

1 Mai C. Tran
2 Tax Counsel III
3 Board of Equalization, Appeals Division
4 450 N Street, MIC: 85
5 PO Box 942879
6 Sacramento CA 95814
7 Tel: (916) 324-8244
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

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

10 In the Matter of the Appeals of:

) **HEARING SUMMARY**
) **CONSOLIDATED PERSONAL INCOME**
) **TAX APPEAL**

13 **CURTICE R. BOOTH AND**
14 **EVELYN BOOTH**
15 **PATRICK J. O'GRADY AND**
16 **LAUREL O'GRADY¹**

) Case Nos. 824057 and 848643

	<u>Years</u>	<u>Amounts at Issue</u>
Booth	2008	\$2,687.10
	2009	\$46,248.24
	2010	\$13,747.80
O'Grady	2008	\$2,379.10
	2009	\$34,438.23
	2010	\$13,531.24

22 Representing the Parties:

23 For Appellants: Gregory G. Wilson, Certified Public Accountant
24 For Franchise Tax Board: Samantha Q. Nguyen, Tax Counsel

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28 ¹ Mrs. Booth and Mr. O'Grady were previously married to each other but have since married other spouses. Both Mrs. Booth and Mr. O'Grady each owned 50 percent of O'Grady Meyers Inc. The interest in this appeal accrued in the proposed assessments that resulted from the sale of their stock in O'Grady Meyers Inc.

1 QUESTION: Whether appellants are entitled to interest abatement for the years at issue.

2
3 HEARING SUMMARY

4 Legal Background

5 Beginning in 1993, California provided tax incentives for investments in small
6 businesses by allowing individual taxpayers to exclude from their gross income any gain from the
7 sale or exchange of qualified small business stock (QSBS). R&TC section 18152.5 allowed an
8 individual taxpayer to exclude 50 percent of any gain from the sale or exchange of QSBS held for
9 more than five years from the date of its acquisition. (*Cf.* Int.Rev. Code, § 1202.) As relevant to this
10 appeal, the taxpayers were limited to a total aggregate gain exclusion of up to \$10 million from the
11 disposition of stock issued by the relevant corporation. (Rev. & Tax. Code, § 18152.5, subd.
12 (b)(1)(A).) For purposes of R&TC sections 18152.5, the term QSBS generally meant the stock of any
13 domestic C corporation with a specific maximum amount of gross assets (i.e., a small business) that
14 maintained at least 80 percent of its assets and payroll in California (hereinafter referred to as “the
15 California property and payroll requirements”). (Rev. & Tax. Code, § 18152.5, subds. (c)(2),
16 (d)(1)(C), (e)(1)(A).)

17 In 2012, the California Court of Appeal held in *Cutler v. Franchise Tax Board* (2012)
18 208 Cal.App.4th 1247, 1250 (*Cutler*), that R&TC section 18152.5 was discriminatory on its face and
19 violated the United States Constitution’s commerce clause, article I, section 8, clause 3, by
20 discriminating against interstate commerce. This case involved a taxpayer who claimed gain
21 deferrals based on the California QSBS statutes. The FTB disallowed the claimed gain deferrals and
22 assessed the taxpayer additional tax and imposed penalties plus interest. Following the protest and
23 appeal, the taxpayer paid the assessment in full for one of the tax years at issue and filed a refund
24 action in the Superior Court, arguing that the California property and payroll requirements were
25 unconstitutional. After the Superior Court ruled that the requirements for the QSBS exclusion were
26 not discriminatory, the taxpayer filed an appeal with the California Court of Appeal, which reversed
27 and ruled the requirements at issue were discriminatory, and therefore unconstitutional. The *Cutler*
28 opinion was filed on August 28, 2012.

1 The Franchise Tax Board addressed the *Cutler* decision by issuing FTB Notice 2012-
2 03 on December 21, 2012.² In FTB Notice 2012-03, the FTB notified the public that it would be
3 issuing assessments to taxpayers who claimed California QSBS benefits for tax years 2008 through
4 2012 and that it would be denying the claimed QSBS exclusions or deferrals. FTB Notice 2012-03
5 also stated that, if the statute of limitations was still open, the FTB would allow the QSBS benefits for
6 taxpayers who satisfy the requirements, other than the unconstitutional California property and
7 payroll requirement, for tax years beginning before January 1, 2008.³

8 The California Legislature responded to FTB Notice 2012-03 by passing Assembly Bill
9 (AB) 1412,⁴ which Governor Brown signed into law on October 4, 2013. This legislation effectively
10 repealed FTB Notice 2012-03 by allowing taxpayers to claim QSBS exclusions or deferrals by filing
11 amended returns for tax years 2008 through 2012 within the applicable statute of limitations and by
12 filing claims for refund for tax year 2008 by no later than June 30, 2014. AB 1412 thus allowed
13 taxpayers to exclude or defer their gain from the sale or exchange of QSBS for tax years 2008 through
14 2012. As relevant to this appeal, AB 1412 amended R&TC sections 18152.5 by removing the
15 unconstitutional California property requirement and by limiting the benefit of the QSBS rules to
16 five tax years (i.e., 2008, 2009, 2010, 2011, and 2012). Amended R&TC section 18152.5 became
17 effective on October 4, 2013, and is applicable to sales made and installment payments received on or
18 after January 1, 2008, and before January 1, 2013. (Rev. & Tax. Code, § 18152.5, subd. (m).) In
19 addition, AB 1412 added R&TC section 18153, which provides that penalties and interest shall not be
20 assessed with respect to additional tax incurred as a result of the amendments made to R&TC section
21 18152.5 by AB 1412. R&TC section 18153 is applicable to tax increases as a result of the amendments
22 for tax years beginning after 2007 and before 2013. (Rev. & Tax. Code, § 18153, subd. (b)(1).)

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26 ² FTB Notice 2012-03 can be found on the FTB's website (www.ftb.ca.gov).

27 ³ The *Cutler* decision and FTB Notice 2012-03 only affected California's QSBS provisions and have had no bearing on the
28 federal QSBS provisions under Internal Revenue Code (IRC) sections 1202 and 1045.

⁴ AB 1412 can be found at http://leginfo.Legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB1412.

1 Factual Background

2 The Booths

3 1) *2008 Tax Year*

4 Appellants, Curtice and Evelyn Booth, (hereafter, “the Booths”) timely filed their
5 California tax return for the 2008 tax year on April 15, 2009. They reported tax due of \$157,073⁵ and
6 remitted a payment for the balance due with their return. According to the Schedule D attached to
7 their federal tax return for the 2008 tax year, the Booths excluded capital gains from the installment
8 sale of their 125 shares of O’Grady Meyers Inc. stock (hereafter, “O’Grady Meyers Stock”) in the
9 amount of \$2,988,083.⁶ (ROB, pp. 1-2, Exhs. A & B.)

10 As a result of the *Cutler* decision, respondent informed the Booths in a letter dated
11 January 16, 2013, that the QSBS transaction reported on their 2008 California tax return was invalid.
12 Respondent also informed the Booths that it was issuing a Notice of Proposed Assessment (NPA)
13 denying the reported gain exclusion on their 2008 tax return and that interest would accrue until the
14 additional tax was paid in full. (ROB, pp. 1-2, Exhs. A, B & C.)

15 Respondent subsequently requested, by a letter dated March 7, 2013, that the Booths
16 sign a QSBS limited issue waiver to extend the statute of limitations to December 31, 2013, to propose
17 an assessment of additional tax for the 2008 tax year. The Booths signed the limited waiver on
18 March 14, 2013. By letter dated May 29, 2013, respondent memorialized a May 21, 2013
19 conversation with the Booths regarding the reported QSBS and the excludable gain limitation.
20 Respondent informed the Booths that they exceeded the maximum lifetime exclusion of \$5 million for
21 the sale of QSBS with its sale of the O’Grady Meyers Stock and that no gain exclusion would be
22 allowed in future tax years. Respondent indicated that this position was the FTB’s secondary position
23 and that it would issue an NPA to disallow the gain exclusion of \$586,189 upon the completion of the
24 examination and prior to the extended statute of limitations of December 31, 2013. Respondent

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26 ⁵ The tax due amount includes an underpayment of estimated tax penalty of \$53.

27 ⁶ As discussed later, the Booths refer in their contentions to an audit by respondent of the O’Grady’s 2007 tax return during
28 2010 that resulted in a “no change” letter. The parties dispute whether that audit of the O’Grady’s 2007 tax return is
relevant to either Mrs. Booth or Mr. O’Grady for the tax years on appeal, which are 2008, 2009, and 2010. (ROB,
Exh. WW; Appeal Letters, Atths.)

1 further informed the Booths that the deferral of their case was continued pending a legislative
2 development on the *Cutler* decision and that interest continued to accrue until the additional tax was
3 paid. By letter dated July 26, 2013, respondent confirmed its July 23, 2013 telephone conversation
4 with the Booths, in which respondent stated that the Booths exceeded their QSBS sale exclusion in the
5 revised amount of \$404,773 based on information the Booths provided. Respondent explained that no
6 gain exclusion would be allowed in future tax years and maintained that this was respondent's
7 secondary position, the case was deferred pending the legislative development on the *Cutler* decision,
8 and that interest continued to accrue until the additional tax was paid. (ROB, p. 2, Exhs. D, E & F.)

9 As mentioned above, on October 4, 2013, AB 1412 was approved by the Governor of
10 California. AB 1412 retroactively allowed the QSBS deferral and 50 percent gain exclusion for tax
11 years 2008 through 2012. On November 5, 2013, respondent issued an NPA that disallowed the
12 portion of appellants' reported QSBS gain exclusion that exceeded the allowable amount (\$404,773)
13 for the 2008 tax year. This adjustment resulted in additional tax of \$18,216, plus applicable interest.⁷
14 Respondent received a payment of \$18,216 from the Booths for the 2008 tax year on December 23,
15 2013. The Booths then protested the NPA by a letter dated January 2, 2014, claiming that interest
16 should be abated based on the amendments made by AB 1412, R&TC sections 18152.5, subdivision
17 (m),⁸ 18153, subdivision (a), and 19104. Respondent acknowledged the Booths' protest and denied
18 the requested interest abatement by a letter dated March 13, 2014. (ROB, pp. 2-3, Exhs. G, H, I, J &
19 K.)

20 By a letter dated April 29, 2014, the Booths disagreed with respondent's determination
21 and further claimed that the 2008 tax year was previously audited in 2010. In support, the Booths
22 submitted copies of correspondence from the audit of the O'Gradys' 2007 tax return, which resulted in
23

24 ⁷ Interest was suspended from April 16, 2012 to November 19, 2013, under R&TC section 19116.

25 ⁸ R&TC section 18152.5, subdivision (m), provides:

26 The amendments made to this section by the act adding this subdivision shall apply to sales, including installment sales,
27 occurring in each taxable year beginning on or after January 1, 2008, and before January 1, 2013, and installment payments
28 received in taxable years beginning on or after January 1, 2008, for sales of qualified small business stock made in taxable
years beginning before January 1, 2013.

(Rev. & Tax. Code, § 18152.5, subd. (m).)

1 the issuance of a “no change” letter in May of 2010. The Booths maintained that respondent engaged
2 in an unreasonable delay in assessing additional tax. After a review, respondent issued a letter dated
3 May 8, 2014, in which respondent informed the Booths that the NPA was not issued as a result of the
4 amendments made to R&TC section 18152.5 by AB 1412. Respondent informed the Booths that the
5 NPA was based on the Booths’ reported QSBS gain exceeding the \$5 million gain exclusion
6 limitation. Respondent restated that interest may not be abated under R&TC sections 18152.5 and
7 18153, subdivision (b). Respondent further stated that its prior audit in February 2010 that resulted in
8 no change was only for the 2006 and 2007 tax years, and that the NPA for the 2008 tax year was
9 timely issued within the extended statute of limitations. Respondent issued a Notice of Action (NOA)
10 dated May 27, 2014, affirming its NPA. The Booths filed this timely appeal. (ROB, p. 3, Exhs. L &
11 M; Appeal Letter, Atth.)

12 *2) 2009 and 2010 Tax Years*

13 The Booths timely filed their tax return for the 2009 tax year, in which they reported an
14 overpayment of \$23,649. The Booths requested that the overpayment be applied to the 2010 estimated
15 tax. On the Schedule D of the Booth’s federal return for the 2009 tax year, the Booths reported an
16 exclusion of capital gain from the installment sale of their 125 shares of the O’Grady Meyers stock in
17 the amount of \$2,963,327. (ROB, pp. 3-4, Exh. N)

18 The Booths also timely filed their tax return for the 2010 tax year, in which they
19 reported tax due of \$21,274.⁹ The Booths remitted a payment for the balance due with their return.
20 On the Schedule D of their federal return for the 2010 tax year, the Booths reported an exclusion of
21 capital gain from the installment sale of their 125 shares of the O’Grady Meyers stock in the amount
22 of \$1,235,057. (ROB, p. 4, Exhs. O & P.)

23 On June 15, 2011, respondent received an amended tax return for the 2009 tax year.
24 The Booths reported additional dividend income of \$23,435 that was not reported on the original
25 return and reported additional tax due of \$1,933. Upon processing, respondent issued a Return
26 Information Notice (RIN) because the amount of the refund reported on the return did not equal the
27

28 ⁹ The tax due included an underpayment of estimated tax penalty of \$142.

1 original return refund, and the Booths paid the corrected balance due of \$3,770 in full. (ROB, p. 4,
2 Exhs. Q, R & S.)

3 After a review, respondent issued NPAs for the 2009 and 2010 tax years dated
4 February 13, 2014, disallowing the claimed QSBS exclusions in their entirety for each tax year as a
5 result of the audit of the 2008 tax year when respondent determined that there was no available
6 exclusion for the years after 2008. These adjustments resulted in additional tax of \$281,713 for the
7 2009 tax year and additional tax of \$115,993 for the 2010 tax year, plus applicable interest.¹⁰ The
8 Booths protested the NPAs for the 2009 and 2010 tax years by a letter dated April 11, 2013. They
9 provided a schedule of the recalculation of the QSBS exclusion for the 2006 through 2010 tax years,
10 including federal Schedule D instructions to support the calculations. The Booths further stated that
11 interest should be abated under AB 1412 and R&TC sections 18153, subdivision (a), and 19104.
12 (ROB, p. 4, Exhs. T, U & V.)

13 Respondent acknowledged the Booth's protest for the 2009 and 2010 tax years by a
14 letter dated July 22, 2014. Respondent stated that the Booths' calculations were incorrect and that the
15 request for interest abatement was denied. Respondent further explained that the FTB was not
16 required to open an examination if return information is unavailable. Respondent stated that a review
17 of the audit files indicated that the audits for the 2006 and 2007 tax years were opened on February 12,
18 2010, and during that time, tax year information for 2008 was not available to the auditor due to
19 processing procedures and because the Booths' 2009 tax return had not yet been filed. Respondent
20 also stated that the Booths did not satisfy the requirements for the doctrine of equitable estoppel to
21 allow interest abatement. (ROB, p. 5, Exh. W.)

22 The Booths responded by a letter dated August 19, 2014, arguing that interest should be
23 abated under R&TC sections 18152.5, subdivision (m), and 18153. The Booths further argued that
24 respondent should have been aware that the Booths exceeded their QSBS exclusion amount at the time
25 of the audit of the 2006 and 2007 tax years in early 2010 because the return information was available
26 for the 2008 and 2009 tax years. The Booths contended that this amounted to a delay by the FTB
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28 ¹⁰ Interest was suspended from April 16, 2013 to February 11, 2014 under R&TC section 19116.

1 manager and entitled the Booths to interest abatement. The Booths further stated that respondent
2 should be estopped from assessing interest. After a review, respondent issued a letter dated October 1,
3 2014, denying interest abatement on the basis that R&TC sections 18152.5, subdivision (m), and
4 18153 did not apply because the NPAs were issued as a result of the Booths exceeding the amount of
5 the eligible gain. Respondent also stated that its records do not show that the Booths were audited for
6 the 2006 and 2007 tax years and respondent informed the Booths that no future exclusions would be
7 allowed for tax years after 2008, by a letter dated July 26, 2013. Respondent further stated that it used
8 its discretionary authority to hold off issuing the NPAs pending the passing of AB 1412, which is not a
9 managerial act. Respondent also stated that the Booths did not meet the requirements for equitable
10 estoppel to apply. Respondent issued NOAs, affirming the NPAs for the 2009 and 2010 tax year. The
11 Booths then filed this appeal.¹¹ (ROB, p. 5, Exhs. X & Y; Appeal Letter, Atths.)

12 The O’Gradys

13 *1) 2008 Tax Year*

14 Appellants, Patrick and Laurel O’Grady, (hereafter “the O’Gradys”), timely filed their
15 California tax returns for the 2008 tax year and reported tax due of \$159,481. The O’Gradys remitted
16 a payment for the balance due with their return. According to the federal Schedule D for the 2008 tax
17 year, the O’Gradys excluded capital gains from the installment sale of their 125 shares of
18 O’Grady Meyers stock in the amount of \$2,988,083. (ROB, p. 6, Exhs. AA & BB.)

19 On May 15, 2009, the O’Gradys filed an amended tax return for the 2008 tax year, in
20 which they reported charitable contribution deductions of \$1,316.00, resulting in a refund of \$476.84.
21 Respondent accepted the amended return as filed and issued a refund to the O’Gradys on July 14,
22 2009.¹² (ROB, p. 6, Exhs. CC & EE.)

23 Respondent subsequently initiated an audit of the O’Gradys’ 2008 tax return by a letter
24

25 ¹¹ Respondent received a payment of \$133,000 from the Booths on December 31, 2014, for the 2009 tax year. Respondent
26 indicated that this payment is currently being held in suspense pending the outcome of this appeal. (ROB, p. 5, Exh. Z.)

27 ¹² Respondent began an audit of the O’Gradys’ 2007 tax return on February 24, 2010. Respondent issued an Information
28 Document Request (IDR) dated March 11, 2010 requesting additional information as to whether the claimed corporation
satisfied the requirements to be a qualified small business. The audit resulted in a “no change” letter issued by respondent
on May 25, 2010. (ROB, Exh. WW, Appeal Letters, Atths.)

1 dated January 29, 2013. In that letter, respondent informed the O'Gradys that respondent relied on an
2 audit of prior years that determined that the stock sold qualified as QSBS and identified that the
3 O'Gradys excluded gain in excess of the \$5 million statutory limitation. Respondent also informed the
4 O'Gradys of the *Cutler* decision and, as a result of the *Cutler* decision and FTB Notice 2012-03, the
5 QSBS transaction reported on their 2008 tax return was invalid. Respondent also informed the
6 O'Gradys that respondent would issue an NPA denying the reported gain exclusion on the 2008 tax
7 return and that interest would continue to accrue until the additional tax is paid in full. By letter dated
8 March 4, 2013, respondent requested that the O'Gradys sign a waiver to extend the statute of
9 limitations to December 31, 2013, for proposing a deficiency assessment for the 2008 tax year. The
10 O'Gradys signed the waiver on March 10, 2013. (ROB, p. 6, Exh. FF & GG.)

11 Respondent received a payment of \$18,311 from the O'Gradys on December 16, 2013,
12 for the 2008 tax year. Respondent issued an NPA for the 2008 tax year dated December 19, 2013,
13 disallowing the excess gain exclusion of \$404,773. The adjustment resulted in a proposed assessment
14 of \$18,311 in additional tax, plus applicable interest. The O'Gradys timely protested the NPA in a
15 letter dated February 12, 2014, in which they agreed with the additional tax, but protested the interest,
16 making the same arguments made by the Booths in their protest of the 2008 tax year. (ROB, p. 6,
17 Exh. HH, II & JJ.)

18 Respondent acknowledged the O'Gradys' protest by a letter dated August 14, 2014, and
19 stated that interest may not be abated because: (1) the 2008 tax deficiency was due to exceeding the
20 gain exclusion, and not due to amendments made to the QSBS statutes; (2) there was no ministerial or
21 managerial error or delay by an FTB employee; and (3) equitable estoppel did not apply. Appellants
22 replied by a letter dated August 22, 2014, in which they maintained that interest should be abated
23 based on their prior contentions. Respondent issued a Notice of Determination Not to Abate Interest
24 dated October 15, 2014, for the 2008 tax year. Respondent stated that: (1) interest may not be abated
25 under R&TC section 18153 because that provision only applies to additional tax determined as a result
26 of AB 1412 which was not the case in the present matter; (2) there was no unreasonable error or delay
27 by respondent; and (3) equitable estoppel did not apply. The O'Gradys then filed this timely appeal.
28 (ROB, pp. 6-7, Exhs. KK, LL; Appeal Letter, Atths.)

1 2) *2009 and 2010 Tax Years*

2 The O'Gradys timely filed their 2009 tax return. They reported an overpayment of
3 \$17,326 which they requested to be applied to their 2010 estimated tax. According to the federal
4 Schedule D for the 2009 tax year, the O'Gradys reported an exclusion of capital gain from the
5 installment sale of their 125 shares of O'Grady Meyers stock of \$3,010,128.¹³ (ROB, p. 7, Exh. MM.)

6 The O'Gradys timely filed their 2010 tax return. They reported an overpayment of
7 \$19,251, which they requested to be applied to their 2011 estimated tax. According to the federal
8 Schedule D for the 2010 tax year, the O'Gradys reported an exclusion of capital gain from the
9 installment sale of their 125 shares of O'Grady Meyers stock of \$1,235,058. (ROB, p. 7, Exh. NN.)

10 By letter dated July 26, 2013, respondent informed the O'Gradys that their 2009 and
11 2010 tax returns had been selected for audit and that, based on respondent's review, respondent
12 proposed to disallow the gain exclusion because the aggregate exclusion exceeded the \$5 million
13 limitation in 2008 and subsequent years. Respondent later issued NPAs for the 2009 and 2010 tax
14 years dated January 28, 2014, disallowing the claimed QSBS exclusions for each year as the QSBS
15 gain exclusion was exceeded in the 2008 tax year when it was determined that there was no exclusions
16 available for the years after 2008. These adjustments resulted in additional tax of \$258,900 for the
17 2009 tax year and additional tax of \$116,605 for the 2010 tax year, plus applicable interest. (ROB,
18 p. 8, Exhs. OO, PP & QQ.)

19 The O'Gradys protested the NPAs for the 2009 and 2010 tax years and provided a
20 schedule which showed their recalculation of the QSBS exclusion for the 2006 through 2010 tax years,
21 including federal Schedule D instructions to support the calculations. The O'Gradys also claimed that
22 interest should be abated under AB 1412, R&TC section 19104, and the doctrine of equitable estoppel.
23 Respondent acknowledged the protest by letter dated August 5, 2014, and requested that the O'Gradys
24 provide any additional information they wanted respondent to consider. In response, the O'Gradys
25 sent a letter to respondent dated August 22, 2014, in which they reiterated the same arguments as in
26 their protest. (ROB, p. 8, Exhs. RR, SS & LL.)

27 _____
28 ¹³ As noted previously, respondent audited the O'Gradys' 2007 tax return early in 2010. (ROB, Exh. WW, Appeal Letters, Atths.)

1 Respondent issued a letter to the O’Gradys dated September 2, 2014, explaining that
2 the O’Gradys’ method of calculating their exclusion was incorrect and that the O’Gradys did not meet
3 the requirements for interest abatement. Respondent issued NOAs affirming the NPAs for the 2009
4 and 2010 tax years dated September 17, 2014. The O’Gradys then filed these timely appeals.¹⁴ (ROB,
5 p. 8, Exh. TT; Appeal Letter, Atths.)

6 Contentions

7 Appellants’ Contentions

8 Both the Booths and the O’Gradys (hereafter, “appellants”) make the same contentions
9 on appeal. Appellants state that the Booths and the O’Gradys each owned 50 percent of the
10 outstanding O’Grady Meyers stock. Appellants state that they both entered into an agreement to sell
11 all of their shares to Meredith Corporation in April 2006 and the sales agreement provided for
12 installment sales for the period 2006 through 2010. Appellants state that the Booths received the
13 following installment payments: \$1,986,750 in 2006; \$2,846,630 in 2007; \$5,976,166 in 2008;
14 \$5,926,654 in 2009; and \$2,470,115 in 2010. Appellants also state that the O’Gradys received the
15 following installment payments: \$1,986,750 in 2006; \$2,846,630 in 2007; \$5,976,166 in 2008;
16 \$6,020,256 in 2009; and \$2,470,115 in 2010. Appellants state that the O’Gradys received a letter from
17 the FTB in February 2010 requesting documentation regarding their eligibility for the QSBS exclusion
18 of the O’Grady Meyers stock. Appellants emphasize that all of their returns for the 2006, 2007, 2008,
19 and 2009 tax years had been timely filed prior to the audit of the O’Gradys, which was conducted on
20 May 13, 2010. In support, appellants provide an affidavit dated August 18, 2014, from their
21 representative, Mr. Gregory Wilson. Appellants assert that the FTB was provided with the
22 information requested in the May 13, 2010 meeting and resulted in a “no change” determination on
23 May 25, 2010 for the O’Gradys’ 2007 tax return. Appellants contend that the O’Gradys and the
24 Booths had no reason to believe that, after the examination of the O’Gradys’ 2007 tax return, there
25 was any additional tax due from both the Booths and the O’Gradys for any of the years already filed
26 (i.e., 2006, 2007, 2008, 2009, and 2010). (Appeal Letters, pp. 1-2, Atths.)

27
28 ¹⁴ Respondent received a payment of \$155,000 from the O’Gradys on December 31, 2014, for the 2009 tax year.
Respondent indicates that this payment is being held in suspense pending the outcome of this appeal.

1 1) *R&TC section 18153*

2 Appellants contend that they are entitled to interest abatement pursuant to R&TC
3 section 18153 as enacted by AB 1412. Appellants contend that AB 1412 made statutory changes to
4 R&TC section 18152.5, including subdivision (m) of that provision. Appellants contend that
5 subdivision (m) of R&TC section 18152.5 is clearly a new paragraph added by the amendments to
6 R&TC section 18152.5. Appellants note that AB 1412 added R&TC section 18153 which provides
7 that no interest or penalty shall apply for a year in the case of an additional tax liability and that a
8 payment plan not to exceed five years is permitted. Appellants contend that, since R&TC section
9 18152.5 applied to them and resulted in an additional tax liability to them for the years at issue, R&TC
10 section 18153 applies to them. Appellants contend that the new law in R&TC section 18153,
11 subdivision (a)(3), that permits “additional tax” to be repaid over five years anticipated that some tax
12 will be owed by taxpayers resulting from the QSBS adjustments made by the FTB. Appellants
13 contend that the adjustments for the years at issue are solely the result of the QSBS installment sale
14 that began in an earlier year (2006) and continued through the years at issue. Accordingly, appellants
15 contend that R&TC section 18153, subdivision (b)(1), applies to appellants such that they are entitled
16 to the interest and penalty waiver pursuant to R&TC section 18153, subdivision (a). (Appeal Letters,
17 pp. 3, 5-6.)

18 In their reply brief, appellants contend that a plain English reading of subdivision (m)
19 of R&TC section 18152.5 shows that the amendments to R&TC section 18152.5 apply to installment
20 sales. Appellants contend that they and respondent agree that appellants received installment
21 payments in 2008, 2009, and 2010. Appellants argue that a literal reading of subdivision (m) of
22 R&TC section 18152.5 results in appellants qualifying for relief from interest pursuant to R&TC
23 section 18153 as enacted by AB 1412. Appellants maintain that R&TC section 18153, subdivision
24 (b), provides that “additional tax” is a tax resulting from an “amendment” to R&TC section 18152.5
25 and argues that subdivision (m) is such an amendment. Appellants note that it is undisputed that
26 appellants disposed of QSBS in an installment sale spanning 2006 through 2010 and are subject to the
27 QSBS provisions provided in R&TC section 18152.5. Appellants contend that their position is
28 supported by the Legislative Counsel’s Digest of AB 1412 which states that the bill would provide that

1 penalties shall not be imposed with respect to “the additional tax, as defined” and interest shall not
2 accrue with respect to the additional tax of that taxpayer due for the taxable year. Appellants further
3 contend that the purpose of AB 1412 is supported in Section 4 of AB 1412 which provides that, in
4 light of the retroactive application of the amendments made to R&TC section 18152.5, the Legislature
5 intends to serve a public purpose by providing equitable tax treatment and fair tax relief to taxpayers
6 that are stimulating the economy of California. Appellants contend that the legislative intent as
7 demonstrated in the Legislative Counsel’s Digest does not limit relief, as respondent suggests, to those
8 taxpayers that would have qualified for gain exclusion under the former QSBS statute by the *Cutler*
9 decision. Appellants further dispute respondent’s position that appellants did not satisfy the
10 requirements of R&TC section 18152.5 before and after the change in the law. Appellants contend
11 that respondent is “unequivocally incorrect” as appellants demonstrated to respondent that the QSBS
12 requirements were satisfied and point to the May 2010 audit that resulted in a “no change”
13 determination in support. (ARB, pp. 1-2; ROB, Exh. G.)

14 In their supplemental brief, appellants dispute respondent’s characterization that it is
15 appellants’ duty to pay interest. Appellants contend that R&TC section 18153 does not state
16 affirmatively or imply that appellants have a duty to pay interest. Appellants contend that, to the
17 contrary, the amendments to R&TC sections 18153 and 18152.5 added paragraphs to the law related to
18 QSBS, including subdivision (m) of R&TC section 18152.5. Appellants maintain that they fall within
19 subdivision (m) of R&TC section 18152.5 as they received installment payments for the 2006 through
20 2010 tax years from the sale of QSBS. (ASB, p. 1.)

21 Appellants further contend that subdivision (m) of R&TC section 18152.5 does not
22 specifically identify itself as a substantive or operative provision of the QSBS statutes. As such,
23 appellants argue that it only matters for administration of the law that appellants received QSBS
24 installment payments as defined in R&TC section 18152.5, subdivision (m). Appellants assert that
25 respondent’s argument as to whether it is an operative or substantive provision is not relevant and,
26 further, respondent has not cited any authority for its position. (ASB, p. 2.)

27 As for respondent’s contentions regarding the intent of AB 1412, appellants contend
28 that respondent’s position ignores the fourth paragraph in the Legislative Counsel’s Digest wherein

1 any mention of the *Cutler* decision is absent. Appellants contend that, in absence of a clear and
2 convincing record of legislative intent, the text of the law, as amended by AB 1412, applies.
3 Appellants contend that they clearly satisfy the definition of Section 4 of AB 1412 which reads
4 “taxpayers that are stimulating the economy of the state.” Appellants contend that the amendments
5 were not exclusive to taxpayers affected by the *Cutler* decision because the statute itself does not limit
6 the application of the amendment solely to taxpayers affected by the *Cutler* decision. As for
7 respondent’s contention that to allow interest abatement to appellants in these appeals would not serve
8 the stated public purpose, appellants contend that they are loyal, respectful California residents that
9 built a successful corporation and employed many Californian employees. Appellants contend that
10 they have, and continue to, stimulate the economy in California. (ASB, p. 2.)

11 2) *R&TC section 19104*

12 Alternatively, appellants contend that interest should be abated pursuant to R&TC
13 section 19104. Appellants contend that the return information was available to the auditor for the
14 2008 and 2009 tax years at the time of a prior audit in early 2010. As such, appellants contend that the
15 disclosures on those returns indicated that the installment sale resulted in payments exceeding
16 \$10 million in eligible gain. Appellants contend that respondent should have been aware that
17 appellants exceeded their QSBS exclusion amount at that time, which amounts to a delay by the FTB
18 manager and entitling appellants to interest abatement and for respondent to be estopped from
19 assessing interest. Appellants further contend that the FTB supervisor’s review of the auditor’s
20 findings demonstrates that the supervisor may not have fully addressed the eligibility limits issue even
21 though, as appellants assert, it was specifically indicated as an issue in the Information Document
22 Requested (IDR) dated March 11, 2010, at the time of the audit. Appellants contend that the
23 connection between 2007 and the subsequent years were “all too real” and the FTB audit concluded a
24 “no change” result. Appellants contend that an adequate review to detect cumulative exclusions
25 claimed by the taxpayers could have been performed within 30 days following the May 25, 2010
26 letter. Appellants contend that this was a managerial act by the FTB that resulted in the significant
27 accrual of interest from which appellants are entitled to claim interest abatement, citing *Lee v. Comm’r*
28 (1999) 113 T.C. 145. (Appeal Letters, pp. 4-5, Atths.)

1 Appellants note that R&TC section 19104, subdivision (a)(1), and Internal Revenue
2 Code (IRC) section 6404(e) provide for the administrative abatement of interest on a deficiency or
3 related to a proposed deficiency as a result of an unreasonable period of delay in the act of determining
4 a tax. Appellants note that they filed all of the tax returns at issue on time. Appellants contend that
5 the delay in the assessment of additional tax resulted in interest for the 2008, 2009, and 2010 tax years.
6 Appellants contend that the delay of more than 2.75 years was due to a managerial or ministerial act
7 performed by respondent in a dilatory manner related to personnel management. Appellants contend
8 that no significant aspect of the delay was attributable to the taxpayers and that the delay occurred
9 after respondent contacted the taxpayers, in writing, with respect to an audit of QSBS eligibility and
10 applicable exclusions and indicated that a supervisory review of the audit would be conducted.
11 Appellants contend that, if they had known that an additional tax was due as a result of exceeding the
12 QSBS exclusion limit, the interest on the unpaid tax would have been substantially less. Appellants
13 contend that interest should be abated due to the delay caused by the “no change” audit performed in
14 May 2010 for the 2007 tax year and because the FTB failed to notify appellants of any deficiency for
15 the tax years at issue as those tax returns had been filed by the time the audit was closed. Appellants
16 contend that, since there was no new law or facts for these years, the FTB did not have to conduct a
17 new audit of the 2008, 2009, and 2010 tax years to inform the taxpayers that the exclusion was
18 exceeded. (Appeal Letters, p. 6.)

19 In their reply brief, appellants contend that respondent abused its discretion based on
20 the auditor ignoring the facts and circumstances surrounding the QSBS claimed in the 2007 audit that
21 gave rise to the increased tax and interest for the 2008 and 2009 tax years. Appellants contend that
22 respondent knew that Evelyn Booth was a 50 percent shareholder that reported QSBS exclusions.
23 Appellants contend that the connection between these facts should not have been ignored by
24 respondent and the managers conducting the May 13, 2010 audit of O’Grady Meyers, Inc.,
25 Evelyn Booth, and Patrick O’Grady. With regard to respondent’s reliance on the *Appeal of*
26 *Royal Crown Cola Co.*, 74-SBE-047, decided by the Board on November 12, 1974, and other
27 authorities, appellants contend that these authorities do not apply to the present appeals because those
28 authorities dealt with respondent’s discretion in applying an apportionment formula in a unitary

1 business audit. (ARB, p. 3.)

2 Appellant further disagrees with respondent's position that the audit of O'Grady's 2007
3 tax year should be limited to the O'Gradys. Appellants contend that the auditor issued an IDR in the
4 May 11, 2010 audit which indicated that the limits for the QSBS exclusion were issues in the
5 examination. Appellants contend that their representative, Mr. Wilson, met with the auditor on
6 May 13, 2010 and they provided information to the auditor showing the stock ownership records for
7 both appellants. Appellants contend that the auditor was very aware that Mrs. Booth similarly claimed
8 gain exclusions under QSBS law. Appellants asserts that, at the May 13, 2010 audit, the auditor knew
9 that: (1) Mr. O'Grady and Mrs. Booth previously were married; (2) Mrs. Booth claimed similar QSBS
10 gain exclusions as Mr. O'Grady as she was the other 50 percent shareholder of O'Grady Meyers, Inc.;
11 (3) both Mr. O'Grady and Mrs. Booth later married other individuals and both Mr. O'Grady and
12 Mrs. Booth each qualified for the QSBS gain exclusion; and (4) the auditor was also auditing
13 Mrs. Booth's QSBS gain exclusion and limits in the same context of Mr. O'Grady's audit. Appellants
14 also contend that the auditor was informed by Mr. Wilson of other facts relevant to the installment
15 sale, including the sales agreement of the stock that provided for payments up to a maximum of
16 \$74,300,000, and copies of the California tax returns for O'Grady Meyers, Inc. which showed
17 Mrs. Booth's 50 percent stock ownership. Appellants assert that there was no reason for appellants
18 not to believe that Mrs. Booth was similarly examined. Appellants contend that, while Mrs. Booth did
19 not receive a specific examination letter from respondent, all of the facts and circumstances in the
20 audit of the O'Gradys applied to the Booths. (ARB, pp. 3-4, Exhs. 1, 2 & 3; ROB, Exh. JJ.)

21 Appellants also dispute respondent's reliance on the *Appeal of Duane H. Laude*,
22 76-SBE-096, decided by the Board on October 6, 1976 (*Laude Appeal*) and other authorities.
23 Appellants further contend that the *Laude Appeal* involved different facts and circumstances regarding
24 residency in two appeal years. Appellants contend that the *Laude Appeal* is not similar to the present
25 appeals as the facts and circumstances in the present appeals are the same for each appellant.
26 Appellants contend that the other authorities cited by respondent, *Burnett v. Sanford & Brooks Co.*
27 (1931) 282 U.S. 359 and *Commissioner v. Sunnen* (1948) 333 U.S. 591, are also not applicable to the
28 present appeals for these same reasons. (ARB, p. 4.)

1 Appellants further dispute respondent's position that the act of examining exclusion
2 limitations was a different application of the tax law than what was applied in the audit. Appellants
3 contend that the law was the same and that the auditor's examination and the supervisory review
4 focused on a gross installment stock sale transaction of a maximum of \$74,300,000. Appellants
5 maintain that the connection between the audit year and the years at issue in these appeals were too
6 strong to separate into individual years. Appellants also reiterate the same arguments claiming that the
7 FTB supervisor missed the exclusion issue within the audit as evidence that there was an error or delay
8 made by respondent that resulted in the significant accrual of interest. Appellants assert that interest
9 for the 2008 tax year should be limited to the period, April 15, 2009 to May 31, 2010, appellants state
10 that interest for the 2009 tax year should be limited to the period, April 15, 2010 to May 31, 2010, and
11 that interest from June 1, 2010 through the current date should be abated due to respondent's delay.
12 (ARB, p. 5.)

13 In their supplemental brief, appellants maintain that respondent abused its discretion in
14 denying interest abatement. With regard to California Code of Regulations, title 18 (Regulation)
15 19032 cited by respondent, appellants note that Regulation 19032, subdivision (a)(4)(B), provides that
16 respondent has the duty to "take into account the materiality of an issue being audited as defined in
17 subsection (a)(7) of this regulation." Appellants further note that Regulation 19032, subdivision
18 (a)(4)(B)(2), states that respondent's staff shall request for issues under examination information of
19 relevance, germane or applicable to the audit issue. Appellants note that Regulation 19032,
20 subdivision (a)(4)(E), provides that respondent has a duty to apply relevant statutes and regulations in
21 a consistent manner regardless of whether the determination of the correct amount of tax results in a
22 proposed assessment or proposed overpayment. Appellants further note that subdivision (b)(5)(C) of
23 the regulation provides that audits may be subject to an additional review by respondent to ensure that
24 the audit recommendations are consistent with respondent's policies, practices, and procedures and
25 that a complete review and notices are supposed to be concluded within 90 days of the close of the
26 audit. Appellants contend that these authorities support appellants' position that respondent did not
27 follow its audit procedures during the May 13, 2010 audit. Appellants contend that respondent's audit
28 staff and supervisors failed to audit the most material aspect of the QSBS limits and exclusions which

1 was the primary purpose of the May 13, 2010 audit. (ASB, p. 3.)

2 Appellants further cite to the FTB Form 860, Manual of Audit Procedures (MAP) for
3 support. Appellants contend that MAP is relevant as to respondent's audit procedures and protocol.
4 Appellants note that paragraph 1.7 of MAP provides that established audit standards and resource
5 considerations govern how the procedures and techniques are used and in the manner which they are
6 applied. Appellants note that paragraph 5.1 of MAP provides that the pre-audit phase includes
7 requesting relevant returns and evaluating the impact to future tax years. Appellants note that
8 paragraph 5.1.4 of MAP provides that an auditor may need to request other tax returns to complete the
9 scope of the audit including the taxpayers' most current tax returns and prior tax returns. Appellants
10 further note that paragraph 6.6.2 of MAP provides guidelines for the auditor to discuss with the
11 taxpayer, including addressing questions a taxpayer has regarding the materiality of an issue that is the
12 subject of the IDR. (ASB, p. 3, Exh. 4.)

13 Appellants contend that Regulation 19032 and the cited MAP provisions support a
14 finding that the auditor had all of the relevant information at the May 13, 2010 meeting to conclude
15 that the 2008 and 2009 tax years could be impacted by the QSBS rules that limit exclusions to
16 \$5 million. Appellants contend that the auditor should have followed the protocol provided in MAP
17 paragraphs 5.1 and 5.1.4 in establishing limits for QSBS for the 2008 and 2009 tax years. Appellants
18 further contend that "materiality" is defined as "having some logical connection to a fact of
19 consequence to the outcome of a case." Appellants contend that respondent's auditor clearly
20 understood the materiality of the QSBS gain and limits as that was the purpose for the audit.
21 Appellants contend that the auditor was provided with the 2008 and 2009 tax returns and the sales
22 agreement indicating the materiality of the evidence and the QSBS limits reported for 2006, 2007,
23 2008, and 2009. Appellants assert that "materiality" questions and disclosures made by appellants
24 regarding this continuing installment sale with QSBS limits were not addressed by the auditor or the
25 supervisor. (ASB, p. 4.)

26 Appellants further contend that respondent's reliance on *Krugman v. Comm'r* (1999)
27 112 T.C. 230 is unsupported because the facts in the present appeals differ from that case. Appellants
28 contend that their returns were not late, in contrast to the taxpayer in *Krugman v. Comm'r, supra*,

1 112 T.C. 230. Appellants contend that they provided all of the information requested by respondent's
2 auditor in the audit that began with a first written contact in the IDR dated March 11, 2010. With
3 regard to respondent's reliance on *Burnett v. Sanford & Brooks Co.*, *supra*, 282 U.S. 359, appellants
4 contend that the facts in the present appeals differ from that case. Appellants contend that *Burnett v.*
5 *Sanford & Brooks Co.*, *supra*, 282 U.S. 359, involved taxpayers that had different facts and
6 circumstances in the years at issue. Appellants contend that, in contrast, appellants have the same
7 facts and circumstances in the year audited as in the years at issue in these appeals. Appellants
8 contend that they did not attempt to hide any facts from the auditor and provided evidence and
9 documents requested by the auditor, such as the sales agreement and the tax returns for the 2008 and
10 2009 tax year. Appellants further contend that they were told by the auditor to not amend the 2009
11 and 2010 tax returns. Appellants contend that respondent's auditor in the later tax years knew of
12 appellants' position that R&TC section 18153 relief was a position that appellants had taken and that
13 the previous examinations of the QSBS issues had been conducted on May 13, 2010. (ASB, pp. 4-5.)

14 3) *Equitable Estoppel*

15 Lastly, appellants contend that the doctrine of equitable estoppel applies to these
16 appeals such that respondent is estopped from assessing interest. Appellants contend that the FTB
17 should have known at the time of the earlier audit of the 2007 tax year that appellants exceeded the
18 maximum gain exclusion. Appellants contend that, contrary to respondent's position that there was no
19 false representation of material facts made by the FTB, the FTB's IDR stated that the FTB would
20 examine the "limits" for gain exclusion and a supervisor for the FTB indicated that the audit would be
21 reviewed and the taxpayers would be notified accordingly. Appellants contend that there was no
22 subsequent notification from the FTB until respondent issued the NPAs for the tax years at issue.
23 Appellants contend that respondent benefited from this action to the detriment of the taxpayers, as
24 respondent caused a delay, by acting in a dilatory manner in the performance of a managerial or
25 ministerial act, resulting in significantly large amounts of interest charged to the taxpayers. (Appeal
26 Letters, pp. 6-7.)

27 In their reply brief, appellants disagree with respondent's position that respondent was
28 not advised of the facts prior to the examination of the 2008 tax year for each appellant. Appellants

1 contend that they advised respondent of the facts in the May 13, 2010 audit. Appellants contend that
2 respondent was informed of the materially large installment sale of the stock transaction of a
3 maximum of \$74,300,000, with payments made in 2006 through 2010. Appellants contend that
4 respondent had access to appellants' timely-filed tax returns for the 2008 and 2009 tax years.
5 Appellants contend that they reported the amounts of the installment payments on the returns and this
6 information was available to respondent's auditor prior to the close of the audit on May 25, 2010.
7 Appellants contend that they had a right to believe that the result for the 2008 and 2009 tax years at the
8 time of the audit would have no difference to appellants for 2008 and 2009 because respondent knew
9 that the installment sale covered the 2008, 2009, and 2010 years as well as the 2006 and 2007 tax
10 years. As such, appellants disagree with respondent's contention that there could be no reasonable
11 reliance on respondent's "no change" audit determination in May of 2010 by appellants. (ARB, p. 6,
12 Exh. 2.)

13 Appellants further contend that they were ignorant of the fact that the cumulative
14 exclusion limits resulting from the installment sale were exceeded in 2008, 2009, and 2010.
15 Appellants contend that they were ignorant of the true fact that the QSBS limits were exceeded
16 because the cumulative limits as presented on respondent's forms for installment sales did not provide
17 a method for tracking QSBS exclusions previously claimed. With regard to detrimental reliance,
18 appellants contend that they had no reason to believe that there would be additional tax owed in 2008,
19 2009, and 2010. Appellants contend that appellants would have had the same increased tax in 2008
20 and 2009 due to respondent's auditor's inaction on May 13, 2010. As such, appellants maintain that
21 equitable estoppel should apply for the 2008, 2009, and 2010 tax years to prevent respondent from
22 charging interest for these years. (ARB, pp. 6-7.)

23 In their supplemental brief, appellants contend that respondent ignores the facts and
24 circumstances in 2010 that appellants provided all of the information relating to the installment sale on
25 May 13, 2010 and the tax returns for 2008 and 2009 had been filed and were available to the auditor
26 on May 13, 2010. As such, appellants contend that respondent was advised of the facts. As to
27 respondent's contention that appellants were aware of the QSBS exclusion limit having been
28 exceeded, appellants contend that this statement is "blatantly false and highly speculative." Appellants

1 cite respondent's "lack of civil decorum" and assert that the May 13, 2010 audit was respondent's
2 "audit project" to audit all taxpayers claiming QSBS exclusions, including the QSBS limits, and their
3 qualification under the QSBS law. Appellants assert that respondent would have been more
4 knowledgeable about the law and facts after conducting the May 13, 2010 audit. As such, appellants
5 contend that respondent's statement that appellants were the most knowledgeable about the excessive
6 QSBS exclusions taken is inaccurate and unfair. Appellants assert that they have satisfied the
7 equitable estoppel conditions such that respondent is estopped from charging interest for the 2008 and
8 2009 tax years. As to respondent's contention that "there is no showing of 'manifest injustice,'" appellants
9 contend that manifest injustice is demonstrated by charging interest on appellants. Appellants contend that it is grossly unfair to charge interest when respondent audited appellants
10 regarding QSBS and respondent should have known that appellants exceeded the QSBS exclusion as
11 respondent had all the information available to it at the time of the May 2010 audit. (ASB, pp. 5-6.)

12
13 Respondent's Contentions

14 *1) R&TC section 18153*

15 Respondent contends that appellants misapply R&TC section 18153 which was enacted
16 by AB 1412. Respondent contends that the interest abatement relief provided by R&TC section 18153
17 is limited to the additional tax attributable to the amendments made to R&TC section 18152.5 by
18 AB 1412. Respondent contends that AB 1412 amended R&TC section 18152.5 to remove
19 requirements found unconstitutional by the court. Respondent emphasizes that AB 1412 did not repeal
20 and re-enact R&TC section 18152.5, but amended that provision as stated in the text of the bill. With
21 regard to appellants' reliance on subdivision (m) of R&TC section 18152.5, respondent contends that
22 this provision merely sets forth the operative date rules for the amendments enacted by AB 1412.
23 Respondent contends that the rule specifies that the amendments apply to certain tax years and not
24 others, and so the addition of subdivision (m) does not lead to "additional tax" as set forth in R&TC
25 section 18153. Respondent contends that appellants' argument fails based on the literal application of
26 R&TC sections 18152.5 and 18153. (ROB, p. 9.)

27 Respondent also contends that appellants' argument fails for policy reasons and
28 appellants' interpretation is contrary to legislative intent. Respondent contends that appellants'

1 position is that any application of the amended R&TC section 18152.5, including the unamended
2 portions of that provision, that leads to increases in tax for the 2008 through 2013 tax years are not
3 subject to interest and penalties. Respondent contends that this is contrary to the Legislature's intent
4 of providing relief to those who would have qualified for gain exclusion under the former QSBS
5 statute but for the *Cutler* decision. Respondent contends that it is uncontroverted that appellants failed
6 the gain exclusion requirements for QSBS because they exceeded the lifetime gain exclusion limit of
7 \$5 million. Respondent notes that the maximum gain exclusion limit was not amended under AB
8 1412 and, thus, R&TC section 18153 does not apply to the proposed tax assessments. Respondent
9 contends that appellants failed the requirements under R&TC section 18152.5 before and after the
10 enactment of AB 1412. Respondent contends that the Legislature did not intend to absolve taxpayers
11 of their obligation to pay interest and penalties for failing the unamended QSBS requirements under
12 R&TC section 18152.5. (ROB, p. 10.)

13 Respondent contends that, for appellants to benefit from R&TC section 18153,
14 appellants must have been subject to a tax increase attributable to an amendment of R&TC section
15 18152.5 by AB 1412. Respondent disputes appellants' position that R&TC section 18152.5,
16 subdivision (m), as the amendment that gave rise to their increase in tax. Respondent contends that
17 subdivision (m) of R&TC section 18152.5 sets forth the operative rule of the statute, the dates the
18 amendments begin to operate and cease to operate. Respondent contends that this provision is not a
19 substantive amendment of the statute. Respondent further contends that, as a result, R&TC section
20 18152.5, subdivision (m), should not be considered an amendment for R&TC section 18153 purposes.
21 (RRB, pp. 1-2.)

22 Respondent further contends that, even if subdivision (m) of R&TC section 18152.5 is
23 considered an amendment of the statute, it does not give rise to any increase in tax. Respondent
24 contends that, to qualify for R&TC section 18153 relief, the increase in tax must arise out of a specific
25 amendment of section 18152.5. Respondent contends that subdivision (m) of R&TC section 18152.5
26 does not contain any substantive elements and, thus, does not give rise to any increase in tax.
27 Respondent also contends that appellants' additional tax is not attributable to any amendments enacted
28 by AB 1412. Respondent contends that appellants' additional tax is attributable to subdivision (b) of

1 R&TC section 18152.5 which limits the amount of gain that may be deferred. Respondent contends
2 that this subdivision was not amended by AB 1412. Respondent notes that appellants were subject to
3 an increase in tax before and after the enactment of AB 1412 under subdivision (b) of R&TC section
4 18152.5. Respondent contends that, as such, appellants misapply the statute in that they seek to apply
5 R&TC section 18153 to the unamended portions of R&TC section 18152.5, which is contrary to the
6 plain language of R&TC section 18153. (RRB, p. 2.)

7 With regard to appellants' assertion that their position is consistent with legislative
8 intent, respondent contends that the Legislature intended to limit the provision of relief to penalties
9 and interest attributable to the "additional tax, as defined." Respondent maintains that appellants do
10 not qualify based on the definition of "additional tax" and therefore, do not fall within the limitation
11 set by the Legislature. As to appellant's contention that the Legislature intended to further the public
12 purpose of providing equitable tax treatment and fair tax relief, respondent contends that excusing
13 appellants from paying the penalties and interest at issue in this appeal would not further this stated
14 purpose. Respondent contends that appellants had an increased tax liability because they exceeded the
15 gain limitation of R&TC section 18152.5, which was not amended by AB 1412. Respondent contends
16 that abating the penalties and interest would not further the stated purpose because appellants'
17 liabilities were not affected by AB 1412. (RRB, pp. 2-3.)

18 With regard to appellants' citations to show that the Legislature did not intend to limit
19 the relief to those affected by the *Cutler* decision, respondent points to the Senate Rules Committee's
20 Third Reading of AB 1412 which states that AB 1412 would require the FTB to waive all penalties
21 and interest for taxes assessed and authorizes a taxpayer to enter into a written installment payment
22 agreement with the FTB for the payment of any taxes due, as a result of the *Cutler* decision, for each
23 taxable year beginning on or after January 1, 2008, and before January 1, 2013. Respondent contends
24 that this document indicates that the intent of the Legislature was to provide relief for those affected by
25 the *Cutler* decision. Respondent argues that appellants' additional tax liabilities were not affected by
26 the *Cutler* decision because that decision and subsequent amendments to R&TC section 18152.5 did
27 not change the amount of gain a taxpayer could exclude. (RRB, pp. 2-3, Exh. YY.)

28 ///

1 2) *R&TC section 19104*

2 Respondent contends that appellants have not shown that respondent abused its
3 discretion in denying interest abatement pursuant to R&TC section 19104. Respondent contends that
4 taxes are due and payable as of the original due date of the tax return without regard to an extension
5 and, if the tax is not paid timely, R&TC section 19101 provides for the charging of interest on the
6 resulting balance due, compounded daily. Respondent notes that the Board has held that the
7 imposition of interest is mandatory and interest may not be abated except where authorized by law.
8 (ROB, p. 10.)

9 Respondent contends that R&TC section 19104, subdivision (a), provides that
10 respondent may exercise its discretion to abate interest for unreasonable delays or errors in the
11 performance of a ministerial or managerial act by an FTB officer or employee. Respondent notes that
12 the Board has jurisdiction to determine whether the FTB's failure to abate interest under this section
13 was an abuse of discretion pursuant to subdivision (b)(2)(B) of R&TC section 19104. Respondent
14 contends that an abuse of discretion occurs where an agency action is unconstitutional, contrary to law,
15 illegal, or beyond the power granted to the agency, citing *Cooper v. State Board of Medical Examiners*
16 (1950) 35 Cal.2d 242. Respondent contends that there is no abuse of discretion where the finding has
17 a "sufficient factual basis," citing *McDonough v. Goodcell* (1939) 13 Cal.2d 741. Respondent
18 contends that, as respondent has discretionary authority, the taxpayers' burden of proof to show an
19 abuse of discretion is by a clear and convincing evidence standard rather than the lesser standard of a
20 mere preponderance of the evidence, citing the *Appeal of Royal Crown Cola Co., supra*, and other
21 authorities. (ROB, p. 11.)

22 Respondent contends that appellants' argument that respondent's auditor engaged in an
23 unreasonable delay when he failed to examine the 2008, 2009, and 2010 tax years during an
24 examination of the O'Gradys' 2007 tax year fails for multiple reasons. Respondent contends that the
25 examination for the 2007 tax year is only relevant to the O'Gradys because respondent's records do
26 not show that respondent examined the Booths' 2007 tax year. Respondent contends that no implied
27 determination can be made from respondent's actions regarding the O'Gradys to the Booths.
28 Respondent further contends that its records show that the examination of the O'Gradys' 2007 tax year

1 was opened on February 24, 2010, and during this time information for the 2008 tax year was not
2 available to the auditor due to processing procedures. Respondent further contends that the 2009 tax
3 returns were not filed until April 15, 2010, and the 2010 tax year had not even ended at that time. As
4 such, respondent contends that it is not reasonable to believe that an audit of the O’Grady’s 2007 tax
5 return which was opened on February 25, 2010 and completed on May 25, 2010 could have included
6 an audit of the O’Gradys’ 2009 or 2010 tax returns or the Booths’ 2008, 2009, and 2010 tax returns.
7 (ROB, p. 12, Exh. WW.)

8 Respondent further contends that appellants’ returns were subject to audit as long as the
9 statute of limitations was opened. Respondent contends that the timeliness of the issuance of an NPA
10 does not give rise to interest abatement, citing *Charles A. Nerad v. Comm’r*, T.C. Memo. 1999-376,
11 and other authorities. Respondent contends that appellants agreed to extend the statute of limitations
12 for the 2008 tax year to December 31, 2013, in accordance with R&TC section 19057. Respondent
13 contends that, as the NPAs for the 2008 tax year were issued to the Booths and the O’Gradys on
14 November 5, 2013 and December 19, 2013, respectively, the NPAs were timely. In addition,
15 respondent notes that the general statute of limitations for the 2009 and 2010 tax year expired on
16 April 15, 2014 and April 15, 2015, respectively. Respondent notes that the NPAs for the 2009 and
17 2010 tax years were issued to the Booths on February 13, 2014, which were timely. Respondent also
18 notes that the NPAs for the 2009 and 2010 tax years were timely issued to the O’Gradys on
19 January 28, 2014. As such, respondent contends that no interest may be abated for any alleged delay
20 in the issuance of assessments that were issued within the relevant statute of limitations. (ROB, p. 12,
21 Exhs. VV, D, GG, H, II, T, U, PP & QQ.)

22 With regard to appellants’ contention that they relied on the May 25, 2010
23 determination letter and the March 11, 2010 IDR (both documents issued only to the O’Gradys for the
24 2007 tax year) in believing that their reporting of the gain exclusion was correct, respondent contends
25 that a determination of “no change” for the O’Gradys’ 2007 tax year does not translate to a “no
26 change” determination for any other tax year for the O’Gradys or for any tax year for the Booths.
27 Respondent contends that appellants fail to recognize that no express or implied determinations as to
28 later years are made by respondent’s determination not to assess additional tax for the 2007 tax

1 returns, citing the *Appeal of Duane H. Laude, supra*. Respondent contends that each tax year stands
2 alone, and must be examined separately, citing *Burnett v. Sanford & Brooks Co., supra*, 282 U.S. at
3 365-366, and other authorities. (ROB, pp. 12-13.)

4 Respondent further contends that the issue of the statutory limitation for gain exclusion
5 was not an issue examined by the auditor during the examination of the O'Grady's 2007 tax year.
6 Respondent contends that the IDR dated March 11, 2010 clearly indicates that the only issue examined
7 was whether the long-term capital gain qualified for the 50 percent exclusion as QSBS under R&TC
8 section 18152.5. Respondent asserts that, based on the audit file for the O'Gradys' 2007 tax year,
9 there is nothing to support that the auditor knew of any potential QSBS exclusion that would exceed
10 the \$5 million threshold and there is nothing in the audit to support that the O'Gradys offered any
11 information to the auditor to put the auditor on notice of this fact. Respondent also contends that the
12 act of a supervisor examining whether appellants had exceeded the exclusion limitation directly
13 involves the application of tax law and, contrary to appellants' claims, is not a managerial or
14 ministerial error or delay which could be used for interest abatement relief under R&TC section
15 19104. (ROB, pp. 13.)

16 Respondent further contends that no interest may be abated for the period that accrued
17 prior to respondent contacting appellants concerning a deficiency for the tax years at issue.
18 Respondent contends that its first written contacts with appellants for the 2008, 2009, and 2010 tax
19 years were in 2013. As such, any interest that resulted from an alleged delay in 2010 may not be
20 abated prior to the first contact in 2013. With regard to the Booths, respondent notes that the first
21 written contact for the 2008 tax year was respondent's letter dated May 29, 2013, in which respondent
22 informed the Booths of the exceeded exclusion amount. Respondent notes that this letter also serves
23 as the first written contact regarding the deficiency for the 2009 and 2010 tax years because it
24 informed the Booths that no exclusion would be allowed for years after 2008. As such, respondent
25 contends that it does not have the discretion to abate any interest accrued prior May 29, 2013 for all
26 three years at issue for the Booths. With regard to the O'Gradys, respondent notes that the first written
27 contact for the 2008 tax year was the January 29, 2013 letter, in which respondent informed the
28 O'Gradys that they exceeded the exclusion limitation for the 2008 tax year. Respondent contends that,

1 for 2009 and 2010, the first written contact was respondent's letter dated July 26, 2013, in which
2 respondent informed the O'Gradys that their 2009 and 2010 tax returns were selected for examination
3 and discussed the disallowance of the gain exclusion. As such, respondent contends that it does not
4 have the discretion to abate any interest accrued prior to January 29, 2013 for the 2008 tax year or
5 prior to July 26, 2013 for the 2009 and 2010 tax years. (ROB, pp. 13-14, Exhs. E, FF & OO.)

6 Respondent notes that, in their reply brief, appellants appear to limit the interest
7 abatement argument under R&TC section 19104 to the 2008 and 2009 tax years. Respondent notes
8 that appellants appear to contend that respondent abused its discretion by not abating interest for the
9 period, June 1, 2010 through the current date, for each of these two tax years. Respondent contends
10 that appellants' arguments relating to when the NPAs for the 2008 and 2009 tax years were issued do
11 not establish a basis for interest abatement as these NPAs were issued within an open statute of
12 limitations. (RRB, pp. 3-4.)

13 With respect to appellants' contention that respondent should have begun the audit of
14 the 2008 and 2009 returns when it examined the O'Gradys' 2007 tax return, respondent contends that
15 appellants cite no authority for this position. Respondent contends that there was no error or delay in
16 the audit process for the appeal years. Respondent contends that there is no requirement as to when
17 respondent audits a return other than the applicable statute of limitations. Respondent argues that the
18 fact that respondent audited the O'Grady's 2007 tax return and issued a "no change" letter at the
19 conclusion of that audit does not require or create an expectation that the same auditor would also
20 examine the O'Grady's or the Booths' tax returns for other tax years. Respondent further contends
21 that courts have held that a decision by the Internal Revenue Service to audit and the timing of the
22 audit cannot be attacked by IRC section 6404(e), the federal counterpart to R&TC section 19104,
23 subdivision (b)(1). Respondent contends that IRC section 6404(e) applies only after the Internal
24 Revenue Service (IRS) contacts a taxpayer in writing about a deficiency or payment of tax, citing
25 *Krugman v. Comm'r, supra*, 112 T.C. at 239, House Report 99-426, at 844 (1985), 1986-3 C.B.
26 (Vol. 2) 1, 844, and Senate Report 99-313, at 208 (1986), 1986-3 C.B. (Vol. 3.) 1, 208. Respondent
27 contends that these authorities are consistent with R&TC section 19104, subdivision(b)(1), which
28 provides that interest may not be abated for the period of time between the date the taxpayer files a

1 return and the date the FTB begins an audit. (RRB, pp. 4-6.)

2 Respondent further contends that appellants' argument, that the auditor had a duty to
3 look at all future years of a transaction, is not supported by law. Respondent contends that its audit
4 procedures are outlined in Regulation 19032, and respondent is not required to examine multiple years
5 during an audit on a single-year audit. Respondent further contends that each tax year stands on its
6 own and must be examined separately, citing the United States Supreme Court's decision in *Burnett v.*
7 *Sanford & Brooks Co., supra*, 282 U.S. at 365-366. (RRB, p. 6.)

8 Respondent also contends that, pursuant to R&TC section 19104, appellants must show
9 that no significant aspect of the alleged error or delay can be attributable to appellants in order for
10 appellants to be entitled to interest abatement. Respondent contends that appellants' own statements
11 indicate that, during the audit of the O'Gradys' 2007 tax return, both appellants were aware of the
12 problems with their 2008 and 2009 tax returns and they should have submitted amended returns in
13 2010. Respondent contends that the respective examinations of both appellants' 2008 tax returns put
14 appellants on notice of the need to amend their 2009 and 2010 tax returns. Respondent contends that
15 the Booths were informed by the auditor involved in the 2008 tax year audit that no qualified QSBS
16 gain exclusion would be allowed for future years on May 29, 2013, and again on July 26, 2013.
17 Respondent notes that it issued its NPA to the Booths for the 2008 tax year on November 5, 2013,
18 about five months after notification. Respondent notes that it issued its NPA to the Booths for the
19 2009 and 2010 tax years on February 13, 2014, about eight months after notification. Respondent
20 contends that the O'Gradys were informed by the auditor involved in their 2008 tax year audit that the
21 O'Gradys exceeded their gain exclusion limitation in 2008 on January 29, 2013. Respondent notes
22 that it issued its NPA to the O'Gradys for the 2008 tax year on December 19, 2013, about 10 months
23 after notification. Respondent notes that it issued its NPA to the O'Gradys for the 2009 and 2009 tax
24 years on January 28, 2014, about five months after notification. Respondent contends that, even after
25 appellants were put on notice, neither appellants filed amended returns for the 2009 and 2010 tax
26 years, and thereby contributing to the additional interest assessed for those years. Respondent argues
27 that appellants could have limited the accrued interest by timely filing amended returns for the 2009
28 and 2010 tax years after they were informed that no future gain exclusions would be allowed. (RRB,

1 p. 7; ROB, Exhs. H, T, U, II, PP & QQ.)

2 3) *Equitable Estoppel*

3 Respondent contends that appellants have not satisfied the requirements for
4 equitable estoppel. Respondent contends that appellants' failure to show that: (1) the FTB was
5 advised of the facts; (2) respondent intended its conduct to be acted upon by appellants, or in such a
6 way that appellants had a right to believe it was so intended; (3) appellants were ignorant of the true
7 facts; and (4) there was detrimental reliance by the appellants. Respondent contends that it was not
8 advised of the facts prior to the examination of the 2008 tax year for appellants. Respondent notes that
9 respondent did not examine, and appellants did not provide, any information to cause respondent to
10 examine whether appellants exceeded the gain exclusion limitation during the examination of the 2007
11 tax year for the O'Gradys. Respondent further contends that at no point during the examination of the
12 O'Gradys' 2007 tax year did respondent give appellants reason to believe that their 2008, 2009, and
13 2010 tax years were also being examined and that no additional tax would be assessed for those years.
14 Respondent contends that, on the contrary, the May 25, 2010 determination letter to the O'Gradys
15 clearly indicated that the determination only applied to the O'Gradys for the 2007 tax year.
16 Respondent further contends that appellants could not have been ignorant of the fact that they
17 exceeded their exclusion limitation because they were advised of this fact prior to the NPAs being
18 issued. Respondent contends that detrimental reliance only exists where the FTB's action results in an
19 increased tax liability of the taxpayer. Respondent contends that, if the taxpayer would have the same
20 liability regardless of the alleged action of the FTB, then equitable estoppel does not apply.
21 Respondent contends that there is no detriment to the taxpayer if the alleged reliance is unreasonable.
22 Respondent asserts that it is simply not reasonable to believe that a determination not to assess
23 additional taxes for the 2007 tax year extends to the 2008, 2009, and 2010 tax years. Respondent
24 further contends that there was no express or implied determinations as to the later years made by
25 respondent's not assessing additional tax for an earlier return. (ROB, pp. 14-15.)

26 With regard to appellants' argument that respondent should have identified the errors
27 on their 2008, 2009, and 2010 tax returns in 2010 when the audit of the O'Gradys 2007 tax return was
28 performed, respondent contends that appellants would have been most knowledgeable of the excessive

1 QSBS exclusions taken on their returns for the appeal years. Respondent maintains that the audit of
2 the O'Gradys' 2007 tax return was limited to whether the stock sold qualified as small business stock
3 under R&TC section 18152.5, subdivision (c). Respondent contends that, if appellants allege that, at
4 that time, while respondent audited a limited issue, respondent should have known of the excessive
5 QSBS exclusions taken on their 2008, 2009, and 2010 tax returns when the amount of the claimed
6 exclusions were not at issue, then appellants would have most assuredly been aware of their errors and
7 yet failed to file amended returns at that time. Respondent further contends that there has been no
8 showing of a "manifest injustice" in charging interest in these appeals. (RRB, pp. 7-8; ROB, Exh. L.)

9 Applicable Law

10 Burden of Proof

11 Respondent's determination is presumed correct and the taxpayer has the burden of
12 proving the determination to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of*
13 *Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Unsupported assertions are not sufficient to satisfy
14 an appellant's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

15 Qualified Small Business Stock Exclusion

16 R&TC section 18152.5 allows qualified taxpayers to exclude from gross income a
17 portion of the gain resulting from the sale of qualified small business stock held by a taxpayer for more
18 than five years. As relevant to this appeal, R&TC section 18152.5, subdivision (b)(1), provides that the
19 aggregate amount of the eligible gain from dispositions of stock issued by the corporation for the
20 taxable year shall not exceed the greater of (A) \$10 million reduced by the aggregate amount of eligible
21 gain taken into account by the taxpayer under subdivision (a) for prior taxable years and attributable to
22 dispositions of stock issued by the corporation; or (B) ten times the aggregate adjusted bases of QSBS
23 issued by the corporation and disposed of by the taxpayer during the taxable year.

24 R&TC section 18152.5, subdivision (c), lists the requirements for stock to qualify as
25 QSBS. As stated above, prior to the *Cutler* decision, the term QSBS generally meant the stock of any
26 domestic C corporation with a specific maximum amount of gross assets (i.e., a small business) that
27 maintained at least 80 percent of its assets and payroll in California. (Rev. & Tax. Code, § 18152.5,
28 subs. (c)(2), (d)(1)(C), and (e)(1)(A).) The Legislature enacted AB 1412 which, as previously

1 stated, amended 18152.5 by removing the requirements that had been ruled unconstitutional and by
2 limiting the benefit of the QSBS rules to five tax years (i.e., 2008, 2009, 2010, 2011, and 2012).
3 (Rev. & Tax. Code, § 18152.5, subds. (c)(2) and (e)(1)(A).)

4 R&TC section 18152.5, subdivision (m) provides:

5 The amendments made to this section by the act adding this subdivision shall apply to
6 sales, including installment sales, occurring in each taxable year beginning on or after
7 January 1, 2008, and before January 1, 2013, and installment payments received in
8 taxable years beginning on or after January 1, 2008, for sales of qualified small business
9 stock made in taxable years beginning before January 1, 2013.

9 (Rev. & Tax. Code, § 18152.5, subd. (m).)

10 R&TC section 18153

11 R&TC section 18153, subdivision (a)(1), provides that interest shall not accrue with
12 respect to the “additional tax” due for the taxable year. R&TC section 18153, subdivision (b), provides
13 that the term “additional tax” means:

14 (1) The increase in tax for a taxable year beginning on or after January 1, 2008, and
15 before January 1, 2013, to the extent that the increase is attributable to the amendments
16 made to Section 18152.5 by the act adding this section.

17 (2) If Section 18152.5, as amended by the act adding this section, is for any reason held
18 invalid, ineffective, or unconstitutional by an appellate court of competent jurisdiction,
19 the term “additional tax” means the increase in tax for a taxable year beginning on or
20 after January 1, 2008, and before January 1, 2013, to the extent that the increase is
21 attributable to the implementation of the appellate court holding invalidating Section
22 18152.5, as amended by the act adding this section, coupled with the implementation of
23 the decision of the California Court of Appeal, Frank Cutler v. Franchise Tax Board,
24 (2012) 208 Cal.App.4th 1247, as announced in Franchise Tax Board Notice 2012-03,
25 dated December 21, 2012.

26 (Rev. & Tax. Code, § 18153, subds. (b)(1) and (2).)

27 Legislative Counsel Digest for AB 1412

28 As relevant to this appeal, the Digest states that AB 1412 is an act to amend and repeal
R&TC section 18152.5, and to add and repeal R&TC section 18153. The bill would allow taxpayers to
exclude certain gain from the sale of QSBS, as defined, held for more than five years, for the taxable
years beginning on or after January 1, 2008 and before January 1, 2013. The bill would provide that a

1 penalty shall not be imposed with respect to the additional tax, as defined, of a taxpayer, and interest
2 shall not accrue with respect to the additional tax of that taxpayer due for the taxable year. The bill also
3 makes a legislative finding and declaration regarding the public purpose served by the bill. Specifically,
4 Section 4 of AB 1412 provides:

5 The Legislature finds and declares that the retroactive application of the amendments
6 made to Section 18152.5 of the Revenue and Taxation Code and the addition of Section
7 18153 to the Revenue and Taxation Code by this act serve a public purpose by providing
8 equitable tax treatment and fair tax relief to taxpayers that are stimulating the economy of
9 the state and do not constitute a gift of public funds within the meaning of Section 6 of
10 Article XVI of the California Constitution.

11 (ROB, Exh. G.)

12 Senate Rules Committee Third Reading of AB 1412

13 According to this document, AB 1412 reenacts the QSBS exclusion for taxable years
14 beginning on or after January 1, 2008 and before January 1, 2013. The bill requires the FTB to waive
15 all penalties and interest for taxes assessed and authorizes taxpayers to enter into written installment
16 payment agreements with the FTB for payment of “any taxes due, as a result of the decision of Cutler
17 v. FTB” for the applicable taxable years. (RRB, Exh. YY.)

18 Statutory Construction

19 Exclusions from income must be narrowly construed. (*Commissioner v. Schleier* (1995)
20 515 U.S. 323, 328 (superseded on other grounds); *United States v. Centennial Sav. Bank FSB* (1991)
21 499 U.S. 573, 583; *Commissioner v. Jacobson* (1949) 336 U.S. 28, 49.) In construing a statute, a court
22 must ascertain the intent of the Legislature so as to effectuate the purpose of the law. To determine
23 legislative intent, the first step is to look to the words of the statute. (*Ordlock v. Franchise Tax Bd.*
24 (2006) 38 Cal.4th 897, 909 – 910 (*Ordlock*); *Lennane v. Franchise Tax Bd.* (1994) 9 Cal.4th 263, 268
25 (*Lennane*); *Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 737 (*Lungren*)). The words of the statute are
26 given their ordinary meaning but are considered in the context of the relevant statutory scheme.
27 (*Ordlock, supra*, 38 Cal.4th at pp. 909 – 910 [citing *Lungren, supra*, at p. 735].) “If the statutory
28 language is clear and unambiguous, then we need go no further.” (*Hoechst Celanese Corp. v.*
Franchise Tax Bd. (2001) 25 Cal.4th 508, 557 [citing *Lungren, supra*, at p. 735]; see also *Lennane*,

1 *supra*, 9 Cal.4th at p. 268.) In determining a statute’s meaning, “courts should, if possible, accord
2 meaning to every word and phrase in a statute so as to better effectuate the Legislature’s intent.”
3 (*Ste. Marie v. Riverside County Regional Park & Open-Space District* (2009) 46 Cal.4th 282, 289
4 (citations omitted).)

5 When the language of a statute “is susceptible of more than one reasonable
6 interpretation,” the California courts consider “a variety of extrinsic aids, including the ostensible
7 objects to be achieved, the evils to be remedied, the legislative history, public policy, contemporaneous
8 administrative construction, and the statutory scheme of which the statute is a part.” (*Eel River
9 Disposal & Resource Recovery, Inc. v. County of Humboldt* (2013) 221 Cal.App.4th 209, 227 (citations
10 omitted).) The California courts should “select the construction that comports most closely with the
11 apparent intent of the Legislature, with a view toward promoting rather than defeating the general
12 purpose of the statute, and avoid an interpretation that would lead to absurd consequences.” (*Id.*
13 (citations omitted).)

14 Interest Abatement

15 R&TC section 19101, subdivision (a), provides that, if any amount of tax imposed is not
16 paid on or before the last date prescribed for payment, interest on that amount shall be paid for the
17 period from that last date to the date paid. Interest is not a penalty but is merely compensation for the
18 taxpayer’s use of the money. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of
19 Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) To obtain interest abatement, an appellant must
20 qualify under one of the following three statutes: R&TC sections 19104, 19112, or 21012.¹⁵

21 Under R&TC section 19104, subdivision (a)(1), respondent may abate all or a part of
22 any interest on a deficiency to the extent that interest is attributable in whole or in part to any
23 unreasonable error or delay committed by respondent in the performance of a ministerial or managerial
24 act. (Rev. & Tax. Code, § 19104, subd. (a)(1).) An error or delay can only be considered when no
25

26 ¹⁵ It does not appear that R&TC section 21012 is applicable because there has been no reliance on any written advice
27 requested of respondent. Under R&TC section 19112, interest may be waived for any period for which respondent
28 determines that an individual or fiduciary demonstrates an inability to pay that interest solely because of an extreme
financial hardship caused by a significant disability or other catastrophic circumstance. It appears that this statute does
not provide any authority for the Board to review the FTB’s determination whether to abate interest for an extreme
financial hardship.

1 significant aspect of the error or delay is attributable to an appellant and after respondent has contacted
2 the appellant in writing with respect to the deficiency or payment. (Rev. & Tax. Code, § 19104,
3 subd. (b)(1); *Appeal of Ernest J. Teichert*, 99-SBE-006, Sept. 29, 1999.) There is no reasonable cause
4 exception to the imposition of interest. (*Appeal of Audrey C. Jaegle*, *supra*.)

5 In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29,
6 1999, the Board adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a
7 “ministerial act” as:

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

12 When a California statute is substantially identical to a federal statute (such as with the interest
13 abatement statute in this case),¹⁶ the Board may consider federal law interpreting the federal statute as
14 highly persuasive. (*Appeal of Michael and Sonia Kishner*, *supra*, (citing *Douglas v. State of California*
15 (1942) 48 Cal.App.2d 835.) In this regard, Treasury Regulation section 301.6404-2(b)(1) defines a
16 “managerial act” as:

17 [A]n administrative act that occurs during the processing of a taxpayer’s case involving
18 the temporary or permanent loss of records or the exercise of judgment or discretion
19 relating to management of personnel. A decision concerning the proper application of
20 federal tax law (or other federal or state law) is not a managerial act. Further, a general
21 administrative decision, such as the IRS's decision on how to organize the processing of
22 tax returns or its delay in implementing an improved computer system, is not a
23 managerial act for which interest can be abated

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

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

¹⁶ R&TC section 19104, subdivisions (a) and (b)(2)(B), are substantially identical to IRC sections 6404 (e) and (h).

1 (Treas. Reg., § 301.6404-2(c), example 3.) (See also, e.g., Treas. Reg., § 301.6404-2(c), examples 4,
2 5, 6, & 10.) In addition, the Tax Court has held that the decision to examine, or not to examine, a
3 taxpayer's income tax return for a particular taxable year involves the exercise of judgment and
4 discretion and, therefore, is not a ministerial act. (*Pettyjohn v. Comm'r*, T.C. Memo. 2001-227.)

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

16 Equitable Estoppel

17 A government agency may be estopped from asserting a tax liability against taxpayers
18 when the taxpayers relied on erroneous advice from the agency to their harm or detriment. (See
19 *Appeal of Jerold E. Wheat*, 83-SBE-150, June 21, 1983.) However, equitable estoppel is applied
20 against the government only in rare and unusual circumstances and when its application is necessary to
21 prevent manifest injustice. (See *Appeal of Richard R. and Diane K. Smith*, 91-SBE-005, Oct. 9, 1991.)
22 The burden of proving estoppel is on the party asserting estoppel. (*Appeal of Priscilla L. Campbell*,
23 79-SBE-035, Feb. 8, 1979.)

24 The four elements of equitable estoppel are: (1) the government agency must be shown
25 to have been aware of the actual facts; (2) the government agency must be shown to have made an
26 incorrect or inaccurate representation to the relying party and intended that its incorrect or inaccurate
27 representation would be acted upon by the relying party or acted in such a way that the relying party
28 had a right to believe that the representation was so intended; (3) the relying party must be shown to

1 have been ignorant of the actual facts; and (4) the relying party must be shown to have detrimentally
2 relied upon the representations or conduct of the government agency. (*Appeal of Western Colorprint*,
3 78-SBE-071, Aug. 15, 1978.) Where one of these elements is missing, there can be no estoppel.
4 (*Hersch v. Citizens Savings & Loan Assn.* (1983) 146 Cal.App.3d 1002, 1011.) Detrimental reliance is
5 present only if, as a result of respondent's omission, the taxpayer takes action which leads to an
6 increased tax liability. (*Appeal of Robert C. and Betty L. Lopert*, 82-SBE-011, Jan. 5, 1982; *Appeal of*
7 *Priscilla L. Campbell, supra.*) Reliance on an informal opinion of an FTB employee is not a sufficient
8 basis to create estoppel against the FTB. (*Appeal of Western Colorprint, supra*; *Appeal of Richard W.*
9 *and Ellen Campbell*, 75-SBE-049, Aug. 19, 1975.)

10 Equitable estoppel cannot apply unless the party asserting estoppel shows, among other
11 things, that it was ignorant of the true facts and relied on the representations of the government agency.
12 (*Appeal of Western Colorprint, supra*; *Strong v. County of Santa Cruz* (1975) 15 Cal. 3d 720; *Appeal of*
13 *Priscilla L. Campbell, supra.*) In order to assert estoppel against the government, a party must show
14 affirmative misconduct going beyond negligence and amounting to "ongoing active
15 misrepresentations" or a "pervasive pattern of false promises." (*S & M Investment Co. v. Tahoe*
16 *Regional Planning Agency* (9th Cir. 1990) 911 F.2d 324, 329; *Purcell v. United States* (9th Cir. 1993)
17 1 F.3d 932, 939.) "The doctrine of equitable estoppel does not erase the duty of due care and therefore
18 is unavailable for the protection of one who has suffered loss because of his own failure to act or
19 inquire." (*Hampton v. Paramount Pictures Corp.* (9th Cir. 1960) 279 F.2d 100, 104.)

20 R&TC section 19801 provides that ". . . neither the [FTB] nor any officer or agency
21 having any administrative duties under this part [Administration of Franchise and Income Tax Laws
22 and Regulations] nor any court is bound by the determination of any other officer or administrative
23 agency of the state." With regard to income tax liabilities, the rule of res judicata is applicable only if
24 the liability involved is for the same year as was involved in another case previously determined.
25 (Rev. and Tax. Code, § 19802, subd. (a).) The Board decides appeals for each year ". . . wholly on
26 their own merits, without regard to any express or implied determination by respondent with respect to
27 other years." (*Appeal of Duane H. Laude, supra*, 76-SBE-096.)

28 In *McCoy v. Comm'r*, T.C. Memo. 2008-91, the Tax Court held that, where the IRS

1 issues a closing notice with regard to a specific year, the closing notice cannot be the basis for
2 equitable estoppel to prevent the IRS from issuing deficiencies for years not referenced in the closing
3 notice. Even if the IRS has erroneously accepted a taxpayer's position in audits of prior years, it "is
4 not precluded from correcting that error in a subsequent year." (*Hawkins v. Comm'r* (8th Cir. 1983)
5 713 F.2d 347, 352-353 [citing additional authorities] (*Hawkins*).

6 STAFF COMMENTS

7 Respondent's proposed assessments for the 2008, 2009, and 2010 tax years for each
8 appellant are based on the determination that appellants exceeded the gain exclusion provided in
9 subdivision (b) of R&TC section 18152.5. Appellants agree with the additional tax, but dispute the
10 accrued interest. R&TC section 19101, subdivision (a), provides that, if tax is not paid by the due date
11 of the tax return, interest shall accrue until the total tax is paid. Appellants contend that they are
12 entitled to interest abatement under R&TC sections 18153 and 19104, or alternatively, under the
13 doctrine of equitable estoppel. In their reply and supplemental briefs, appellants only discuss interest
14 abatement for the 2008 and 2009 tax years. Appellants will want to clarify whether they still seek
15 interest abatement for the 2010 tax year.

16 Interest Abatement Pursuant to R&TC section 18153

17 R&TC section 18153 provides, in part, that interest shall not be assessed with respect to
18 additional tax incurred as a result of the amendments made to R&TC section 18152.5 by AB 1412. The
19 parties dispute whether subdivision (m) of R&TC section 18152.5 is an amendment to R&TC section
20 18152.5 and whether appellants' additional tax is attributable to that subdivision. It appears to staff that
21 the additional tax at issue is the result of appellants exceeding the maximum amount of gain exclusion
22 provided in subdivision (b) of R&TC section 18152.5. The maximum gain exclusion limit provided by
23 R&TC section 18152.5, subdivision (b), was not amended by AB 1412. Appellants' additional tax due
24 as a result of exceeding the maximum gain exclusion did not change after the enactment of AB 1412
25 amending R&TC section 18152.5. In addition, the parties should be prepared to discuss whether
26 subdivision (m) of R&TC section 18152.5 merely sets forth the operative date rules for the
27 amendments enacted by AB 1412. It appears to staff that the Legislature intended to limit the
28 amendments apply to certain tax years and added subdivision (m) to R&TC section 18152.5 to that

1 effect. The parties should be prepared to discuss how, if at all, the application of subdivision (m) of
2 R&TC section 18152.5 results in additional tax.

3 Staff notes that, when the language of a statute is susceptible to more than one
4 reasonable interpretation, the Board may consider a variety of extrinsic aids in order to select the
5 interpretation that comports most closely to the apparent intent of the Legislature. (*Eel River Disposal*
6 *& Resource Recovery, Inc. v. County of Humboldt, supra*, 221 Cal.App.4th at 227.) In this regard, the
7 parties should be prepared to discuss the applicability of the Legislative Counsel's Digest for AB 1412
8 and the Senate Rules Committee's Third Reading of AB 1412. The parties should be prepared to
9 discuss whether the Legislature intended to absolve taxpayers of their obligation to pay interest and
10 penalties for failing to satisfy the unamended QSBS requirements under R&TC section 18152.5. In
11 addition, the parties should be prepared to discuss whether R&TC section 18153 relief is limited to
12 those taxpayers impacted by the *Cutler* decision.

13 Interest Abatement Pursuant to R&TC section 19104

14 Appellants appear to contend that respondent engaged in unreasonable delay when it
15 failed to examine the 2008, 2009, and 2010 tax years for both appellants during an examination of only
16 the O'Gradys' 2007 tax year since the facts and circumstances of the 2007 audit were the same for the
17 later years for both appellants. Respondent opened the audit of the O'Gradys on February 24, 2010.
18 (ROB, Exh. WW.)

19 In order to provide potential grounds for the abatement of interest, an alleged error or
20 delay must occur after respondent initially contacts the taxpayer regarding the deficiency. (Rev. & Tax.
21 Code, § 19104, subd. (b)(1); *Appeal of Ernest J. Teichert, supra*, 99-SBE-006.) Here, with respect to
22 the O'Gradys, respondent's first written contact with regard to the deficiencies was January 29, 2013
23 for the 2008 tax year, and July 26, 2013 for the 2009 and 2010 tax years. With respect the Booths,
24 respondent's first written contact about the deficiency occurred on May 29, 2013. Under the law, any
25 alleged errors or delay occurring prior to these dates cannot give rise to interest abatement. Therefore,
26 in order to potentially set forth a legal basis for interest abatement, appellants must identify an
27 unreasonable error or delay (in the performance of a ministerial or managerial act) that occurred after
28 these dates for these tax years.

1 Appellants contend that the first written contact from respondent for the tax years at
2 issue for both the Booths and the O'Gradys occurred on March 11, 2010, the date of the IDR
3 respondent issued to the O'Gradys in the audit of the 2007 tax return. However, R&TC section 19104,
4 subdivision (b)(1), refers to the first written contact regarding the proposed deficiency on which the
5 interest at issue accrued; it does not refer generally to any written contact with the taxpayer. The IDR
6 was specifically limited to the O'Gradys' 2007 tax year (which is not on appeal), and, further, the FTB
7 did not propose a deficiency for 2007. Therefore, it appears to staff that the FTB's IDR or other
8 correspondence with regard to the 2007 tax year cannot constitute the first written contact with respect
9 to interest abatement for the deficiencies at issue in this appeal.

10 Staff notes that a general administrative decision, such as respondent's decision on how
11 to organize the processing of tax returns or its delay in implementing an improved computer system, is
12 not a managerial act for which interest can be abated. (Treas. Reg., § 301.6404-2(b)(1).) As noted
13 previously, the Tax Court has held that the decision to examine, or not to examine, a taxpayer's income
14 tax return for a particular taxable year involves the exercise of judgment and discretion and, therefore,
15 is not a ministerial act. (*Pettyjohn v. Comm'r, supra*, T.C. Memo. 2001-227.) Staff notes that the
16 examples provided in Treasury Regulation section 301.6404-2(c) relating to managerial acts involving
17 the management of personnel are limited to the failure of reassigning cases where the revenue agent is
18 unavailable for an extended period of time. (Treas. Reg., § 301.6404-2(c), examples 3, 4, 5 & 10.)

19 The parties dispute whether respondent considered the maximum gain exclusion issue in
20 the audit of the O'Grady's 2007 tax return. Staff questions whether this dispute is relevant to the issue
21 of interest abatement under R&TC section 19104 since respondent's audit of the 2007 tax return
22 occurred in 2010 and the first written contacts with regard to the proposed deficiencies for which
23 interest abatement is sought occurred during 2013, after the tax years at issue when appellants exceeded
24 the gain exclusion ceilings.

25 Both parties should also be prepared to discuss whether any significant aspect of any
26 alleged error or delay is attributable to appellants. (Rev. & Tax. Code, § 19104, subd. (b)(1).) The
27 O'Gradys should be prepared to discuss whether they were aware of the excessive gain exclusion
28 reported on their tax returns for the years at issue during the audit of the O'Gradys' 2007 tax return and

1 why they did not file amended returns in 2010. The parties should also be prepared to address whether
2 the subsequent audits of both appellants' 2008 tax returns put appellants on notice of the need to amend
3 their 2009 and 2010 tax returns.

4 Equitable Estoppel

5 Staff notes that equitable estoppel is applied against the government only in rare and
6 unusual circumstances and when its application is necessary to prevent a manifest injustice. (See
7 *Appeal of Richard R. and Diane K. Smith, supra.*) Appellants would have to show affirmative
8 misconduct going beyond negligence and amounting to "ongoing active misrepresentations" or a
9 "pervasive pattern of false promises." (*S & M Investment Co. v. Tahoe Regional Planning Agency,*
10 *supra*, 911 F.2d 324, 329; *Purcell v. United States, supra*, 1 F.3d 932, 939.)

11 Among other things, in order to prevail on an equitable estoppel argument, appellants
12 would have to demonstrate that they were ignorant of the true facts and relied on the representations of
13 the government agency. (*Appeal of Western Colorprint, supra; Strong v. County of Santa Cruz,*
14 *supra.*)

15 Staff notes that, in *McCoy v. Comm'r, supra*, T.C. Memo. 2008-91, the Tax Court
16 determined that, where the IRS issued an audit closing notice as to one year (2002), the IRS is not
17 precluded by equitable estoppel to issue deficiencies in years not mentioned in the notice (1999 and
18 2000). The Tax Court noted that, as the closing notice did not reference the years at issue, it could not
19 serve as a basis for the application of equitable estoppel. Even if the IRS has erroneously accepted a
20 taxpayer's position in audits of prior years, it "is not precluded from correcting that error in a
21 subsequent year." (*Hawkins, supra*, 713 F.2d 347, 352-353.)

22 In light of the applicable legal precedents, staff questions whether the FTB's issuance
23 of a "no change" letter for 2007, or conversations surrounding that "no change" letter, can constitute
24 grounds for estopping the FTB from collecting interest imposed under California law.

25 In R&TC section 21012, the Legislature set forth narrow circumstances in which
26 reasonable reliance on written advice from the FTB may provide grounds for the relief of tax and
27 interest. However, subdivision (a)(1) of the statute states that relief may only be provided if the
28 person's failure to make a timely return or payment was due to a person's reasonable reliance "on the

1 written advice of a legal ruling by the chief counsel, and only if the [FTB] itself finds all the
2 conditions satisfied.” Among the required conditions are that the person have requested advice in
3 writing as to whether a particular activity or transaction is subject to tax, the FTB have responded in
4 writing and stated whether or not the described activity or transaction was subject to tax or the
5 conditions for taxation, and that the taxpayer, in reasonable reliance on the written advice, did not
6 remit the tax due. These requirements do not appear to be satisfied on the facts of this appeal.

7 Additional Evidence

8 If either party has any additional evidence to present, they should provide their
9 evidence to the Board Proceedings Division at least 14 days prior to the oral hearing pursuant to
10 California Code of Regulations, title 18, section 5523.6.¹⁷

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12 ///
13 ///

14 Booth, et al._mt

28 ¹⁷ Evidence exhibits should be sent to: Khaaliq Abd’ Allah, Appeals Analyst, Board Proceedings Division, State Board of
Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.