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

10 In the Matter of the Appeal of:) **HEARING SUMMARY²**
11) **PERSONAL INCOME TAX APPEAL**
12 **VICTOR H. BOYD¹**) Case No. 575575

	<u>Year</u>	<u>Claim For Refund</u>
	2006	\$104,204

17 Representing the Parties:

18 For Appellant: Hugh M. Saddington, CPA, Saddington Shusko LLP
19 For Franchise Tax Board: Jenna Mayfield, Tax Counsel

21 **QUESTIONS:** (1) Whether appellant has shown that Franchise Tax Board (FTB or respondent)
22 improperly denied his claim for refund for additional losses claimed as a result of
23 a purported Internal Revenue Service (IRS) adjustment.
24 (2) Whether appellant has shown that respondent improperly denied his claim for

26 ¹ Appellant resides in Fountain Valley, Orange County, California.

27 ² This matter was originally scheduled for oral hearing at the Board’s February 26-28, 2013 Culver City Board meeting, but
28 was postponed as appellant’s representative had a scheduling conflict. This matter was rescheduled for the Board’s
July 17-18, 2013 Culver City Board meeting.

1 refund for additional losses based on the recharacterization of prior year losses as
2 passive losses rather than nonpassive losses.

3 (3) Whether the duty of consistency bars appellant's claims on appeal.

4 HEARING SUMMARY

5 Background

6 Appellant states he was involved in numerous real estate projects conducted through a
7 series of partnerships and limited liability companies (LLCs) from 1993 through 2006. (Appeal Letter,
8 p. 1.) Appellant asserts he was involved in QB Properties (QBP), formed in 1976, as an active manager
9 of properties up until 1988, and has not been involved in the daily operations of QBP since 1997.³
10 (*Id.* at p. 2.) QBM Companies (QBM) was a partnership formed in 1988 of which appellant was a
11 60 percent owner and the remaining 40 percent was held by Mr. McClelland. Appellant contends he
12 was not an active manager of QBM, and states that he provided the funding for QBM's property
13 development activities while Mr. McClelland or his successor managed QBM's activities. Appellant
14 states that QBM disposed of its last property prior to or in 1996. Appellant hired Mr. Groat in 1997 to
15 develop several properties in Las Vegas, and partnered with Mr. Bowie to develop properties in and
16 around Hawthorne, California, in 2003. Appellant asserts that he worked less than 750 hours per year
17 on all these property endeavors from about 1994 on, and states that he was a passive investor in all these
18 projects since at least 1997. (*Id.* at pp. 2-3.)

19 Appellant filed his 2006 California resident tax return on August 15, 2008, after the
20 April 15, 2007 deadline. Appellant reported a federal adjusted gross income (AGI) of negative
21 \$397,328, and a California AGI of \$1,539,804. The California adjustments were reportedly due to a
22 decrease in net operating losses (NOLs) for California purposes of \$1,960,150 and a decrease in
23 Schedule E income for California purposes of \$23,018. (Resp. Op. Br., p. 1 and exhibit A.) In
24 September of 2008, appellant filed late returns for 2004 and 2005. Appellant's 2004 return reported a
25 federal AGI of negative \$3,112,054, California adjustments including a decrease in NOLs for
26 California purposes of \$2,666,140 and a decrease in Schedule E income of \$497,184 for California
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28 ³ Appellant asserts that QBP was no longer "actively developing any real estate projects," but also states that QBP still owns three rental properties as of December 31, 2009. (Appeal Letter, p. 2.)

1 purposes, and a California AGI of negative \$943,098. (*Id.* at p. 2 and exhibit B.) The return reported
2 zero tax due, and an NOL carryover of \$946,263 to 2005. A statement in the return stated that prior
3 years' losses had been recharacterized and NOLs were adjusted accordingly. (*Id.* at p. 2 and exhibit B,
4 p. 16.) Appellant's 2005 return reported a federal AGI of negative \$2,146,581, California adjustments
5 including a decrease in NOLs for California purposes of \$2,170,641 and a decrease in Schedule E
6 income of \$212,237 for California purposes, and a California AGI of negative \$188,177. (*Id.* at exhibit
7 C.) The return reported zero tax due and an NOL carryover of \$191,431.

8 Appellant filed an amended return for the 2006 year on January 5, 2009, claiming a
9 refund of \$104,204 based on an adjustment to NOL carryover from 2005 as reflected in the late-filed
10 2004 and 2005 returns. (Resp. Op. Br., p. 2 and exhibit D.) The adjustments on the amended return
11 include a \$903,875 reduction in federal AGI, a California adjustment (subtraction) of \$158,925 based on
12 NOL carryover adjustments made for 2004 and 2005, and a reduction of \$1,062,800 in California AGI.
13 The amended return included a recomputed Form 3805V showing NOLs used of \$1,254,231 from 2004
14 and no NOL carryovers. (*Id.* at p. 2 and exhibit D, p. 5.) Appellant stated on his return that the change
15 to the 2005 NOL calculation was made to conform with changes made to his returns by the IRS during
16 audit. (*Id.* at exhibit D, p. 2.)

17 Appellant filed amended returns for the 2004 and 2005 tax years on January 15, 2009.
18 The 2004 amended return explained that its adjustments were due to an IRS audit which "restored"
19 \$1,064,940 of appellant's basis in the QBM partnership, and states that QBM was liquidated in 2004
20 and the remaining basis of \$1,030,589 was being "written off for a loss." (Resp. Op. Br., p. 2 and
21 exhibit E, p. 2.) The return reported a reduction of \$1,064,940 for both federal and California AGI.
22 The return included an incomplete Schedule D-1, titled "Sales of Business Property," showing gain of
23 \$1,324,333, and an "abandonment" loss of \$1,030,589 from QBM. (*Id.* at pp. 2-3 and exhibit E, p. 4.)
24 The 2005 amended return states in its explanation that it was filed based on the IRS adjustment to
25 appellant's 2004 tax year and the resulting 2004 amended California return. (*Id.* at p. 3 and exhibit F,
26 p. 2.) The amended return reports a reduction in federal AGI of \$903,875, and California reduction of
27 \$158,965.

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1 The return included a revised Form 3805V showing NOLs of \$754,832⁴ used and a carryover to 2006
2 of \$1,254,271. (*Id.* at p. 3 and exhibit F, pp. 6-7.)

3 Respondent opened an examination of appellant's 2006 tax year on July 15, 2009, and
4 requested a copy of the IRS audit determination and an explanation of how appellant calculated the
5 adjustments reported on the amended return. (Resp. Op. Br., p. 3.) Appellant responded by letter dated
6 November 20, 2009, stating that the adjustments were made based on the recharacterization of NOL
7 carryovers from 1993 through 1999 from nonpassive losses to passive losses, and providing schedules
8 and returns as support.⁵ (*Id.* at p. 3 and exhibits G and H.) Appellant also provided an examination
9 report from the IRS for the 2001 tax year, dated July 19, 2007. (*Id.* at exhibit I.) The IRS audit for
10 appellant's 2001 federal tax account shows an adjustment to NOL, and ultimately additional tax and
11 penalties imposed. Respondent states that it was unable to connect the NOL adjustment to the refund
12 claimed on appellant's 2006 amended California return, and requested additional clarification from
13 appellant.⁶ Appellant provided "corrected" state returns for tax years 2000 through 2003, which were
14 never filed, and additional schedules to show the impact of the recharacterization of losses on the 2000
15 through 2006 tax years. (*Id.* at p. 4 and exhibit J.) Respondent reviewed the information provided and
16 determined that the provided returns and schedules, referred to as "Schedule 1" by respondent, did not
17 support appellant's calculations on his 2006 amended return, and therefore denied his claim for refund.
18 (*Id.* at p. 4.) This timely appeal followed.

19 Appellant provides two schedules showing the recharacterization of losses from 1993
20 through 1999, and revised Forms 3801 showing the recharacterization of losses for 1994 through 2005
21 with his appeal letter. (Appeal Letter, exhibits 2-16.) Appellant also provided revised Form 3805V for
22 the 2004 tax year showing either a \$1,653,218 or \$1,621,269 NOL carryover to 2005, and a revised

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25 ⁴ This NOL amount is an aggregate of carryovers from tax years 1999, 2000, 2001, 2003, and 2004 in the amounts of
26 \$59,513; \$100,150; \$325,158; \$123,223; and \$146,788, respectively.

27 ⁵ Respondent asserts it made numerous attempts to contact appellant before appellant responded to this request. (Resp. Op.
28 Br., p. 3.)

⁶ Respondent asserts that it again had to make "numerous requests" of appellant before receiving a response. (Resp. Op. Br.,
p. 4.)

1 Form 3805V for the 2005 tax year reporting a \$1,651,956 NOL carryover to 2006.⁷ (*Id.* at exhibits 17
2 and 18.) Respondent states it made several phone calls to appellant’s representative, and appellant’s
3 representative called respondent back on September 29, 2011, allegedly conceding that “there was no
4 basis for the claim regarding the IRS adjustment to basis in QBM on the 2004 through 2006 amended
5 returns.” (Resp. Op. Br., p. 4.) Appellant’s representative asserted during this call that appellant was
6 entitled to the refund claimed due to the recharacterization of losses from nonpassive to passive during
7 years prior to the 2006 tax year. Appellant then supplied a new schedule, referred to as Schedule 2 by
8 respondent, showing NOL and passive activity losses generated, used, and carried over for tax years
9 2001 through 2008. (*Id.* at exhibit L.) Respondent states appellant also provided schedules showing
10 the computation of NOLs for federal purposes and copies of appellant’s federal returns as filed for tax
11 years 2001 through 2006. Respondent notes that Schedule 2 contains figures different than those
12 presented in Schedule 1. Respondent asserts that it attempted to contact appellant’s representative by
13 telephone to discuss Schedule 2, but was unable to get a response. (*Id.* at pp. 4-5.)

14 Contentions

15 Appellant’s Contentions

16 Appellant asserts that in July of 2007, the IRS filed an audit report which eliminated
17 losses in the amount of \$1,064,940 that had been allocated to appellant from QBM in 2001. (App.
18 Reply Br., p. 1.) However, this resulted in no tax due, and therefore appellant contends he was unable to
19 protest the adjustment. Appellant states that he adjusted his California returns to conform to this
20 adjustment in an effort to avoid an “inadvertent statute extension.” Appellant contends that he carried
21 forward and utilized the \$1,064,940 in losses on his federal returns as if the IRS adjustment eliminating
22 those losses was never issued, and appellant asserts the IRS has not challenged his utilization of those
23 losses.⁸ (*Id.* at p. 1 and exhibit 1.) Appellant contends that when QBM ceased operations in 2004,
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25 ⁷ Appellants appear to provide two 3805V Forms for 2004, both as exhibit 17, without clear distinction or explanation of the
26 discrepancy in reported carryover to 2005.

27 ⁸ Appellant provides as evidence of the federal adjustment a letter his representative sent to respondent on September 28,
28 2011 (i.e., after he filed his appeal letter). This letter states that appellant cannot locate a copy of the IRS report, but provides
copies of NOL and passive loss schedules and portions of federal returns for tax years 2001 through 2006, all dated after the
filing deadlines for each respective year. Appellant asserts that these returns show he made no adjustments to his federal
returns as a result of the alleged IRS audit determination for tax year 2001. (App. Reply Br., exhibit 1.)

1 appellant had \$1,046,940 of additional basis in the partnership as a result of the disallowed loss, and
2 provides his amended 2004 California return as support. (*Id.* at exhibit 2.) Appellant asserts the loss
3 adjustment on his amended 2004 California return was not an abandonment loss, but rather a
4 “restoration of loss which was eliminated to allow the California Statute to run,” and contends this
5 treatment had no impact on the amended 2006 California return. (*Id.* at p. 1.) Appellant states he “did
6 not adjust the loss carry over to reflect the changes in character of the losses as reflected in the original
7 California returns” when he filed his amended 2004 and 2005 California tax returns, but asserts that for
8 2006 he adjusted the losses from both QBM and QBP to reflect their proper characterization under
9 California law. (*Ibid.*)

10 Appellant’s amended 2006 return included a statement explaining that the amended
11 return was filed to correspond to the 2004 and 2005 amended returns, and that the changes on the 2005
12 amended return were made to comply with the alleged IRS audit adjustments. (Resp. Op. Br., exhibit
13 D.) Appellant states on appeal that a more accurate explanation would be that the 2005 NOL carryover
14 was adjusted to reflect the correct characterization of losses as passive based on California law. (App.
15 Reply Br., p. 2.) Appellant states that the NOL recalculations provided reconcile the federal loss per
16 year by entity to the recalculated losses utilized on the amended 2006 state return. (*Id.* at p. 2 and
17 exhibit 3.)⁹ Appellant acknowledges that the losses utilized on the amended 2006 state return are
18 overstated by \$86,878, but are otherwise correct. (*Id.* at p. 2.)

19 Appellant asserts the recharacterization of losses from nonpassive to passive are not
20 inconsistent, contrary to respondent’s contention, noting that California does not conform to Internal
21 Revenue Code (IRC) section 469(c)(7). (App. Reply Br., p. 2.) Appellant contends, “They losses
22 clearly do not tie to the 2004 and 2005 returns as stated above, but for the \$86,878 error stated above
23 they are totally consistent with the schedules provided.” (*Sic.*) Appellant asserts that the “loss
24 carryover ties to the schedule of the FTB’s Response and to our Exhibit 18 of the October 21, 2011
25 letter.” (*Id.* at p. 2 and exhibit 5.)

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28 ⁹ Appellant’s exhibit 3 to his reply brief is a copy of the attachments provided with his appeal letter.

1 Appellant contends the duty of consistency doctrine prevents a taxpayer from taking a
2 favorable position in one tax year and then taking a contrary favorable position in a later tax year after
3 the statute of limitations has run on the prior year. (App. Reply Br., p. 3.) Appellant states respondent
4 is arguing that losses reported as non-passive for tax years 1993 through 1999 cannot be converted to
5 passive losses in the 2006 tax year based on the duty of consistency. However, appellant contends that
6 the reclassification of losses from nonpassive to passive would not have resulted in any additional taxes
7 for tax years 1993 through 1999, since the items of income in those years were mostly passive and any
8 income realized would have been offset by passive loss carryovers. (See *Id.* at p. 3 and exhibit 6.)
9 Therefore, appellant argues that the incorrect characterization of the losses in previous years did not
10 harm respondent or the government, which is a requirement for duty of consistency. Appellant cites
11 *U.S. v. Kollman*, a United States District Court case from Oregon, as an example of where a taxpayer
12 was allowed to amend returns in years for which the statute had run in order to take deductions for
13 those years that resulted in an increase in NOLs because such action resulted in no harm to the
14 government. (*Id.* at pp. 3-4; *U.S. v. Kollman* (D. Or. 2010) 2010 U.S. Dist. Lexis 19716.)

15 Appellant concedes that respondent could argue that it has been harmed by the fact that
16 it relied on appellant's classification of losses as NOL rather than passive losses, which resulted in the
17 expiration of the loss carryover and would therefore not be available to appellant in 2006. (Appeal
18 Letter, p. 6.) However, appellant contends, courts consistently have held that the IRS could audit a year
19 that was closed by the statute of limitations to reduce a loss or credit in a year that is open. Appellant
20 cites a U.S. district court case out of North Carolina in asserting that respondent could have audited
21 appellant's closed years to determine whether the passive losses carried forward should be disallowed,
22 but that it chose not to undertake those audits. (Citing *R.H. Donnelley Corp. v. U.S.* (E.D.N.C. 2010)
23 684 F.Supp. 2d 672.) Appellant contends this analysis shows that the duty of consistency does not
24 apply to bar appellant's claim for refund. (Appeal Letter, p. 6.)

25 Respondent's Contentions

26 Respondent asserts that its reasonable determinations are presumed correct, and the
27 burden is on appellant to prove otherwise through the use of uncontradicted, credible, competent, and
28 relevant evidence. (Resp. Op. Br., p. 5; citing *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514;

1 *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Respondent further contends that
2 taxpayers are required to keep records adequate to establish their income, deductions, or other matters
3 required to be shown on their return, and failure to provide evidence within a taxpayer's control gives
4 rise to a presumption that such evidence is unfavorable to the taxpayer's position. (Citing *Treas. Reg.*
5 *§ 1.6001-1(a)*; *Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

6 Respondent asserts appellant has not shown that he is entitled to additional losses in the
7 2006 tax year based on a "restoration of loss" from the 2004 tax year. Respondent contends appellant's
8 treatment of the purported IRS adjustment denying losses for the 2001 tax year are inconsistent,
9 unsupported, contradicted, and do not provide any basis for appellant's claim for refund. (*Resp. Reply*
10 *Br.*, pp. 1-2.) Respondent asserts appellant has not provided any evidence of the alleged IRS
11 adjustment for 2001. Respondent provides the revenue agent report (RAR) from the IRS showing there
12 was no adjustment to a loss from QBM or any other loss in the amount of \$1,064,940, and respondent
13 states the RAR shows that federal adjustments resulted in a deficiency of \$5,199, contradicting
14 appellant's claim that the adjustment did not result in any additional tax due.¹⁰ (*Id.* at p. 2; *Resp. Op.*
15 *Br.*, exhibit I.) Respondent contends the RAR shows that the federal AGI accepted by the IRS for the
16 2004 through 2006 tax years is the federal AGI reported on appellant's originally-filed state returns,
17 and not the amount reported on his amended returns and schedules. (*Resp. Op. Br.*, p. 6 and exhibit
18 M.) Respondent notes that respondent does not address the RAR, and asserts that appellant's
19 representative conceded that the purported IRS adjustment never occurred in a phone conversation on
20 September 28, 2011. (*Resp. Reply Br.*, p. 2.)

21 Respondent indicates that appellant's contention regarding the statute of limitations, and
22 how it affects whether he claimed the loss or not in 2001, is unclear. Respondent notes that the general
23 statute of limitations for proposing an assessment is four years from the date of filing, and assessments
24 may be made at any time when respondent is not properly notified of a final federal adjustment. (*Resp.*
25 *Reply Br.*, p. 2; citing *Rev. & Tax. Code*, §§ 19057, 19306 and 19059.) Respondent contends appellant
26 has not provided a complete copy of his 2001 California return as filed, has not shown the alleged IRS
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28 ¹⁰ Respondent contends that it appears appellant did not make the adjustments that were presented in the IRS RAR for the
2001 tax year. (*Resp. Op. Br.*, p. 6.)

1 adjustment for 2001 exists, and has not exhibited that he is entitled to an additional loss in 2004 or a
2 resulting refund in 2006. Respondent asserts that even if appellant could somehow show he was
3 entitled to a loss from QBM in 2001, the loss was disallowed by the IRS and he did not claim it for
4 California purposes, and respondent is unaware of any provision allowing for a “restoration of loss” in
5 a future year. Respondent contends that appellant may be claiming his basis in QBM should be
6 increased based on this purported disallowance of loss in 2001, but appellant has not provided any
7 schedule K-1s or other evidence of his basis in QBM or how this results in a loss to appellant in the
8 2004 tax year. (Resp. Reply Br., p. 3.) Respondent states that appellant’s representative may now be
9 conceding that there was no basis increase based on a telephone conversation during this appeal.
10 (Resp. Op. Br., p. 6.) Respondent contends that even if appellant could show he is entitled to an
11 additional loss in the 2004 tax year, appellant states in his reply brief that this adjustment does not
12 affect the 2006 year (in his duty of consistency discussion), contradicting his other arguments and prior
13 reporting as well as refuting his claim for refund for the 2006 tax year. (Resp. Reply Br., p. 4.)

14 Respondent references appellant’s amended return for the 2004 tax year, in which he
15 claims he was amending his return because the IRS restored basis of \$1,064,940, leaving him with a
16 basis of \$1,030,589, and that the remaining basis was being “written off for a loss” and claimed as
17 “abandonment loss” on his schedule D-1. (Resp. Op. Br., p. 6 and exhibit E, pp. 2, 4.) Respondent
18 states that taxpayers are entitled to a deduction for an abandonment loss under IRC section 165 if they
19 can show an intention to abandon an asset and an affirmative act of abandonment, but appellant has not
20 claimed or shown that he satisfies either of these requirements. (*Id.* at p. 7.) Respondent also contends
21 that appellant used the schedule D-1 incorrectly. Schedule D-1 is used to report California adjustments
22 to gain from the sale of business property, but appellant apparently used it to adjust both California and
23 federal figures by the same amount. Respondent states that appellant may be claiming a deduction
24 based on a bad debt argument. Respondent asserts that appellant must show there was a bona fide debt
25 and an identifiable event establishing the debt’s worthlessness to claim a bad debt deduction. (*Ibid.*;
26 Citing Int.Rev. Code, § 166; Rev. & Tax. Code, § 17201, subd. (a).) Respondent contends appellant has
27 not shown that his remaining basis in QBM qualifies as a bad debt.

28 Respondent contends that none of appellant’s provided returns and schedules provide

1 support for his claim for refund based on his theory of recharacterization of prior year losses. (Resp.
2 Reply Br., p. 4.) Respondent notes that appellant reduces both his federal and California AGI on his
3 amended 2004 through 2006 state returns, and asserts that these reductions are not only unsupported
4 but also contrary to his claim that the amendments are due to a recharacterization of losses for
5 California purposes only. Respondent alleges there are inconsistencies in appellant's presentation of
6 schedules and returns in support of his claim for refund. (*Ibid.*) Respondent asserts that, according to
7 appellant's original 2004 state return and his appeal letter, the adjustment for the recharacterization of
8 losses from nonpassive to passive was made in 2000, well before the year at issue, and any
9 recharacterization now claimed would be duplicative. (Resp. Op. Br., p. 8; Resp. Reply Br., p. 5.)
10 Respondent contends that for tax years 1993 through 1999, appellant only provided returns either "as
11 corrected" by him or unsigned (aside from 1994) and otherwise not verified as representing the returns
12 as filed for those years, and respondent does not have access to returns for those years due to its
13 retention policies. (*Ibid.*) Respondent states that the federal RAR also indicates that the IRS
14 disallowed a portion of the NOLs claimed for the 1995 through 2001 tax years. (Resp. Reply Br., p. 5;
15 Resp. Op. Br., exhibit I, p. 14.) Respondent argues, therefore, that appellant's provided returns for tax
16 years 1993 through 1999 do not provide sufficient substantiation for any of appellant's claims. (Resp.
17 Reply Br., p. 5.)

18 Respondent provides charts to illustrate how appellant's schedules cannot be reconciled
19 with appellant's amended returns or the forms provided with his appeal letter. Respondent's chart on
20 page 9 of its opening brief shows that amounts entered on appellant's schedules as "original" figures do
21 not match the figures originally reported on appellant's returns for the 2004 through 2006 tax years.
22 (Resp. Op. Br., pp. 8-9.) Respondent provides another chart to illustrate how the numbers provided in
23 appellant's Schedule 1 as NOL carryover from the prior year are inconsistent with the amounts reported
24 on appellant's Schedule 2. (*Id.* at pp. 9-10.) Respondent notes that the \$1,621,269 NOL carryover to
25 2005 shown on appellant's Form 3805V for 2004 provided on appeal does not appear on any of the
26 schedules provided. (Resp. Op. Br., p. 10 and exhibit K, p. 3.) Based on these discrepancies and lack
27 of information, respondent asserts that appellant has not met his burden of proving entitlement to the
28 claim for refund for the 2006 year based on recharacterization of prior years' losses from nonpassive to

1 passive. (*Id.* at p. 10.)

2 Respondent's original denial of appellant's claim for refund was based on the duty of
3 consistency. (Appeal Letter, attachment.) Respondent asserts that the duty of consistency bars a
4 taxpayer from taking a certain position in one year, which is relied upon by the taxing agency, and then
5 changing that position in a later year when the statute of limitations is closed on the first year.
6 Respondent contends that when the requirements for the duty of consistency are met, "the
7 [government] may act as if the previous representation, on which [it] relied, continued to be true, even
8 if it is not. The taxpayer is estopped to assert the contrary." (Resp. Op. Br., p. 10; citing *Ashman v.*
9 *Commissioner* (9th Cir. 2000) 231 F.3d 541, 545.) Respondent contends that the Oregon District Court
10 case cited by appellant, *U.S. v. Kollman, supra*, is not binding authority and, regardless, appellant has
11 not provided sufficient information for respondent to determine what his tax liability was or should
12 have been in prior years. (*Id.* at p. 11; Resp. Reply Br., p. 6.) Respondent asserts that the information
13 provided on appellant's returns and schedules provided is inconsistent and contradictory, and appellant
14 has not provided sufficient information to determine whether appellant's adjustments would have an
15 impact on his tax liability in prior years. Therefore, respondent asserts that "appellant has not shown
16 that the duty of consistency should not act to bar him from taking an inconsistent position after over 20
17 years." (Resp. Op. Br., p. 11.)

18 Applicable Law

19 Burden of Proof

20 In determining whether a taxpayer has shown that respondent improperly disallowed
21 deductions, respondent's determination is presumed correct, and the taxpayer bears the burden of
22 proving that the determination was erroneous. (*Todd v. McColgan, supra.*) Deductions from gross
23 income are a matter of legislative grace and the taxpayer has the burden of proving an entitlement to the
24 deductions claimed; unsupported assertions are not sufficient to satisfy the taxpayer's burden of proof.
25 (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of James C. and Monablanche A.*
26 *Walshe*, 75-SBE-073, Oct. 20, 1975.)

27 In general, taxpayers are required to keep records adequate to establish their income,
28 deductions, or other matters required to be shown on their return. (Treas. Reg. § 1.6001-1(a).) Failure

1 to provide evidence within a taxpayer's control gives rise to a presumption that such evidence is
2 unfavorable to the taxpayer's position. (*Appeal of Don A. Cookston, supra.*) In the absence of
3 uncontradicted, credible, competent, and relevant evidence showing error in the FTB's determination, it
4 must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer, 80-SBE-154, Nov. 18, 1980.*)

5 Statute of Limitations

6 In general, respondent must issue a proposed deficiency assessment within four years of
7 the date the taxpayer filed its California return. (Rev. & Tax. Code § 19057.) A taxpayer is required to
8 report federal changes to income or deductions to respondent within six months of the date the federal
9 changes become final. (Rev. & Tax. Code, § 18622.) If the taxpayer complies with that requirement,
10 respondent may issue the NPA within two years of the date of notification, or within the general four-
11 year period, whichever expires later. (Rev. & Tax. Code, § 19059.) If the taxpayer notifies respondent
12 more than six months after the date the federal changes became final, then respondent may issue the
13 NPA within four years of the date of notification. (Rev. & Tax. Code, § 19060, subd. (b).) Finally, if
14 the taxpayer fails to notify respondent of the federal changes, then respondent may issue the NPA at any
15 time. (Rev. & Tax. Code, § 19060, subd. (a); *Ordlock v. Franchise Tax Board* (2006) 38 Cal.4th 897.)

16 In *R.H. Donnelley Corp., supra*, a federal district court case out of North Carolina cited
17 by appellant on appeal, the taxpayer filed claims for refund for tax years 1991 and 1992 based on the
18 carryback of credits from 1994. These claims were filed just two days before the statute of limitations
19 expired for the 1994 tax year. The IRS reviewed the 1994 tax year, even though it was beyond the
20 statute of limitations, and determined that the taxpayer underreported its liability, and therefore there
21 were no tax credits to carry back to previous years. The IRS was not able to assess additional tax for the
22 1994 tax year since it was beyond the statute of limitations, but it did deny the claims for refund for
23 previous years based on its audit of the 1994 tax year and determination that there were no credits to
24 carry back to those previous years.

25 IRC section 469

26 California incorporates, with some changes, IRC section 469, which generally prohibits
27 the use of passive activity losses to reduce nonpassive activity income (e.g., wages, interest, or
28 dividends). (Rev. & Tax. Code, § 17561.) In general, a taxpayer's passive losses can be deducted only

1 to the extent of income from the taxpayer's passive activities; any unused passive losses are generally
2 suspended and carried forward to future years to offset passive income generated in those years. (*Lowe*
3 *v. Commissioner*, T.C. Memo 2008-298; see also, *Jafarpour v. Commissioner*, T.C. Memo 2012-165.)
4 IRC section 469(c)(2) provides that the term "passive activity" includes any rental activity. IRC section
5 469(c)(7) allows taxpayers in the real property business to treat rental activity losses as non-passive
6 losses for federal purposes; however, R&TC section 17561, subdivision (a), states that, "Section
7 469(c)(7) of the Internal Revenue Code, relating to special rules for taxpayers in [the] real property
8 business, shall not apply." Therefore, for California purposes, rental real estate activities are considered
9 passive activities, and any losses from such activities generally can only be applied to offset passive
10 activity gains.

11 Duty of Consistency

12 As to a duty of consistency in a taxpayer's reporting of his income and losses, the Ninth
13 Circuit Court of Appeal addressed this doctrine in *Ashman v. Commissioner, supra*, at page 543, as
14 follows:

15 While it is true that income taxes are intended to be settled and paid annually each year
16 standing to itself, and that omissions, mistakes and frauds are generally to be rectified as
17 of the year they occurred, this and other courts have recognized that a taxpayer may not,
18 after taking a position in one year to his advantage and after correction for that year is
19 barred, shift to a contrary position touching the same fact or transaction. When such a
20 fact or transaction is projected in its tax consequences into another year there is a duty of
21 consistency on both the taxpayer and the Commissioner with regard to it, whether or not
22 there be present all the technical elements of an estoppel.

23 Thus, a party, whether a taxpayer or a taxing authority, is precluded from gaining an advantage by
24 taking one position and then seeking a second advantage by taking an incompatible position.

25 The court in *Ashman, supra*, put forth the following elements for the duty of consistency
26 doctrine:

27 (1) A representation or report by the taxpayer; (2) on which the Commissioner has relied;
28 and (3) an attempt by the taxpayer after the statute of limitations has run to change the
previous representation or to recharacterize the situation **in such a way as to harm the
Commissioner**. If this test is met, the Commissioner may act as if the previous
representation, on which he relied, continued to be true, even if it is not. The taxpayer is
estopped to assert the contrary.

(*Ashman, supra*, at p. 545 [emphasis added].)

1 In *Kollman, supra*, a federal district court case out of Oregon cited by appellant on
2 appeal, the court looked at whether individual taxpayers could amend their returns to claim deductions
3 originally claimed by a corporation. The corporation, in turn, would amend its returns to remove the
4 deductions. The court determined that, for the years at issue, the corporation's use of the deductions did
5 not reduce its income tax liability, but added to its NOL, and that not taking the deductions would not
6 have increased the corporation's tax liability during the relevant years. The court found that allowing
7 the individual taxpayers to amend their returns to include the deductions would not harm the
8 Commissioner financially. This case was not appealed beyond the federal district court level.

9 STAFF COMMENTS

10 Burden of Proof

11 The claim for refund on appeal is based on appellant's amended return claiming
12 additional losses carried forward from prior tax years. Respondent's denial of appellant's claim for
13 refund is presumed correct, and appellant bears the burden of showing error in respondent's
14 determination. Failure to provide evidence within the taxpayer's control, including personal tax returns,
15 gives rise to a presumption that such evidence is unfavorable to appellant's position.

16 On appeal, appellant has taken more than one position, and it is unclear whether they are
17 being argued in the alternative, and whether appellant has conceded one or more positions. As stated
18 above, respondent contends that appellant's representative conceded during a phone call that the
19 purported IRS adjustment for the 2001 tax year never occurred. Respondent asserts that appellant's
20 representative also may have conceded over the phone that there was no basis increase in QBM, as
21 argued on appeal. Appellant should clarify whether he concedes these or any other arguments, and
22 clarify what arguments he is asserting on appeal. Appellant should be prepared to support his
23 contentions in a clear manner, and demonstrate through the use of legal and evidentiary support that he
24 is entitled to the asserted claim for refund.

25 Statute of Limitations

26 Appellant asserts that there was an IRS adjustment that affected his 2001 tax year. It
27 appears this audit was concluded on June 19, 2007. Appellant states that he did not follow the audit
28 results for his federal reporting, but "in order to protect [his] client from an inadvertent statute extension,

1 [appellant’s representative] adjusted his California returns to conform to this adjustment.” (App. Reply
2 Br., p. 1.) Appellant should clarify whether the returns mentioned here are his original late-filed 2004,
3 2005, and 2006 returns, filed in September of 2008, or his amended returns for the same tax years filed
4 in January of 2009. Appellant should also clarify how the returns were adjusted to conform to the
5 federal adjustment, and what effect appellant believes this conformity had on any statute of limitations.
6 Appellant also states that the loss adjustment reflected on his amended 2004 state return was “a
7 restoration of loss which was eliminated to allow the California Statute to run.” (*Ibid.*) Appellant
8 should explain how the adjustment on this return affected any statute of limitations.

9 IRC section 469

10 As explained above, California law generally conforms to IRC section 469 in prohibiting
11 the use of passive losses to reduce nonpassive gains. Important to this appeal, California law adopts
12 IRC section 469(c)(2), which provides that rental activities are per se passive, but does not adopt IRC
13 section 469(c)(7), which provides, for federal purposes, an exception to the per se passive rule for rental
14 activities for taxpayers in the “real property business.” Therefore, for California purposes, all rental real
15 estate activity losses are typically considered passive losses, regardless of whether the taxpayers actively
16 participated in the rental business. Therefore, it appears appellant incorrectly reported his real estate-
17 related income and losses as nonpassive rather than passive income for tax years 1993 through 1999.
18 These amounts appear to have been accepted by respondent as nonpassive. Appellant asserts his
19 recharacterization of the losses for these years as passive will correct his prior returns and bring them
20 into conformity with the law.

21 Appellant’s original returns for 1993 through 1999 offset nonpassive real estate gain
22 with real estate nonpassive losses. When appellant recharacterized the nonpassive losses as passive
23 losses, it is unclear whether he also recharacterized the offset gains as passive rather than nonpassive.
24 Failure to recharacterize both gains and losses as passive could result in (1) appellant’s gains being
25 offset by losses as originally reported and thus not taxed, while those losses are also reported as passive
26 and carried forward; (2) a failure to reduce the amount of passive losses by the amount of offsetting
27 passive gains prior to calculating carryforward losses; or (3) both. Appellant should be prepared to
28 explain whether his schedules recharacterize real estate-related gains as passive, and the effect this has

1 on his claimed passive loss carryforward.

2 Even though the recharacterization of all real property business gains and losses may be
3 the appropriate treatment under California law, appellant must still show he correctly calculated the tax
4 liability and carryforward losses for the years involved. Appellant must also address respondent's
5 contention that any recharacterization now claimed on his 2006 amended return is duplicative because
6 appellant already recharacterized the losses from nonpassive to passive on his original 2004 returns,
7 based on statements made on the return, the reporting of QBM as a passive activity on the
8 accompanying Form 3801, and the NOL reported as generated in 1999. (See App. Reply Br., p. 5;
9 Resp. Op. Br., exhibit B, pp. 16-20.) Appellant should also provide evidence showing that the duty of
10 consistency does not apply to bar his claim for refund, as discussed below.

11 Schedules and Returns

12 Appellant provides returns, schedules, and other tax forms and documents spanning over
13 twenty tax years, and, for the most part, treats them as self-explanatory. Appellant bears the burden of
14 showing error in respondent's determination, and should explain how the provided documentation
15 supports his contentions. Appellant should address respondent's contentions that there are
16 inconsistencies in appellant's presentation of schedules and returns. As discussed below in the Duty of
17 Consistency section, appellant may want to provide copies of original returns along with amended
18 returns, and detailed discussions thereof, to show conclusively how the recharacterization of losses from
19 prior years would affect appellant's 2006 state tax liability.

20 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
21 any additional evidence to present, it should be provided to the Board's Board Proceedings Division at
22 least 14 days prior to the oral hearing.¹¹

23 Federal Audit and Loss Calculation

24 Appellant asserts there was an adjustment by the IRS audit that eliminated QBM losses
25 in the amount of \$1,064,940 for the 2001 tax year, which was completed in July of 2007. Appellant
26 alleges that there was no additional tax liability due, and therefore he could not protest the adjustment.
27

28 ¹¹ Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of
Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.

1 According to the record provided, the IRS audit of appellant's 2001 tax year, which concluded in June
2 of 2007, resulted in an additional tax liability of \$5,199.00 and penalties in the amount of \$2,559.55.
3 (See Resp. Op. Br., exhibit I, pp. 8-9.) Appellant should address the IRS audit report provided, and
4 discuss how his representation of the IRS audit matches the audit report. Appellant contends that he
5 essentially ignored the federal audit elimination of the QBM loss when filing his subsequent federal
6 returns, and this treatment was never challenged by the IRS. (App. Reply Br., p. 1.) Appellant should
7 clarify why he chose to utilize the disallowed loss for federal purposes subsequent to the audit.
8 Appellant should also clarify how it reported this alleged disallowed loss for California purposes, and
9 how the alleged disallowed loss prompted appellant to recharacterize prior losses as passive losses.

10 Appellant appears to contend that he did not adjust the reporting of losses on his amended
11 2004 and 2005 tax returns, and only reported it on his amended 2006 state return. However, the record
12 appears to show that appellant made the adjustment for the recharacterization of losses from nonpassive
13 to passive in 2000, prior to the 2006 amended return. The parties should discuss whether appellant
14 recharacterized the previous years' losses prior to the 2006 amended return, and whether the
15 recharacterized losses that are the basis of this claim for refund are duplicative, as suggested by
16 respondent. The parties should also address respondent's assertion that the federal RARs show that the
17 AGIs accepted by the IRS match the AGIs reported on appellant's original returns, and whether there is
18 basis to reduce the AGIs with amended returns. (See Resp. Op. Br., exhibit M.) Similarly, appellant
19 should address respondent's contention that his amended returns reduce both federal and state AGIs
20 based on the Schedule D-1, and explain these revisions.

21 Appellant also puts forth a contention that he is entitled to a loss based on the alleged IRS
22 audit results disallowing the QBM loss for the 2001 tax year. Appellant should provide legal authority
23 for his claimed "restoration of loss" applied to his 2004 tax year. Based on comments made on his
24 amended returns, it appears appellant may be contesting that there was a disallowed loss in 2001 that
25 increased appellant's basis in QBM, and that this resulted in a loss when QBM was dissolved in 2004.
26 (See Resp. Op. Br., exhibit E, p. 2.) However, in appellant's reply brief, he states that he is not claiming
27 an abandonment loss in 2004 from QBM. (See App. Reply Br., p. 2.) Appellant should be prepared to
28 clarify this inconsistency and state whether he is claiming a loss under this fact pattern based on an

1 abandonment loss, as contended by appellant at one point, or a bad debt deduction, and support this
2 contention with evidence.

3 Duty of Consistency

4 The original denial of appellant's claim for refund was predicated on the duty of
5 consistency. The parties will want to discuss at the hearing whether the three elements for the duty of
6 consistency are met here, and whether appellant's claim for refund is therefore barred by the doctrine.
7 It appears appellant reported his real estate activity income, received through his various partnerships,
8 as nonpassive gain and loss for tax years of at least 1993 through 1999. Appellant asserts that this
9 representation was incorrect, and contends that by "correcting" this error and recharacterizing these
10 losses as passive, after the statute of limitations has run, it results in the carryover of additional passive
11 losses and a refund for 2006 in the amount of \$104,204.

12 Here, it appears that appellant made representations on which respondent relied and thus
13 the first two elements of the doctrine are met. According to respondent, the third element was satisfied
14 in that appellant attempts to change the previous representation or to recharacterize the situation after
15 the statute of limitations has run. Appellant contends the third element is not met because it requires
16 that the recharacterization must be done "in such a way as to harm the [taxing agency]." (See *Ashman*,
17 *supra*.) Appellant states on appeal that recharacterizing the losses as passive rather than nonpassive
18 would not have resulted in any additional tax liability for tax years 1993 through 1999, since "items of
19 income and loss were primarily passive and any income realized would have been offset by passive loss
20 carryovers." (App. Reply Br., p. 3.) Appellant treats this statement as fact without further explanation
21 or analysis. At the hearing, appellant should be prepared to provide copies of the original returns filed
22 for tax years 1993 through 1999 and amended returns for those years reflecting the recharacterization of
23 the losses as passive, which show that there would be no additional tax liability for those years, or
24 subsequent years based on the elimination of carryforward nonpassive NOLs. Without such evidence,
25 it is unclear whether allowing a recharacterization after the statute of limitations has run would provide
26 appellant with an additional tax benefit.

27 As discussed above, respondent's disallowance of deductions are presumed correct and
28 appellant bears the burden of proving the determination is erroneous through the presentation of

1 evidence. Appellant’s claim for refund recharacterizes losses from prior years, which are beyond the
2 statute of limitations for additional assessments, to generate a refund of \$104,204, and it appears, on its
3 face, to violate the duty of consistency. Appellant should have access to his own tax records, and should
4 be able to clearly provide evidence showing whether or not his actions in recharacterizing previous loss
5 amounts would in any way increase his tax liability for years that are beyond the statute of limitations
6 and thereby harm respondent. Respondent may also want to use the tax documents available to
7 determine whether or not it can definitively show that it would be harmed if appellant’s
8 recharacterization of losses for past years was allowed.

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