, the employee gives the
taxpayer an incorrect amount due. As a result, the taxpayer pays less than the amount
required to satisfy the tax liability. Interpreting complex provisions of federal tax law is
neither a ministerial nor a managerial act. Consequently, interest attributable to an error
or delay arising from giving the taxpayer an incorrect amount due to satisfy the

1 taxpayer's income tax liability in this situation cannot be abated under paragraph (a) of
2 this section.

3 (Treas. Reg., § 301.6404-2(c), example 12.)

4 Tax Courts have held that the decision to examine, or not to examine, a taxpayer's
5 income tax return for a particular taxable year involves the exercise of judgment and discretion and,
6 therefore, is not a ministerial act. (*Pettyjohn v. Comm'r*, T.C. Memo. 2001-227.) Tax Courts have also
7 held that workload constraints are not a basis for an abatement of interest. (*Leffert v. Comm'r, supra*;
8 *Strang v. Comm'r, supra*.) Tax Courts have also held that a taxpayer's inability to pay the tax is not a
9 basis for interest abatement. (*Mitchell v. Comm'r*, T.C. Memo. 2004-277.)

10 Respondent's determination not to abate interest is presumed correct and the burden is
11 on an appellant to prove error. (*Appeal of Michael E. Myers, supra*.) The Board's jurisdiction in an
12 interest abatement case is limited by statute to a review of respondent's determination for an abuse of
13 discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, an appellant
14 must establish that, in refusing to abate interest, respondent exercised its discretion arbitrarily,
15 capriciously, or without sound basis in fact or law. (*Woodral v. Comm'r* (1999) 112 T.C. 19, 23.)
16 Interest abatement provisions are not intended to be routinely used to avoid the payment of interest,
17 thus abatement should be ordered only "where failure to abate interest would be widely perceived as
18 grossly unfair." (*Lee v. Comm'r* (1999) 113 T.C. 145, 149.) The mere passage of time does not
19 establish error or delay in performing a ministerial or managerial act. (*Id.* at p. 150; *Howell v. Comm'r*,
20 T.C. Memo. 2007-204; *Bucaro v. Comm'r, supra*; *Larkin v. Comm'r*, T.C. Memo. 2010-73.)

21 STAFF COMMENTS

22 Timeliness of the NPA

23 Appellants contend that the FTB's proposed assessment based on federal adjustments is
24 untimely because the NPA dated September 10, 2008, was issued after the two-year statute of
25 limitations pursuant to R&TC section 19059, subdivision (a), expired. The federal adjustments were
26 final as of May 30, 2006, as reflected on appellants' federal Account Transcript. (Resp. Op. Br.,
27 Exh. K.) The parties dispute the date when respondent was notified of the federal adjustments.
28 Respondent contends that the date of notification was September 13, 2006. Appellants contend that the

1 FTB received the RAR from the taxpayers on August 17, 2006. The evidence in the record pertaining
2 to the date of notification includes the following:

- 3 • The July 13, 2007 letter from the FTB to appellants, in which respondent acknowledges the
4 receipt of the federal information from appellants' representative on August 17, 2006. (App.
5 2nd Reply Br., Exh. C.)
- 6 • The fax header information found at the top of the RAR submitted by appellants, which reflects
7 that appellant's former representative faxed the RAR on August 17, 2006 at 1:57 p.m. from the
8 representative's fax number. There is no information in the fax header as to the recipient of the
9 fax. This document does not include the date stamp. (App. Supp. Info., Exh. C; App. Addl.
10 Ev., Exh. A.)
- 11 • Appellants' protest letter dated October 17, 2008, submitted by their former representative in
12 which appellants acknowledge the receipt of the FTB's July 13, 2007 letter. (App. 2nd Reply
13 Br., Exh. F.)
- 14 • The FTB's audit work papers which state that the FTB received the federal information on
15 September 13, 2006. (App. Supp. Info., Exh. I.)
- 16 • The RAR contained in respondent's files which reflect a date stamp "REC'D SEP 13 2006
17 SAC". It appears that the last digit of the year in the date stamp is partially obscured. (Resp.
18 Op. Br., Exh. E.)
- 19 • The affidavit from Mr. Bonton who states that the date stamp "REC'D SEP 13 2006 SAC"
20 demonstrates that the document was hand-delivered to respondent's Sacramento office.
21 Mr. Bonton further states that a document with such a date stamp means that it was not sent by
22 facsimile to respondent. (Resp. 2nd Reply Br., Exh. A.)

23 The parties should be prepared to discuss the credibility and weight of the above
24 evidence relating to the date of the notification. If the Board determines that the date of notification
25 was August 17, 2006, then the NPA is untimely. If the Board finds that the date of notification was
26 September 13, 2006, then the NPA was issued timely and the Board will need to consider whether
27 appellants have shown error in the proposed assessment based on the federal adjustments and whether
28 appellants are entitled to further interest abatement.

1 Federal Assessment

2 Based on the federal adjustments, respondent followed the federal capital gain
3 adjustment of \$9,533,451, and disallowed itemized deductions of \$303,609. Appellants do not appear
4 to have provided any specific contentions or evidence to dispute the capital gain or the disallowed
5 itemized deductions. It appears that appellants contend that the amount of the additional tax should be
6 waived due to the allegedly unreasonable error and delay committed by respondent during the protest
7 process, as discussed below. It appears that appellants agreed with the federal adjustments and the
8 resulting additional federal tax liability became final. The federal tax liability was then satisfied by
9 transferred payments from other tax years. (Resp. Op. Br., Exh. K.)

10 Interest Abatement

11 Appellants should be prepared to clarify whether they are now requesting an abatement
12 of all of the interest that accrued on their account. According to respondent's most recent computation
13 for the 2000 tax year, interest has been charged for the following periods: (1) April 15, 2001 to
14 September 14, 2007;²⁷ (2) September 25, 2008 to May 27, 2009; and (3) after August 6, 2012. (Resp.
15 2nd Reply Br., Exh. C.)

16 R&TC section 19104, subdivision (b)(1), provides, in part, that only unreasonable errors
17 or delays occurring after the FTB initially contacts an appellant in writing with respect to the deficiency
18 are taken into account. Respondent issued the NPA for the 2000 tax year on September 10, 2008.
19 Pursuant to R&TC section 19104, subdivision (b)(1), it appears that interest may not be abated for the
20 entire period prior to September 10, 2008, the date of respondent's first written contact to appellants
21 about the 2000 tax deficiency. This period of time accounts for over seven years of the interest that has
22 accrued on the proposed assessment. Accordingly, the period of time for which the Board may abate
23 interest is limited to the period, September 10, 2008 to the present. Of this period, respondent agreed to
24 abate interest for the period May 27, 2009 through August 6, 2012. The parties should be prepared to
25 discuss whether respondent abused its discretion by not abating interest for the periods:
26 (1) September 25, 2008 to May 27, 2009; and (2) after August 6, 2012.

27 _____
28 ²⁷ Respondent has agreed to suspend interest pursuant to R&TC section 19116 for the period September 14, 2007 through
September 25, 2008.

1 The parties should be prepared to discuss whether respondent committed an
2 unreasonable error or delay in the performance of a ministerial or managerial act. Specifically, the
3 parties should be prepared to discuss whether any actions by respondent can be considered a ministerial
4 act and whether any of those actions caused an unreasonable error or delay. The parties may wish to
5 discuss whether respondent's actions fall under the examples listed in Treasury Regulation
6 section 301.6404-2(c). The parties should be prepared to discuss whether respondent's determination
7 to impose and then to later abate the IBP and NEST penalty is a ministerial or managerial act. It
8 appears to staff that the decision to impose and then to later abate penalties involves discretion and
9 judgment in applying the facts to the applicable law. As such, it appears to staff that such a decision is
10 not a ministerial or managerial act. (See Treas. Reg., § 301.6404-2(c), examples 9 & 12; *Bucaro v.*
11 *Comm'r, supra.*) The parties should also be prepared to discuss whether respondent had to interpret
12 California law with respect to the facts and circumstances of appellants' 2000 state tax liability and the
13 imposition of the penalties that respondent later abated.

14 Appellants contend that the amount of continuing accrued interest negates the effect of
15 respondent abating the originally-imposed IBP and NEST penalty and the subsequent interest
16 suspension and abatement concessions. Interest abatement provisions are not intended to be routinely
17 used to avoid the payment of interest and the mere passage of time does not establish error or delay that
18 can be the basis for interest abatement. (*Lee v. Comm'r, supra; Howell v. Comm'r, supra; Larkin v.*
19 *Comm'r, supra.*) With regard to appellants' contentions regarding their reduced financial
20 circumstances, staff notes that a taxpayer's inability to pay is not a basis for interest abatement.
21 (*Mitchell v. Comm'r, supra.*)

22 It appears that appellants also contend that respondent committed an unreasonable error
23 or delay by not refunding appellants for the overpayments for the 2001, 2002, and 2003 tax years.
24 However, it also appears that, once the 2000 tax year liability is final, respondent will credit
25 overpayments for the 2001, 2002, and 2003 tax years against the 2000 tax year liability.

26 As to appellants' contention that the IRS did not charge interest, the 2000 federal
27 Account Transcript shows that the IRS initially charged \$785,656.61 in interest on appellants' 2000 tax
28 account. (Resp. Op. Br., Exh. K.) The federal Account Transcript further reflects that the IRS

1 subsequently abated a portion of interest charged (i.e., interest totaling \$567,552.94). It appears that
2 the IRS abated this portion of interest because those amounts represented accrued interest on a
3 previously-imposed federal late payment penalty. Since the IRS abated the late payment penalty, it
4 also abated the accrued interest on that amount, leaving the remaining portion of interest on appellants'
5 2000 tax account of \$218,103.67, which was satisfied through credits from appellants' other tax year
6 accounts. The parties should be prepared to discuss, and provide evidence of, whether the IRS abated
7 interest pursuant to IRC section 6404(e).

8 In conclusion, interest accrued in this matter because of the underlying tax liability that
9 remains unpaid. Further, as mentioned above, pursuant to R&TC section 19104, subdivision (b)(1),
10 then, it appears that interest may not be abated for the entire period prior to September 10, 2008, the
11 date of respondent's first written contact to appellants about the 2000 tax deficiency.

12 Additional Evidence

13 If either party has any additional evidence to present, they should provide their evidence
14 to the Board Proceedings Division at least 14 days prior to the oral hearing pursuant to California Code
15 of Regulations, title 18, section (Rule) 5523.6.²⁸

16 Section 40

17 As noted above, this matter is subject to Revenue and Taxation Code section 40.
18 Therefore, within 120 days from the date the Board's vote to decide the appeal becomes final, a written
19 opinion (i.e., Summary Decision or Formal Opinion) must be published on the Board's website.
20 (Cal. Code Regs., tit. 18, § 5552, subds. (b), (f).) The Board's vote to decide the appeal will become
21 final 30 days following the date of the Board's vote, except when a petition for rehearing is filed within
22 that period.²⁹ (Cal. Code Regs., tit. 18, § 5460, subd. (a).)

23 Following the conclusion of this hearing, if the Board votes to decide the appeal, but
24 does not specify whether a Summary Decision or a Formal Opinion should be prepared, staff will
25

26 ²⁸ Evidence exhibits should be sent to: Khaaliq Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of
27 Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.

28 ²⁹ If a petition for rehearing is filed, the Board's decision will not become final, and no written opinion under Section 40 will
be considered until after the petition for rehearing is resolved.

1 expeditiously prepare a nonprecedential Summary Decision and submit it to the Board for
2 consideration at a subsequent meeting. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(2).) Unless the
3 Board directs otherwise, the proposed Summary Decision would not be confidential pending its
4 consideration by the Board (Cal. Code Regs., tit. 18 § 5551, subd. (b)(5)); accordingly, it would be
5 posted on the Public Agenda Notice for the meeting at which the Board will consider and vote on the
6 Summary Decision.

7 A taxpayer may request that the Board hold in abeyance its vote to decide the appeal so
8 the taxpayer may review the Board’s written opinion prior to the expiration of the 30-day period for the
9 filing of a petition for rehearing. If the vote is held in abeyance, the proposed Summary Decision will
10 be confidential until it is adopted by the Board. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(5).) Any
11 request that the Board’s vote be held in abeyance should be made in writing to the Board Proceedings
12 Division prior to the hearing or as part of oral argument at the hearing. Any such request would then be
13 considered by the Board during its deliberations on the appeal.

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