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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9
10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **CORPORATION FRANCHISE TAX APPEAL**
12 **DANIEL V, INC.**) Case No. 527082

	<u>Years</u>	<u>Claims For Refund</u>
	1997	\$123,414.02
	1998	\$2,150,000.00 ¹

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17 Representing the Parties:

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19 For Appellant: Marty Dakessian, Attorney at Law
20 Joonsik Maing, Attorney at Law
21 David L. Keligian, Attorney at Law
22 For Franchise Tax Board: William Gardner, Tax Counsel III

23 QUESTIONS: (1) Whether the Board's determination on appellant's previous appeal involving the
24 same tax years and same issues is controlling in the present appeal pursuant to the
25 doctrine of res judicata or the Board's opinion regarding the controlling nature of
26 a previous appeal stated in the *Appeal of George H. and Sky Williams et al.* (Sky
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28 ¹ Respondent states that it has already refunded \$136.02 of the amount of refund claimed for 1998 and, for that reason, takes the position that the refunded amount is no longer at issue here. Appellant does not seem to dispute respondent's statement.

1 *Williams*) (84-SBE-050), decided on February 28, 1984.

2 (2) If not, whether appellant was commercially domiciled in Nevada or California
3 during the appeal years, and;

4 (3) Whether appellant has shown that it had reasonable cause for late filing.

5 (4) Lastly, appellant raises a new issue in this appeal not previously determined by
6 the Board in appellant's prior appeal: whether the Board has jurisdiction to
7 consider the constitutionality of Revenue and Taxation Code (R&TC) section
8 19777.5 (the amnesty penalty).

9 HEARING SUMMARY

10 Background

11 On May 28, 2008, the Board considered appellant's prior appeal on this matter and
12 sustained the action of respondent denying appellant's protest against the assessment of additional tax, a
13 late filing penalty for 1997, and accuracy-related penalties for both appeal years. Thus, the Board
14 determined that, although appellant was formed as a Nevada corporation in 1993, appellant was
15 commercially domiciled in California during the appeal years and, for that reason, its income for those
16 years was properly taxed by California.

17 Appellant filed a petition for rehearing on June 27, 2008. On October 28, 2008, the
18 Board granted a rehearing but limited the scope of the rehearing to the abatement of the late filing
19 penalty and the accuracy-related penalties. The Board held the rehearing on June 30, 2009, and abated
20 the accuracy-related penalties for both appeal years but did not abate the late filing penalty for 1997.²
21 The Board's determination became final 30 days later, on July 30, 2009, pursuant to California Code of
22 Regulations, title 18, section (Regulation) 5465, subdivision (b). Appellant made payments satisfying
23 its remaining tax liability for the appeal years and then filed refund claims with respondent for the same
24 years. After respondent denied appellant's refund claims, appellant filed this appeal.

25 Issue 1: Whether the Board's determination on appellant's previous appeal is controlling in this
26 appeal.

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28 ² Attached as Exhibit C is the hearing summary for the rehearing.

1 Contentions

2 Appellant argues that the doctrine of res judicata does not apply to the instant matter
3 because this appeal and the previous decision of the Board are both parts of the same administrative
4 appeal process or, put another way (in appellant’s view), the same action. In support of that argument,
5 appellant, like respondent, relies upon *Sunnen Commissioner v. Sunnen* (1948) 333 U.S. 591, 597
6 (*Sunnen*), and R&TC section 19802. Appellant states that those authorities “bar rehearing of the same
7 matters in a subsequent, separate case or suit.” (App. Reply Br, p. 3.) Appellant also cites *Lennane v.*
8 *Franchise Tax Board* (1996) 51 Cal.App.4th 1180, 1185-1186, for the proposition that the doctrine of
9 res judicata does not apply to rulings in the same action. Appellant concludes this argument by stating
10 that appellant’s appeal of respondent’s deficiency assessment and appellant’s refund claim are rulings in
11 the same case and, for that reason, the doctrine of res judicata “does not bar your Board from hearing the
12 instant tax refund appeal.” (App. Reply Br, p. 4.)

13 Appellant also argues that policy reasons prevent the application of the doctrine of res
14 judicata here. Appellant points out that, in the *Appeal of Raymond H. and Margaret R. Berner (Berner)*
15 (2001-SBE-006-A), decided on August 1, 2002, the Board, quoting from *Jackson v. City of Sacramento*
16 (1991) 117 Cal.App.3d 596, 603, adopted the position that “policy considerations may limit [the use of
17 the doctrine of collateral estoppel (described by the Board in *Berner* as an aspect of the doctrine of res
18 judicata)] where the limits on relitigation underpinnings of the doctrine are outweighed by other
19 factors.” Appellant further cites *Sky Williams* for the proposition that the Board can hear an appeal
20 related to issues raised in a previous appeal if the taxpayer presents new supporting evidence. Appellant
21 points out that *Sky Williams* contains the sentence “[n]o new facts are presented in the instant appeals.”
22 Appellant characterizes respondent’s reliance on *Sky Williams* as taking the position that the opinion was
23 intended to result in the application of the doctrine of res judicata to administrative appeals, such as the
24 appeal here, but also relies on the previously quoted sentence from that opinion to support its own
25 position that the doctrine of res judicata should not be applied here because of policy considerations. In
26 that regard, appellant alleges that, in its opening brief, it presented additional evidence and arguments,
27 such as those relating to respondent’s burden of proving appellant’s commercial domicile, respondent’s
28 failure to satisfy that burden, and the constitutionality of the amnesty penalty imposed by respondent.

1 Appellant's final argument is that the doctrine of res judicata should not be applied here
2 because appellant will not be entitled to attorney's fees from the State of California under R&TC section
3 19717, subdivision (a), unless appellant exhausts all administrative remedies, including the filing of an
4 appeal with the Board under R&TC section 19324.³ R&TC section 19717, subdivision (b)(1), provides,
5 in pertinent part, that a judgment for reasonable litigation costs shall not be awarded under subdivision
6 (a) unless the court determines that the prevailing party exhausted all administrative remedies available
7 to that party under the R&TC, including the filing of an appeal under R&TC section 19324. In
8 appellant's view, the application of the doctrine of res judicata here would render R&TC section 19717,
9 subdivision (a), nugatory.

10 Respondent contends, in essence, that both the doctrine of res judicata and the rule stated
11 in *Sky Williams* prevent appellant from prevailing here with regard to the issues of the commercial
12 domicile of appellant and the late filing penalty because the Board conclusively resolved those issues
13 against appellant in earlier actions. Citing *Sunnen*, respondent contends that the doctrine of res judicata
14 has the effect of preventing the relitigation of a matter when there has been a final judgment involving
15 the same parties and the same issues. Respondent also quotes R&TC section 19802, subdivision (a),
16 which provides that, for income tax purposes, the rule of res judicata is applicable only if the liability at
17 issue is for the same year as was at issue in another case previously determined. Respondent states that
18 the rule announced in *Sky Williams* is that, in appropriate circumstances, a previous decision of the
19 Board will be controlling and result in the denial of a taxpayer's refund claim when the previous
20 decision (as in this appeal) involves the same year, the same basic issues, and the same parties as those
21 in the taxpayer's refund claim.

22 Law

23 Res Judicata. The United States Supreme Court has held that the doctrine of res judicata
24 has the effect of preventing the relitigation of a matter when there has been a final judgment involving
25 the same parties and the same issues. (*Commissioner v. Sunnen, supra.*) The California Supreme Court
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27 ³ R&TC section 19717, subdivision (a), provides that the prevailing party may be awarded a judgment for reasonable
28 litigation costs that it incurred, in the case of any civil proceeding brought by or against the State of California in a court of
record of California in connection with the determination, collection, or refund of any tax, interest, or penalty concerning
California personal income tax.

1 has held that the doctrine of res judicata, or claim preclusion, prevents relitigation of the same cause of
2 action in a second suit between the same parties or parties in privity with them. (*Mycogen Corporation*
3 *et al. v. Monsanto Company* (2002) 28 Cal.4th 888, 896.) However, the doctrine of res judicata will not
4 be applied if injustice would result or the public interest requires that relitigation not be foreclosed.
5 (*Citizens for Open Access to Sand and Tide, Inc. v. Seadrift Association et al.* (1998) 60 Cal.App.4th
6 1053, 1065.) R&TC section 19802, subdivision (a), provides that, for income tax purposes, the rule of
7 res judicata is applicable only if the liability at issue is for the same year as was at issue in another case
8 previously determined.

9 *Sky Williams*. The Board has held that a previous decision of the Board will be
10 controlling and result in the denial of a taxpayer's refund claim when the previous decision involves the
11 same year, the same basic issues, and the same parties as those in the taxpayer's refund claim. (*Appeal*
12 *of George H. and Sky Williams et al., supra.*) In *Sky Williams*, the appellants filed claims for refund for
13 the same years, but brought their arguments under a different legal theory (estoppel). The Board noted
14 that no new facts were presented in the subsequent appeal and that the appellants were "in essence"
15 asking the Board to consider the same issue it had already determined in the previous appeal. The Board
16 concluded its prior decision was controlling and determined it must sustain FTB.

17 STAFF COMMENTS

18 It appears that the Board's opinion in *Sky Williams* declining to reconsider a previous, final
19 decision, where the same appellant returned to the Board to decide the same basic issues, for the same
20 tax years, applies here. This appeal involves the same appellant, the same basic issues, and the same tax
21 years. Appellant is asking the Board to reconsider the issues that were not decided in its favor in the
22 previous appeal. With respect to those issues, appellant's arguments are substantially the same (as
23 detailed below), while also questioning the correctness of the Board's decision (which questions are
24 appropriate on petition for rehearing, which the Board has already heard). Staff notes that, in *Berner*,
25 the case cited by appellant with respect to the collateral estoppel issue, that case is factually
26 distinguishable from the instant appeal in that the Board's previous determination there involved a
27 different tax year, the Board determined that it would not apply the doctrine of collateral estoppel in that
28 appeal because the taxpayers there presented substantially more evidence (regarding different tax years)

1 in support of their position in their subsequent appeal (for later tax years) than they did in their previous
2 appeal. Given the foregoing, the parties may wish to discuss at the hearing whether reconsideration of a
3 previous result for policy reasons is available under the rule stated in *Sky Williams* (and not just as an
4 exception to the doctrine of res judicata). If the Board then concludes that policy reasons are material in
5 the instant matter, the parties should be prepared to discuss whether the policy reasons advanced by
6 appellant justify a reconsideration when the Board has previously considered and rejected in appellant's
7 previous appeal, including the petition for rehearing process, essentially the same arguments and
8 evidence presented by appellant here.

9 Staff notes that should the Board conclude that its decision on appellant's previous appeal
10 is controlling here, that FTB would continue to be sustained with respect to the tax and the late filing
11 penalty for 1997; further, the accuracy related penalties for 1997 and 1998 would continue to be abated
12 (pursuant to the Board's decision on rehearing). The Board should then consider the fourth issue raised
13 in appellant's claim for refund, whether the Board has jurisdiction to consider the constitutionality of the
14 amnesty penalty (discussed below).

15 Issue 2: Commercial Domicile

16 The Board need not reach this issue if it decides that its determination in appellant's
17 previous appeal is controlling. The following discussion is thus applicable should the Board determine
18 to reconsider the issues it previously determined in the prior appeal.

19 Appellant's Contentions

20 Appellant's contention that it was commercially domiciled in Nevada during the appeal
21 years, and therefore its income was not subject to California taxation during those years, remains the
22 same as in the two initial hearings in this matter. Appellant's arguments in support of this contention are
23 predominately the same as those included in the attached hearing summaries (Exhibits A and B) for the
24 first two hearings in the underlying matter. Appellant also alleges in its appeal letter here that Mr. Hehn,
25 the president of appellant, was paid an unspecified amount of money by an unidentified limited liability

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1 company in which appellant owned a one-half interest to manage a Nevada self-storage facility.⁴
2 Appellant further alleges that this payment was in addition to his regular salary from appellant.

3 In commenting upon the result adverse to appellant reached by the Board on May 28,
4 2008, appellant argues in its appeal letter that “based on the transcript, your Board: (1) appeared to be
5 unsure about who properly bears the burden of proof; (2) incorrectly applied the burden of proof; and
6 (3) was wrong in weighing the evidence presented.” (App. Ltr., p. 8.) One of the arguments that
7 appellant makes to address this putative problem involves its reliance upon California Evidence Code
8 sections 605 and 606.⁵ California Evidence Code section 605 provides, in pertinent part, that a
9 presumption affecting the burden of proof is a presumption established to implement some public policy
10 other than to facilitate the determination of the particular action in which the presumption is applied.
11 California Evidence Code section 606 provides that the effect of a presumption affecting the burden of
12 proof is to impose upon the party against whom it operates the burden of proof as to the nonexistence of
13 the presumed fact. Appellant concludes that the effect of those sections is that “[i]n the case of a
14 presumption that affects the burden of proof, the presumption does not disappear in the face of evidence
15 of the nonexistence of the presumed fact, and the burden of proof shifts to the party against whom the
16 presumption operates.” (App. Reply Br., p. 8.) Therefore, appellant argues, respondent has the burden
17 of overcoming the presumption that appellant’s commercial domicile was in Nevada because there is a
18 public policy that a jurisdiction providing benefits and protections to a corporation should be allowed to
19 tax it. Ultimately, appellant takes the position not only that respondent has not met its burden of proving
20 appellant’s commercial domicile but also that the only evidence presented regarding that issue
21 establishes that Nevada was appellant’s commercial domicile.

22 In response to appellant’s arguments, staff notes that a member of the Board requested
23 staff to discuss the burden of proof with the Board on May 28, 2008, before it voted. At that time, staff
24 discussed with the Board the relationship of the presumption of the correctness of respondent’s
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26 ⁴ Appellant should be prepared to clarify at the hearing whether the limited liability company was Piclane LLC, discussed in
27 footnote 8, and elsewhere, in the hearing summary for the first hearing in the underlying matter and attached as Exhibit A.

28 ⁵ Staff notes that it discussed with the Board the presumption affecting the burden of proof under California Evidence Code
section 605, and its possible implications here, before the Board voted on May 28, 2008. (Reporter’s Transcript of May 28,
2008, Item H2 of Franchise and Income Tax Matters, pp. 59-62.)

1 determination to the burden of proof regarding appellant's commercial domicile. Staff explained that
2 the relationship was an issue of first impression and how both the presumption and the burden of proof
3 might operate in the matter the Board was considering. However, staff further explained that the Board
4 did not have to resolve that issue because, in any event, appellant would prevail if respondent could not
5 show that the commercial domicile of appellant was in a place other than Nevada and respondent would
6 prevail if it could show that California was the commercial domicile of appellant. In regard to how it
7 could be shown that the commercial domicile of appellant was other than Nevada, staff discussed with
8 the Board such concepts as credibility of witnesses, weight of the evidence, and inferences. In response
9 to a question by a member of the Board essentially asking for confirmation that the concepts of
10 credibility of witnesses and weight of the evidence were evidentiary concepts that the Board was used to
11 considering, staff confirmed that they were and, in addressing one possibility, urged the Board to
12 consider what inferences could legitimately be made from the various kinds of evidence before it if the
13 Board concluded that it disbelieved the testimony of appellant's witnesses. (Reporter's Transcript of
14 May 28, 2008, Item H2 of Franchise and Income Tax Matters, pp. 56-63.)

15 In its petition for rehearing of June 27, 2008, appellant argued that staff's presentation
16 was contrary to law for purposes of California Code of Regulations, title 18, section (Regulation) 5461,
17 subdivision (c)(5)(D), because staff allegedly (and, by implication, the Board) appeared to conclude that
18 appellant in the underlying matter bore the burden of proof with regard to the commercial domicile of
19 appellant. That section provides that a petition for rehearing must provide all the facts and legal
20 authorities necessary to demonstrate there was insufficient evidence to justify the Board's decision or
21 the decision was contrary to law. Appellant continues in this vein by stating again its view that the issue
22 of the burden of proving appellant's commercial domicile was not appropriately considered in earlier
23 proceedings. Appellant states further that "[y]our Board was not fully briefed on the issue by Appeals
24 staff or by the parties."

25 Law

26 The law applicable to the underlying matter has been stated in the "Law Section" of the
27 hearing summary attached as Exhibit A or in other parts of the three attached Exhibits. Evidentiary rules
28 that the Board may have considered in resolving the underlying matter, after receiving advice on various

1 evidentiary rules from staff on May 28, 2008, include:

2 Direct and Circumstantial Evidence. California Evidence Code section 410 provides that
3 the term “direct evidence” means evidence that directly proves a fact, without an inference or
4 presumption, and which in itself, if true, conclusively proves that fact. The term “circumstantial
5 evidence,” as opposed to direct evidence, is used when an inference needs to be drawn from the
6 evidence to prove a fact. (*Ajaxo Inc. v. E*Trade Group Inc. et al.* (2005) 135 Cal.App.4th 21, 50.)
7 California Evidence Code section 600, subdivision (b), provides that an inference is a deduction of fact
8 that may logically and reasonably be drawn from another fact or group of facts found or likewise
9 established in the action.

10 Credibility of Witnesses and Weight to be given their Testimony. The California
11 Supreme Court stated that it was the province of the jury [trier of fact] at the trial of a case to disbelieve
12 any testimony that appeared to them to lack verity. (*Gray v. Southern Pacific Company (Gray)* (1944)
13 23 Cal.2d 632, 640-641.) The Court further stated that the jurors [triers of fact] were the exclusive
14 judges of the credibility of the witnesses and the weight to be given their testimony. (*Gray v. Southern*
15 *Pacific Company, supra*, 23 Cal.2d at p. 641.)

16 Sufficiency of Circumstantial Evidence. The California Supreme Court stated that a jury
17 [trier of fact] is permitted to reject positive testimony and accept circumstantial evidence of proof of the
18 facts, as it is elementary that direct evidence may be disbelieved and contrary circumstantial evidence
19 relied upon to support a verdict or finding. (*Gray v. Southern Pacific Company, supra.*)

20 Failure to Obtain Testimony. California Evidence Code section 412 provides that if
21 weaker and less satisfactory evidence is offered when it was within the power of the party to produce
22 stronger and more satisfactory evidence, the evidence offered should be viewed with distrust. California
23 Evidence Code section 413 provides that in determining what inferences to draw from the evidence or
24 facts in the case against a party, the trier of fact may consider, among other things, the party’s failure to
25 explain or to deny by his testimony such evidence or facts in the case against him, or by his willful
26 suppression of evidence relating to such evidence or facts, if such is the case. However, an appellate
27 court indicated that, in California civil cases, the failure to produce evidence on the part of the opponent
28 whose case is a denial of the other party’s affirmation may not be considered until a prima facie case has

1 been made by the other party. (*Vaughn v. Coccimiglio et al.* (1966) 241 Cal.App.2d 676, 678.) Staff
2 notes that a “prima facie case” has been described as such that will prevail until contradicted and
3 overcome by other evidence. (*Pacific Telegraph & Telephone Company v. Wallace* (1938) 158
4 Ore. 210, 221.)

5 STAFF COMMENTS

6 It appears that appellant’s arguments are in the nature of a petition for rehearing, on the
7 grounds that the Board’s previous decision was in error. However, the Board has already heard and
8 determined appellant’s previous appeal, petition for rehearing, and rehearing. The Board granted
9 appellant’s petition for rehearing on October 28, 2008, limiting the scope of rehearing to the abatement
10 of the late filing penalty and the accuracy-related penalties. The Board has already made its decision on
11 the rehearing to abate the accuracy related penalties for both appeal years, but not the late filing penalty
12 for 1997. A review of the discussion between the Board members regarding the petition for rehearing
13 makes clear that the petition was not granted with regard to the issue of the commercial domicile of
14 appellant. (Reporter’s Transcript of October 28, 2008, Item H2 of Tax Program Nonappearance Matter,
15 Adjudicatory, pp. 3-6.) The Board’s decision on the previous appeal, including the petition for
16 rehearing and the rehearing, is final, and it appears that appellant is asking the Board to reconsider the
17 same issues previously decided.

18 With respect to appellant’s arguments, staff notes that it advised the Board before its vote
19 on May 28, 2008, that, under certain circumstances, it would not matter to the result which party had the
20 burden of proof regarding the commercial domicile of appellant. Staff notes further that, in *Schmeltzer*
21 *v. Gregory* (1968) 266 Cal.App.2d 420, 423 (one of the cases cited by appellant in its petition for
22 rehearing), the court stated, in pertinent part, that a failure to find on a material issue was “against law”
23 unless the correction of defective or omitted findings would not change the result.

24 In the previous appeal, staff sought information concerning whether Mr. Lane and
25 Mr. Gadbois knew each other and, if so, the nature of their relationship, either by way of explanation by
26 appellant or testimony requested from Mr. Gadbois. Staff notes that Mr. Richard Gadbois was
27 characterized by appellant in earlier proceedings as a California stockbroker with Merrill Lynch. The
28 response from appellant did not clarify the relationship between Mr. Lane and Mr. Gadbois, as

1 appellant’s main response focused on the relationship of Mr. Gadbois to Mr. Hehn and a Merrill Lynch
2 stock broker in Nevada named Shelly Weinberg, and did not directly address the relationship between
3 Mr. Gadbois and Mr. Lane. (See App. Supp Br. of December 14, 2007 (addressing questions posed by
4 the Board before the second hearing in the earlier proceedings), p.11.)

5 With respect to Mr. Gadbois’ relationship to Mr. Lane, the Main Management Inc. LLC
6 website indicates that Mr. Gadbois’ job title at Merrill Lynch during the period from 1994 to 2002 was
7 “Senior Vice President- Private Wealth Management.” Private wealth management is a term often used
8 to describe highly customized and sophisticated investment management and financial planning services
9 delivered to high net worth investors. The Main Management Inc. LLC website also indicates that
10 Mr. Gadbois is currently the President and Managing Partner of Mullin Asset Management LLC, located
11 in Newport Beach, California. In order to assist in the determination of whether appellant’s commercial
12 domicile was in California, appellant should provide information regarding the nature of the services (if
13 any) provided by Mr. Gadbois and any others at Merrill Lynch and, in particular, address whether
14 appellant was managed or controlled in California by or through Mr. Gadbois or others at Merrill Lynch.

15 In this regard, staff requests that, at least 14 days before the hearing in the instant matter,
16 Mr. Lane provide a declaration under penalty of perjury that specifically addresses the following: (1)
17 whether Mr. Lane knew Mr. Gadbois and, if so, the nature and duration of their relationship; (2) the
18 identity and professional description of any person, including, if applicable, Mr. Gadbois, who assisted
19 in the establishment, operation or management of appellant or investments made by appellant and the
20 location where such services were provided; (3) the frequency with which Mr. Lane or appellant
21 communicated with any person described in (2) of this sentence; (4) whether there was any express or
22 implied agreement that any person identified in (2) above would manage appellant (or investments made

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1 by appellant);⁶ and (5) whether Mr. Lane and/or appellant was a client of Merrill Lynch during the years
2 at issue and, if so, the identity of any Merrill Lynch staff member who performed services with regard to
3 appellant or any investments made by appellant, the nature of such a service, the dates on which the
4 service was performed, and the location of the Merrill Lynch office at which the staff member
5 performed the service. Staff also requests that appellant provide at the same time any documentary
6 evidence that would be informative with regard to the questions to be answered by Mr. Lane in his
7 declaration (or the declaration requested below from Mr. Gadbois), including but not limited to any
8 billing records for services ever performed by Mr. Gadbois for appellant or Mr. Lane and any
9 correspondence that relates to such services. In this regard, it would clarify this relationship for the
10 Board's consideration for Mr. Lane to testify under oath at the hearing in the instant matter.

11 Staff also requests that appellant provide a declaration under penalty of perjury from
12 Mr. Gadbois, at least 14 days before the hearing in the instant matter, that addresses, as specifically as
13 possible, the following: (1) whether he knew Mr. Lane and, if so, the nature and duration of their
14 relationship; (2) whether he or any other persons at Merrill Lynch assisted in the establishment,
15 operation or management of appellant or investments made by appellant and, if so, the location where
16 such services were provided; and (3) whether he communicated in any way, including through
17 Ms. Weinberg or any other third-party, with Mr. Lane, appellant or any other party, regarding appellant
18 or any of appellant's investments and, if so, the identity of all such persons and those investments as
19 well as the contents and dates of those communications; and (4) whether there was any express or
20 implied agreement that he or others at Merrill Lynch would manage appellant or its investments with no
21 or little direction from Mr. Lane.

22 _____
23 ⁶ Staff notes that, according to two undated declarations under penalty of perjury by Messrs. David Moore (no title or
24 professional affiliation identified) and William L. Davenport (Managing Director, Investments, Roth Capital Partners),
25 respectively, that are contained in the record, Mr. Lane gave each declarant discretionary authority for trading stocks in the
26 account that he managed for Mr. Lane. Mr. Moore states in his declaration that "I can and do make major financial
27 commitments on Ron's behalf without obtaining his approval, or engaging in any communication with him, before I make
28 my decision." Mr. Moore states further that "Ron's providing me with discretionary authority is consistent with his
philosophy. He is the type of individual who is willing to completely delegate items and empower those who are working
with him to make major decisions without consulting with him." In that regard, Mr. Davenport points in his declaration to
"Ron's long outstanding reputation as a master delegator amongst his closest friends." Mr. Davenport states further that Mr.
Lane's "reputation and practice of completely delegating very important matters to the people he has chosen to manage the
projects, businesses, and investments Ron is involved in is well known."

1 Any information that staff has requested be sent to the BPD should be addressed as
2 follows:

3 Claudia Madrigal
4 Board Proceedings Division
5 State Board of Equalization
6 P.O. Box 942879 MIC:80
7 Sacramento, CA 94279-0080

8 Issue 3: Late Filing Penalty

9 The Board need not reach this issue if it determines that its decision on appellant's
10 previous appeal is controlling.

11 Appellant's Contentions

12 Appellant contends that the late filing penalty should be abated because appellant had
13 reasonable cause to file a late return for 1997. Appellant's arguments in support of this contention are
14 essentially the same as those included in the attached hearing summaries (Exhibits A and B) for the first
15 two hearings in the underlying matter and in the attached hearing summary (Exhibit C) for the rehearing
16 in that matter. As noted above, the Board rejected this contention in its decision on rehearing on
17 June 30, 2009.

18 Law

19 R&TC section 19131, subdivision (a), provides that if a taxpayer fails to file a California
20 tax return on or before the regular or extended due date of the return, then a penalty shall be imposed,
21 unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. The
22 Board has interpreted "reasonable cause" as such cause as would prompt an ordinarily intelligent and
23 prudent businessman to have acted in that manner under similar circumstances. (*Appeal of Thomas K.*
and Gail G. Boehme, 85-SBE-134, Nov. 6, 1985)

24 STAFF COMMENTS

25 Appellant's contention with respect to the late filing penalty also attempts to again raise
26 an issue that the Board previously decided against appellant. The Board previously determined that no
27 reasonable cause was demonstrated, both on hearing and rehearing. There do not appear to be any
28 arguments here supporting a finding of reasonable cause. Appellant may wish to discuss at the oral
hearing how this argument constitutes an issue not previously determined by the Board that should be

1 reconsidered.

2 Issue 4 Constitutional Issue

3 Appellant's final contention is that the amnesty penalty under R&TC section 19777.5 is
4 unconstitutional because (a) it affords no prepayment or postpayment review, (b) it operates
5 retroactively for an excessive period of time, and (c) it fails to give clear notice of what conduct it seeks
6 to prohibit.

7 Respondent contends that it is precluded by Article III, section 3.5, of the California
8 Constitution from determining that a statute is unconstitutional or unenforceable, and that the Board is
9 bound by the same constitutional rule, and that this appeal should therefore be dismissed pursuant to
10 Regulation 5412, subdivision (b)(1).

11 Law

12 Article III, section 3.5, of the California Constitution provides, in pertinent part, that an
13 administrative agency, including an administrative agency created by the California Constitution or an
14 initiative statute, has no power: (1) to declare a statute unconstitutional; or (2) to declare a statute
15 unenforceable, or refuse to enforce a statute, on the basis that it is unconstitutional unless an appellate
16 court has made a determination that the statute is unconstitutional. Regulation 5412, subdivision (b)(1),
17 states that the Board has determined that does not have jurisdiction to consider whether a California
18 statute or regulation is invalid or unenforceable under the Federal or California Constitutions, unless a
19 federal or California appellate court has already made such a determination.

20 STAFF COMMENTS

21 The law is clear on this issue, the Board may not declare the amnesty penalty statute
22 unconstitutional or unenforceable, or refuse to enforce the amnesty penalty statute, unless an appellate
23 court has made a determination that the statute is unconstitutional. Appellant does not cite to any such
24 authority here, and staff is aware of none.

25
26 Exhibits A, B, & C

27 ///

28 Daniel V. Inc._cdd

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2 Board of Equalization, Appeals Division
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4 Tel: (916) 322-5891
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5
6 Attorney for the Appeals Division

7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
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10 In the Matter of the Appeal of:

11
12 **DANIEL V, INC.¹**

) **HEARING SUMMARY**
) **CORPORATION FRANCHISE TAX APPEAL**
)
) Case No. 342609

	<u>Years Ended</u>	<u>Proposed Assessments²</u>
	Dec. 31, 1997	\$ 40,759.23 ³
	Dec. 31, 1998	840,010.32 ⁴

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17 Representing the Parties:

18 For Appellant: David L. Keligian, Attorney
Marty Dakessian, Attorney

19
20 For Franchise Tax Board: William Gardner, Tax Counsel III
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22 QUESTIONS: (1) Whether respondent has shown that appellant had a commercial domicile in
23 California during the appeal years.
24

25
26 ¹ Appellant is headquartered in Las Vegas, Nevada.

27 ² Respondent should be prepared to provide the interest calculations for the appeal years at the hearing.

28 ³ Respondent also imposed an accuracy related penalty (\$8,151.85) and a late filing penalty (\$10,189.80).

⁴ Respondent also imposed an accuracy related penalty (\$168,002.06).

- 1 (2) Whether appellant has shown that accuracy-related penalties imposed by the
2 Franchise Tax Board (FTB or respondent) for the appeal years should be abated.
3 (3) Whether appellant has shown that it had "reasonable cause" for filing a late tax
4 return for 1997.
5

6 HEARING SUMMARY

7 Background

8 Appellant was formed as a Nevada corporation in October of 1993. In December of
9 1993, a California corporation with the same name as that of appellant (designated here, for ease of
10 reference, as "Daniel V-California"), was merged into appellant. Mr. Ron Lane, a California resident
11 with extensive financial experience and particular expertise in California real estate development, was
12 the president, secretary, and sole director of both corporations at the time of their merger. Mr. Lane's
13 revocable trust, of which he is the trustee and beneficiary, is the sole shareholder of appellant.

14 Appellant elected to be taxed as an "S corporation" for federal tax purposes, but as a "C
15 corporation" for California tax purposes. On its California corporate franchise tax returns for the appeal
16 years, appellant took the position that it did not conduct business in California during those years and
17 that, as a result, none of its investment income at issue was taxable by California.

18 After the merger, appellant held a number of investments in financial assets and real
19 estate, the most substantial of which was a position in Cannae LP (Cannae). (Resp. Br. at p. 2.) Cannae
20 was a Nevada limited partnership formed in December of 1993, allegedly for the purpose of assisting
21 Carl Karcher Enterprises (CKE), a large corporation which operated Carl's Jr. restaurants. At that time,
22 Mr. Lane and Daniel V-California each invested \$4,650,000 in Cannae in exchange for a substantial
23 limited partnership interest (17.18%) in the partnership, and Mr. Lane became a director of CKE shortly
24 afterwards. In addition, Cannae paid a debt of \$23.75 million owed by Mr. Carl Karcher, the founder of
25 CKE, to a bank and received, in return, shares of CKE stock held by the bank as collateral. As a result,
26 Cannae became the largest shareholder of CKE. During the appeal years, appellant apparently received
27 distributions of CKE stock that reduced its ownership interest in Cannae to 8.3%. In 1997, appellant
28 exchanged 100,000 shares of CKE stock for a membership interest in Belair Capital Fund, LLC (Belair).

1 an "exchange fund" that enabled its members to diversify, on a tax-deferred basis, their appreciated
2 financial positions.

3 In September of 1994, Mr. David Hehn became president, secretary, and chief financial
4 officer/treasurer of appellant. Mr. Hehn was also a director of appellant. In a declaration executed by
5 Mr. Hehn (Resp. Br., Exhibit H), he makes statements regarding his background and activities on behalf
6 of appellant.⁵ For example, he states that he had worked in the trust and investment management
7 services departments of the Bank of America and a Nevada bank before becoming appellant's president.
8 He states further that those positions required him to monitor investment performances for capital
9 markets portfolios and real estate investments. In addition, he states that, in discussions with Mr. Lane
10 regarding Mr. Hehn's possible employment with appellant, Mr. Lane expressed an interest in acquiring
11 Nevada real estate and continuously evaluating investments outside of California. With regard to real
12 estate investments after he became appellant's president, Mr. Hehn states that his activities included
13 physical reviews of the real estate, hiring and firing the onsite manager, negotiating leases, and
14 marketing the property to prospective tenants. Mr. Hehn also states that his duties with appellant did not
15 require his full-time services but that if additional suitable real estate investments were found, he
16 anticipated that his responsibilities and his compensation would grow. With regard to investments in
17 financial assets during his employment with appellant, Mr. Hehn states that he used the services of an
18 account executive and other professionals at Merrill Lynch, including a stockbroker apparently named
19 "Gadbois" who was located in California. However, he emphasizes that he also used his own best
20 judgment with regard to investments and that no California stockbroker or any other person at Merrill
21 Lynch ever dictated his investment decisions. Finally, Mr. Hehn states that he never traveled to
22 California on business for appellant and that all decisions with regard to investments in financial assets
23 and real estate were made in Nevada.

24 Appellant's investments changed after its formation. In particular, appellant held
25 promissory notes during the appeal years for loans made in large amounts with regard to golfing and
26 other enterprises that were located near Mr. Lane's office in Newport Beach, California. (Resp. Br. at
27 _____
28 _____)

⁵ Staff notes that Mr. Hehn's declaration was apparently not made under penalty of perjury.

1 pp. 5-15.) For example, one of those notes was made in 1998 by West Hills Golf (West Hills), a
2 partnership located in Chino Hills, California, in the amount of \$3,500,000. Mr. Lane allegedly held a
3 one-half ownership interest in West Hills. In addition, appellant made substantial personal loans to Mr.
4 Lane (\$108,586 in 1997) and his son (\$110,000 in 1998) during the appeal years. (Resp. Br. at pp. 6,
5 14-15.) Appellant also held a large position (\$2,305,718) in what respondent characterizes as "Merrill
6 Lynch Mutual Funds" in 1998. (Resp. Br. at p. 6.) Respondent appears to allege that the foregoing
7 position, or some other account with Merrill Lynch, was used to purchase shares of CKE stock. (Resp.
8 Br. at pp. 10-11.)

9 Upon audit, Mr. Hehn apparently told respondent's auditor that he worked between eight
10 and ten hours a month for appellant. Mr. Hehn's compensation from appellant was \$4,650 during 1997
11 and \$1,958 during 1998. During the appeal years, Mr. Hehn was also the president of the Dito Devcar
12 Corporation (Dito Devcar) and the director of Nevada operations for the Busch Firm's Las Vegas office.
13 Dito Devcar was one of two "managers" or "members," along with appellant, of Piclane. The Busch
14 Firm, a California law firm whose main office is in Irvine, California, allegedly provided legal services
15 to Mr. Lane for many years. During the appeal years, appellant shared office space in Las Vegas with
16 The Busch Firm and Dito Devcar, and paid rent to The Busch Firm at least during 1997.

17 Respondent requested certain records from appellant before a visit to appellant's Las
18 Vegas office in November of 2001. Appellant apparently provided those records, but when respondent's
19 auditor requested additional records during the visit, Mr. Hehn allegedly stated that the information was
20 located in California. Respondent states that appellant's records showed payments by appellant to an
21 employee of Mr. Lane, payment of Mr. Lane's travel expenses, payment of appellant's expenses with
22 respect to property owned by Mr. Lane, and billings from third-party service providers who considered
23 appellant to be located in Newport Beach, California.

24 On December 17, 2002, respondent's issued against appellant a Notice of Proposed
25 Assessment (NPA) for each appeal year that proposed an assessment of additional underlying tax and an
26 accuracy-related penalty. Respondent also imposed a late filing penalty against appellant for 1997.
27 After respondent denied appellant's protest, this timely appeal followed.
28

Exhibit A
Page 4 of 8

1 Law

2 Revenue and Taxation Code (R&TC) section 23040 provides, in pertinent part, that
3 income derived from, or attributable to sources within, California includes income from tangible or
4 intangible personal property located or having a situs in California. Intangible property owned by a
5 corporation is presumed to have a tax situs in the state of incorporation of its owner, but the presumption
6 may be overcome if it can be shown that the corporation has established a commercial domicile in
7 another state. (*Appeal of Rajaw Realty Company*, 68-SBE-030, Jun. 6, 1968.) The Board in the *Appeal*
8 *of Vinnell Corporation* (78-SBE-030), decided on May 4, 1978 (*Vinnell*), has cited with approval the
9 following language from *Southern Pacific Co. v. McColgan* (1945) 68 Cal.App.2d 48, 81 (*Southern*
10 *Pacific Co.*), with regard to the concept of "commercial domicile":

11 We perceive the law to be that where corporation has only a paper domicile,
12 where the only function performed by the state of incorporation is to breathe life
13 into the corporation, and where no substantial corporate activities are thereafter
14 carried on in that state, then the law looks at such corporation and says that that
15 state where, under the facts, the corporation receives its greatest protection and
16 benefits, that state where the greatest proportion of its control exists, that state
shall be the commercial domicile, with constitutional power to tax income from
intangibles. (Emphasis added.)

17 The Board also stated in *Vinnell* that although the location of actual management and
18 control has repeatedly been stressed as a major factor in determining the situs of a corporation's
19 commercial domicile, the location of ultimate control has been rejected when it does not correspond to
20 the place of actual management and control. (*Appeal of Vinnell Corporation, supra.*)

21 Internal Revenue Code (IRC) section 6662(a), incorporated by reference through R&TC
22 section 19164 for the years on appeal, provides that there shall be an addition to tax of 20 percent of the
23 substantial underpayment of tax required to be shown on a return. IRC section 6664(c), incorporated by
24 reference through R&TC section 19164, subdivision (d), for the years on appeal, provides, in pertinent
25 part, that no penalty shall be imposed under IRC section 6662 with respect to any portion of an
26 underpayment of tax if it is shown that there was reasonable cause for such portion and that the taxpayer
27 acted in good faith with respect to such portion.

1 R&TC section 19131, subdivision (a), provides, in pertinent part that if a taxpayer fails to
2 file a return before its regular or extended due date, then a penalty shall be imposed, unless it is shown
3 that the failure is due to reasonable cause and not due to willful neglect.

4 Respondent's determinations with respect to both tax and penalties are presumptively
5 correct, and the burden is on the taxpayer to prove them erroneous. (*Appeal of David A. and Barbara L.*
6 *Beadling*, 77-SBE-021, Feb. 3, 1977.)

7 Contentions

8 Appellant contends that it should prevail because it was incorporated in Nevada and
9 respondent has not shown that it established a commercial domicile in California. Relying heavily on
10 *Vinnell*, appellant alleges that respondent has confused ultimate control with actual control over
11 appellant and argues that even though Mr. Lane had ultimate control of appellant as its sole shareholder,
12 Mr. Hehn exercised actual management and control over appellant from Nevada. Appellant alleges that
13 respondent has not identified any specific act of Mr. Lane that would be adequate evidence that he
14 exercised actual management and control over appellant from California. In particular, appellant alleges
15 that phone and fax records provided to respondent at protest show that Mr. Lane did not communicate
16 with Mr. Hehn and argues that, as a result, Mr. Lane was not in a position to instruct Mr. Hehn regarding
17 the actions of appellant. Further, appellant has provided a declaration by one of appellant's financial
18 advisors at Merrill Lynch that her only contact with appellant was through Mr. Hehn and that she was
19 essentially unaware of Mr. Lane's existence.⁶ (App. Reply Br., Exhibit H.) In reply to respondent's
20 allegations regarding the lack of substance of Mr. Hehn's activities, appellant explains that some of its
21 investments did not require or permit active management participation because they were long-term or
22 otherwise passive investments. Appellant has also provided a declaration from the president of a
23 commercial property broker who apparently worked with Mr. Hehn on a Nevada mini-storage
24 transaction in which he briefly describes Mr. Hehn's "due diligence" with regard to the transaction.⁷

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27 ⁶ Staff notes that the declaration by the financial advisor was apparently also not made under penalty of perjury.

28 ⁷ Again, the declaration was apparently not under penalty of perjury.

1 (App. Reply Br., Exhibit G.) Appellant disputes numerous other allegations made by respondent that
2 relate to the relationship of Mr. Lane and Mr. Hehn to appellant.

3 With regard to the accuracy-related penalties imposed by respondent, appellant contends
4 that the penalties should be abated because its position that it did not have a commercial domicile in
5 California was reasonable and made in good faith. Appellant does not appear to address the late filing
6 penalty for 1997.

7 Respondent contends that it should prevail in the instant matter because it has shown that
8 appellant was commercially domiciled in California rather than in Nevada during the appeal years.
9 Relying heavily on the language from *Southern Pacific Co.* that was quoted in *Vinnell* respondent argues
10 that appellant had only a "paper domicile" in Nevada, and was actually controlled by Mr. Lane from
11 California and received its greatest protection and benefits in this state. In support of its argument,
12 respondent places great emphasis upon appellant's large concentration of holdings in California real
13 estate and CKE stock.⁸ Respondent takes the position that the record shows that those holdings were so
14 large and intimately connected to Mr. Lane that he clearly controlled appellant from California.
15 Alleging that the record does not disclose with any specificity what independent actions Mr. Hehn took
16 with respect to appellant's transactions at issue here, respondent characterizes him as essentially a
17 cipher. Respondent also attempts to show that Mr. Hehn played no significant role in appellant's
18 California real estate transactions in particular by emphasizing Mr. Hehn's statement in his declaration
19 that he never traveled to California on business for appellant. Finally, respondent contends that the
20 accuracy-related and late filing penalties should not be abated because appellant has not shown
21 "reasonable cause" for understating its income during both appeal years or filing a late return for 1997.

22 Staff Analysis

23 In staff's view, it would be helpful if Messrs. Lane and Hehn testified at the hearing,
24 particularly with regard to the nature and extent of their communications with one another about
25 appellant's investments during the appeal years. Appellant should also be prepared to identify more
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28 ⁸ Respondent alleges that the only Nevada real estate in which appellant invested during the appeal years was held through Piclane LLC (Piclane), a Nevada limited liability company that owned a mini-storage facility in Las Vegas and that the Nevada investment was trivial in relation to appellant's total holdings.

1 fully the Merrill Lynch stockbroker apparently named "Gadbois" and to explain his relationship, if any.
2 with Mr. Lane. Finally, appellant should be prepared to address more fully what appears to be Mr.
3 Hehn's relatively small salary in relation to his alleged duties with appellant and whether appellant had
4 real estate holdings in Nevada other than through Piclane during the appeal years.

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

10 In the Matter of the Appeal of:

11 **DANIEL V, INC.**

) **REHEARING SUMMARY**

) **CORPORATION FRANCHISE TAX APPEAL**

) Case No. 342609

<u>Years Ended</u>	<u>Proposed Assessments</u> ¹
Dec. 31, 1997	\$40,759.23 ²
Dec. 31, 1998	\$840,010.32 ³

17 Representing the Parties:

18 For Appellant: David L. Keligian, Attorney
19 Marty Dakessian, Attorney

21 For Franchise Tax Board: William Gardner, Tax Counsel

22
23 **QUESTIONS:** (1) Whether respondent has shown that appellant had a commercial domicile in
24 California during the appeal years.
25

26 ¹ At the hearing, respondent should be prepared to provide a calculation of the accrued interest.

27 ² Respondent also imposed an accuracy-related penalty (\$8,151.85) and a late filing penalty (\$10,189.80).

28 ³ Respondent also imposed an accuracy-related penalty (\$168,002.06).

1 (2) Whether appellant has shown that accuracy-related penalties imposed by the
2 Franchise Tax Board (FTB or respondent) for the appeal years should be abated.

3 (3) Whether appellant has shown that it had "reasonable cause" for filing a late tax
4 return for 1997.

5 REHEARING SUMMARY

6 Background

7 The first hearing in the instant matter was held on October 2, 2007. At that hearing, the
8 Board directed staff to request the parties to submit additional briefing and information. On October 9,
9 2007, staff sent a letter to the parties (attached as Exhibit A) that requested (1) respondent to submit any
10 additional evidence demonstrating that Mr. Ron Lane exercised control over the operations and
11 investments of appellant, specifically any evidence of communication and coordination between Mr.
12 Lane and Mr. David Hehn, and to explain how such evidence shows that Mr. Lane was directing the
13 activities of Mr. Lane or otherwise exercising authority over him;⁴ (2) both parties to address whether
14 any payments by appellant that might be characterized as being to Mr. Lane or on behalf of him were
15 treated as expenses or distributions; and (3) both parties to describe appellant's investment portfolio,
16 including investments in real property and intangible property, and to explain where all real property
17 investments are located and where any brokers for intangible investments are located. The letter also
18 informed the parties that a new hearing would be scheduled and that its scope would be limited to any
19 new evidence and arguments raised in the additional briefing.

20 Attached as Exhibit B is the Hearing Summary that was distributed to the Board before
21 the first hearing. That Hearing Summary describes the underlying facts, law, issues to be resolved, and
22 contentions of the parties in this matter.

23 Discussion

24 In its post-hearing supplemental brief, respondent has provided the following exhibits and
25 characterizations of those exhibits:

26 (a) Exhibit 1-The Third Amendment to Limited Partnership Agreement of
27 _____
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⁴ In this regard, the letter also requested respondent to submit certain facsimile documents that respondent's representative mentioned at the first hearing.

STATE BOARD OF EQUALIZATION
CORPORATION FRANCHISE TAX APPEAL

STATE BOARD OF EQUALIZATION
COMMISSIONER OF REVENUE AND TAX APPEALS

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Cannae Limited Partnership.

(b) Exhibit 2-Various expenses claimed by appellant during 1997 and 1998, including: (1) auto insurance expenses related to vehicles maintained in Idaho and billed to Mr. Lane in California; (2) condominium insurance coverage related to property in Idaho and billed to Mr. Lane in California; (3) auto repair expenses related to vehicles maintained in Idaho and billed to Mr. Lane in California; (4) accounting expenses billed to appellant in California; (5) aviation transportation expenses billed to Mr. Lane in California; (6) legal expenses billed to appellant in California by a California law firm; and (7) interest expense billed a Southern California bank.

(c) Exhibit 3-Appellant's Working Trial Balance and Adjusting Journal Entries for 1997 and 1998.

(d) Exhibit 4-ProShot Golf, Inc. related materials.

Respondent also provided appellant's federal and California tax returns for 1997 as Exhibit 5 and its federal and California tax returns for 1998 as Exhibit 6.

In support of its contention that Mr. Lane was directing Mr. Hehn's actions and exercised control over appellant's operations and investments from California, respondent has provided in Exhibit 1 two somewhat different copies of The Third Amendment to Limited Partnership Agreement of Cannae Limited Partnership (Amended Cannae LP Agreement). Respondent argues that the facsimile marking on the signature pages of the respective documents show that the signature page of the Amended Cannae LP Agreement was faxed first from Mr. Lane's office Newport Beach, California, to the Busch law firm in Nevada before it was faxed to respondent. Respondent argues further that this alleged sequence of events, together with Mr. Lane's significant connections with Cannae and CKE, show that the actual making of decisions occurred in Mr. Lane's office in Newport Beach and that Mr. Hehn's role was merely that of a signatory on the paperwork. Respondent also emphasizes the importance of income from Cannae and CKE to appellant during 1997 and 1998 in support of the foregoing argument, stating that Cannae generated most of appellant's income during this period.

As support for its contention that Mr. Lane effectively controlled appellant from

1 California, respondent discusses appellant's expenses that are substantiated in Exhibits 2 and 3. First,
 2 respondent points to a number of expenses paid by appellant that allegedly benefited Mr. Lane
 3 personally. For example, respondent has provided an invoice from a Nevada law firm that was
 4 apparently for estate planning services for Mr. Lane and a corresponding check to the law firm for the
 5 amount of the services from appellant. (Resp. Supp. Br., Exhibit 2 at p. 22.) In addition, respondent has
 6 provided documentation allegedly showing that appellant paid for auto insurance on Mr. Lane's personal
 7 vehicles located in Idaho and homeowner's insurance on his personal residence in Idaho. However,
 8 respondent states that appellant did have not copies of those insurance documents for the appeal years,
 9 and respondent has provided instead a copy of an auto insurance policy for 2001-2002 and a
 10 homeowner's policy for 2001. (Resp. Supp. Br., Exhibit 2 at pp. 1-4.)

11 Second, respondent points to amounts paid by appellant to Ms. Fran Spurlock, who was
 12 apparently an assistant to Mr. Lane in California but not an employee of appellant. For example,
 13 respondent has provided a copy of a check from appellant to Ms. Spurlock that allegedly reimbursed her
 14 for expenses that she incurred paying for repairs to Mr. Lane's vehicles in Idaho. (Resp. Supp. Br.,
 15 Exhibit 2 at pp. 5-9.)

16 Third, respondent points to various bills and other kinds of correspondence addressed to
 17 appellant and sent to Mr. Lane's office in Newport Beach. For example, respondent has provided copies
 18 of invoices from a California law firm for services rendered to appellant that was sent to Mr. Lane's
 19 California office, at least one of which was allegedly later paid by Mr. Hehn. (Resp. Supp. Br., Exhibit
 20 2 at pp. 40-41.)

21 With regard to whether payments that appellant made to Mr. Lane, or for him, should be
 22 characterized as corporate expenses or distributions to him, respondent states that even though some of
 23 the expenses at issue seem to be personal expenses of Mr. Lane, respondent did not make at audit a
 24 determination that they were his personal expenses. Respondent further states that those expenses are
 25 the type of expenses that would normally be incurred in the operation of an investment company.
 26 Finally, respondent states that those expenses were largely incurred in California and billed to Mr. Lane
 27 for the benefit of appellant.

28 With regard to the description of appellant's investments, respondent states that most of

1 appellant's investments were in intangible property, such as stocks, debt, and partnership interests, but
2 that appellant also had some investment in real property. With regard to the location of appellant's real
3 property, respondent states that appellant apparently held real property in Chula Vista, California, and
4 may have held an interest in a condominium in Idaho that Mr. Lane sometimes occupied. With regard to
5 the location of the brokers who had responsibility for appellant's investments in intangible property,
6 respondent states that brokers with responsibility for appellant's stocks and similar assets were national
7 and international firms. Respondent states further that it is not aware where appellant maintains its
8 interests in partnerships or debt instruments.

9 Appellant essentially takes the position that the information and legal arguments provided
10 by respondent in reply to staff's letter should be given little weight, particularly when weighed against
11 the sworn testimony of Messrs. Lane and Hehn at the first hearing. Notably, appellant contrasts the
12 statement of respondent's auditor at the first hearing that "[i]n many instance I reviewed documents that
13 were faxes from Mr. Lane's California office to Mr. Hehn with instructions as to where to decide and
14 what to do" (Hearing Transcript at p. 27, lines 8-10) with the documents actually provided by
15 respondent. Appellant states that the Amended Cannae LP Agreements provided by appellant were only
16 one fax that contained no instructions from Mr. Lane and was merely forwarded by him to appellant's
17 office in Nevada. Appellant also argues that Mr. Lane's relationship with Cannae and CKE does not
18 demonstrate that he exercised control over appellant's investment decisions. Appellant states that its
19 investment in Cannae was purely passive because it had only a limited partnership interest in the
20 partnership. In addition, appellant states that the only control that it exercised over CKE was through
21 the sale of the stock of that corporation and that Mr. Hehn's sworn testimony establishes that only he
22 made the decision to sell the stock.

23 With regard to the expenses at issue, appellant minimizes the significance of the
24 documentation provided by respondent. For example, appellant argues that the mailing of appellant's
25 bills and other correspondence to Mr. Lane's office in Newport Beach is easily explained by its vendors'
26 lack of knowledge that appellant's address had been changed. Appellant also argues that the payment of
27 various expenses by appellant with respect to Mr. Lane is a normal corporate function with no
28 implications for the location of the place of control over appellant. Appellant does not address

1 specifically some instances of its payments with respect to Mr. Lane, such as its payment of legal fees
2 for estate planning services.

3 Appellant argues that the location of the sources of appellant's income should not
4 influence the determination of the location of its commercial domicile. Appellant also reiterates its
5 position that all of its investments, including the Bel Air Capital Investment Fund (Bel Air), were
6 controlled by Mr. Hehn from Nevada. Appellant states that respondent misstated in its briefing that Bel
7 Air was "promoted by Richard Gadbois," a Merrill Lynch broker located in California. Appellant
8 explains that Mr. Hehn asked Ms. Shelly Weinberg, appellant's Merrill Lynch broker located in Nevada,
9 about exchange funds like Bel Air and that Ms. Weinberg then referred him to Mr. Gadbois as the firm's
10 most knowledgeable person in that area. Appellant emphasizes that it was only incidental that Mr.
11 Gadbois was located in California rather than in Nevada or some other state.

12 STAFF COMMENTS

13 Appellant should be prepared to elaborate at the rehearing regarding its payment of what
14 apparently were Mr. Lane's personal expenses. Both parties should be prepared to discuss the
15 relationship, if any, between such payments and Mr. Lane's alleged control over appellant from
16 California. Messrs. Lane and Hehn should be prepared to testify at the rehearing. It would also be
17 helpful for Mr. Gadbois to testify regarding his relationship with Mr. Lane before and after appellant's
18 incorporation in Nevada.

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22 Daniel V, Inc._cdd

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24 Attachments: Exhibit A, B

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7 **BOARD OF EQUALIZATION**
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19 Marty Dakessian, Attorney

20 For Franchise Tax Board: William Gardner, Tax Counsel III

22 QUESTIONS: (1) Whether the accuracy-related penalty imposed by the Franchise Tax Board (FTB
23 or respondent) should be abated.

24 ///

26 _____

27 ¹ Respondent should provide at the hearing the amount of interest that has accrued by the date of the hearing.
28 ² Respondent also imposed an accuracy-related penalty (\$8,151.85) and a late filing penalty (\$10,189.80).
³ Respondent also imposed an accuracy-related penalty (\$168,002.06).

1 (2) Whether appellant has shown that it had "reasonable cause" for filing a late tax
2 return for 1997.

3 HEARING SUMMARY

4 Background

5 On October 28, 2008, the Board considered appellant's petition for rehearing and
6 concluded that the petition set forth good cause for a new hearing, as required by the *Appeal of Wilson*
7 *Development, Inc.*, decided by the Board on October 5, 1994. Under California Code of Regulations,
8 title 18, section 5463, subdivision (c)(1), the Board limited the scope of the rehearing to the issues of
9 whether the accuracy-related penalty and the late filing penalty imposed by respondent should be abated.
10 There were two hearings in this matter before the Board ordered a rehearing. Attached to this rehearing
11 summary are the hearing summaries for the first hearing in this matter, which was held on October 2,
12 2007 (Exhibit I), and the second hearing, which was held on May 15, 2008 (Exhibit II). The two
13 hearing summaries discuss extensively the underlying facts and issues in this matter but contain, like the
14 briefing by the parties before the two hearings, relatively little discussion about the two penalties
15 imposed by respondent. In their briefing after the Board ordered a rehearing, the parties have discussed
16 in much more depth the issues of whether the accuracy-related penalties and the late filing penalty
17 should be abated. This rehearing summary will discuss separately the two penalties.⁴

18 Accuracy-Related Penalty

19 Both parties apparently agree that the following three statutory "exceptions" to the
20 imposition of the accuracy-related penalty should be addressed here: (1) Internal Revenue Code ("IRC")
21 section 6662(d)(2)(B)(i) provides that the amount of the understatement of tax is reduced by the portion
22 of the understatement that is attributable to the tax treatment of any item by the taxpayer if there is or
23 was "substantial authority" for such treatment; (2) IRC section 6662(d)(2)(B)(ii) provides, in pertinent
24 part, that the amount of the understatement of tax is also reduced by the portion of the understatement
25 that is attributable to any item if (I) the relevant facts affecting the item's tax treatment are adequately
26

27 ⁴ The discussion of each penalty will address basically relevant legal issues and the contentions of the parties regarding them.
28 Such discussion will sometimes contain extensive treatment of legal authorities, while a statement of the law will at other
times appear in the Law section of this hearing summary.

1 disclosed in the return or in a statement attached to the return and (II) there is a “reasonable basis” for
2 the tax treatment of such item by the taxpayer; and (3) IRC section 6664(c)(1) provides, in pertinent
3 part, that no penalty shall be imposed under section 6662 with any portion of an underpayment if it is
4 shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with
5 regard to that portion. In addition, appellant contends that the imposition of the accuracy-related penalty
6 is contrary to “public policy.”

7 With regard to the issue of whether there is “substantial authority” under IRC section
8 6662(d)(2)(B)(i) for its treating items of gross income as attributable to Nevada on its returns for the
9 appeal years, appellant states that it relied heavily upon such cases as the *Appeal of Vinnell Corporation*
10 (78-SBE-030) (“*Vinnell*”), decided by the Board on May 4, 1978, and the *Appeal of Rajaw Realty*
11 *Company* (68-SBE-030) (“*Rajaw Realty*”), decided by the Board on June 6, 1968. Appellant states
12 further that, in those cases, the Board has “consistently looked to” objective factors, such as the location
13 of the corporate office, the location of the meetings of the corporation’s Board of Directors, the location
14 of payment of the corporation’s payroll, and the location of the place of corporate control of “decisions
15 and assets” in determining the commercial domicile of a corporation.⁵ Appellant alleges that, in this
16 matter, all of the “objective indicia” took place in Nevada and quotes the following language from
17 Treasury Regulation section (“Treasury Regulation”) 1.6662-4(d) to support the proposition that the
18 legal standard for “substantial authority” is:

19 [A]n objective standard involving an analysis of the law and application of the law to
20 relevant facts. The substantial authority standard is less stringent than the more likely
21 than not standard (the standard that is met when there is a greater than 50-percent
22 likelihood of the position being upheld), but more stringent than the reasonable basis
23 standard as defined in Section 1.6662-3(b)(3). The possibility that a return will not be
24 audited or, if audited, that an item will not be raised on audit, is not relevant in
25 determining whether the substantial authority standard (or the reasonable basis standard)
26 is satisfied.

24 Appellant characterizes the conclusion of the Board regarding the underlying issues in this matter as
25 being based upon “circumstantial and subjective” evidence outweighing, in the view of three members
26 of the Board, the allegedly “direct and objective” evidence presented by appellant. Appellant contends
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28 ⁵ For a discussion of those cases, see the Law section of the hearing summary attached as Exhibit I.

1 that the view of the evidence in this matter by three members of the Board does not negate the existence
2 of the “substantial authority” allegedly represented by the foregoing cases of the Board.

3 Respondent rejoins that “[o]nce Respondent factually demonstrated that Appellant’s
4 connections to Nevada only created a paper domicile in Nevada, that actual control and operation was
5 occurring in California, and that the corporation received its greatest protections and benefits from
6 California, then the law was clear in how Appellant’s investment income would be taxed.” (Resp.
7 Reh’g Br., pp. 6-7.) Respondent then argues that commercial domicile cases are not the type of cases
8 for which the substantial authority exception was intended because of the highly factual analysis
9 necessary to resolve them. In that regard, respondent states that “[t]he substantial authority exception is
10 intended for those cases where the legal significance of the facts could arguably support the taxpayer’s
11 reporting position. Whether or not people would differ in interpreting what the facts are is not relevant
12 for purposes of the substantial authority exception.” (Resp. Reh’g Br., p. 7.) Appellant replies that there
13 is no authority holding that the “substantial authority” standard was not intended to apply to “highly
14 factual” cases and points out that respondent has not cited such authority.

15 With regard to the issue of whether the relevant facts affecting the tax treatment of the
16 items of gross income at issue here were adequately disclosed for purposes of IRC section
17 6662(d)(2)(B)(ii), appellant contends in its opening rehearing brief that those facts were adequately
18 disclosed on its tax returns for the appeal years. In support of its contention, appellant alleges that, on
19 both tax returns, it fully disclosed each item of income and expense. Appellant also alleges that, on
20 Schedule R on both tax returns, it clearly apportioned its income between California and non-California
21 sources. Finally, appellant points out that it stated, on line one of Schedule R-2 of both tax return, that it
22 had “[n]o California business activities at this time.”

23 Respondent contends in its rehearing brief that appellant did not adequately disclose the
24 relevant facts. With regard to its contention, respondent first argues that appellant’s alleged method of
25 disclosure (by placing what appellant characterizes as the relevant facts on the tax returns themselves
26 rather than on an attached form) was inadequate. In support of its argument, respondent discusses the
27 provisions of Treasury Regulation 1.6662-4(f)(1). Treasury Regulation 1.6662-4(f)(1) provides, in
28 pertinent part, that (1) disclosure is adequate if the disclosure is made on a properly completed form

1 attached to the tax return; (2) disclosure must be made on Internal Revenue Service (IRS) Form 8275 in
2 the instance of an item or position other than one that is contrary to a regulation; and (3) disclosure must
3 be made on IRS Form 8275-R in the instance of a position contrary to a regulation. .

4 Respondent also argues that, even if appellant's method of disclosure was adequate, the
5 substance of what it allegedly disclosed was not adequate. Respondent cites *Little v. Commissioner* (9th
6 Cir. 1997) 106 F.3d 1445 ("*Little*"), aff'g *Little v. Commissioner* T.C. Memo 1993-281, in support of its
7 argument. In *Little*, the Ninth Circuit Court of Appeals ("Ninth Circuit") upheld the decision of the Tax
8 Court that the taxpayer was not entitled to capital gain treatment on his real estate sales because the
9 properties that he sold were held primarily for sale to customers in the ordinary course of his business.
10 The taxpayer argued in that mater that the penalty imposed against him under a predecessor statute to
11 IRC section 6662 for substantial understatement of tax should be abated, allegedly because his listing
12 each sale separately on IRS Form 4797, entitled "Gains and Losses from Sales or Exchanges of Assets
13 Used in a Trade or Business and Involuntary Conversions," and then characterizing the gains on
14 Schedule D as long term capital gain, constituted adequate disclosure for purposes of that statute. The
15 Ninth Circuit in *Little* followed *Reinke v. Commissioner* (8th Cir. 1995) 46 F.3d. 760 ("*Reinke*"), as well
16 as other cases interpreting the predecessor statute, in concluding that the taxpayer's alleged disclosures
17 on his returns were not adequate because they did not "indicate the potential controversy regarding the
18 capital gains treatment of the transactions." (*Little v. Commissioner, supra*, 106 F.3d. at p. 1452.) The
19 Ninth Circuit quoted language from *Reinke* that the information on the returns of the taxpayers there
20 "did not disclose to the Commissioner the possible issue whether those amounts constituted capital gains
21 or ordinary income, or provide the facts relevant to such a determination." (*Little v. Commissioner,*
22 *supra*, quoting *Reinke v. Commissioner, supra*, at p. 765 (citing *Schirmer v. Commissioner* 89 T.C. 277,
23 286).) The Ninth Circuit in *Little* also relies upon superseded Treasury Regulation 1.6661-4(b)(1)(iv),
24 which provided that disclosure must show "[t]he facts affecting the tax treatment of the item (or group
25 of similar items) that reasonably may be expected to apprise the Internal Revenue Service of the nature
26 of the potential controversy concerning the tax treatment of the item (or items)." (*Little v.*

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1 *Commissioner, supra*, 106 F.3d. at p. 1452.)⁶

2 In its rehearing reply brief, appellant essentially reiterates its position that the information
3 stated on its tax returns represented adequate disclosure of the facts for purposes of IRC section
4 6662(d)(2)(B)(ii). Appellant also points out that it did not complete line 14 of Schedule R on its tax
5 returns, which requires an entry for interest and dividends allocable to California if the taxpayer's
6 commercial domicile is in California, even though it received interest and dividends during the appeal
7 years. In addition, appellant states that there are no forms in California equivalent to IRS Forms 8275
8 and 8275-R and argues that, for that reason, any disclosure of facts for purposes of IRC section
9 6662(d)(2)(B)(ii) is appropriately made on the California tax returns themselves. Finally, appellant does
10 not discuss *Little* or the cases cited in that matter but does emphatically argue that it is not required to
11 elaborate upon the information contained in its California tax returns by providing additional
12 documentary evidence or legal argument.

13 With regard to the issue of whether there is "reasonable basis" for the treatment on its tax
14 returns of the items of gross income as attributable to Nevada, appellant explicitly incorporates by
15 reference in its opening rehearing brief its arguments with regard to "reasonable cause" under IRC
16 section 6664(c)(1), which are discussed below. In its rehearing brief, respondent discusses language in
17 Treasury Regulation 1.6662-3(b) to the effect that "reasonable basis" is a relatively high standard of tax
18 reporting and that, in particular, it is a standard that is significantly higher than a "frivolous or not
19 patently improper" standard. Respondent further points out that the regulation states that the
20 "reasonable basis" standard is not satisfied by a return position that is merely arguable or represents a
21 merely colorable claim. In addition, respondent states that the regulation provides that "in situations

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24 ⁶ Staff notes that Judge Reinhardt, in his partial dissent, quotes language from *Reinke* that, in order to avoid the penalty for
25 substantial understatement of tax, "the tax return must at least provide sufficient information to enable the Commissioner to
26 identify the controversy involved." (*Little v. Commissioner, supra*, 106 F.3d at p. 1455, quoting *Reinke v. Commissioner,*
27 *supra*, at p. 765.) Judge Reinhardt distinguishes *Reinke* and the other cases on which the majority in *Little* relies on the basis
28 that, in those cases, it was clear that there was insufficient information to alert the IRS to the existence of a possible
controversy, while the large number of sales stated on the returns of the taxpayer in *Little* should have, in Judge Reinhardt's
view, alerted the IRS that the taxpayer may have claimed capital gain treatment improperly. Judge Reinhardt summarizes his
position by stating first that, in order to avoid the penalty at issue, the taxpayer must adequately disclose facts "within the
return or in a statement attached to the return [quoting 26 U.S.C.A. § 6661(b)(2)(B) (West 1989)]" He then states that the
information must be enough to enable the IRS to identify the potential controversy but that the taxpayer need not add "[h]ey
guys, there's a problem." (*Little v. Commissioner, supra*, 106 F.3d at p. 1455.)

1 where the disclosure relates to questions of law, the reasonable basis standard is not as high as the
2 substantial authority standard.”⁷ (Resp. Reh’g Br., p. 9.) Respondent takes the position that, in any
3 event, appellant had no “reasonable basis” for its treatment on its tax returns of the items of gross
4 income as attributable to Nevada allegedly because virtually all of appellant’s relevant contacts were
5 with California rather than Nevada. In its rehearing reply brief, appellant rejects respondent’s position
6 that appellant had more significant contact with California than Nevada and relies upon what it
7 characterizes as the actual facts in the record regarding appellant’s contacts with the two states, as well
8 as such cases as *Rajaw Reality*, to show that its reporting position had a “reasonable basis.”

9 With regard to the issue of whether appellant has shown “reasonable cause” under IRC
10 section 6664(c)(1) regarding its understatement of tax,⁸ appellant essentially takes the position that the
11 “objective factors” in the record, as well as such cases as *Vinnell* and *Rajaw Realty*, establish
12 “reasonable cause” for purposes of that statute, even though the majority of the Board did not evaluate
13 the evidence in this matter in the same way that appellant advocated. Appellant indicates that the
14 “objective factors” included, in part, (1) sworn testimony by Mr. Ron Lane that he did not control
15 appellant from California, (2) sworn testimony by Mr. Lane that Mr. David Hehn purchased a real estate
16 asset in Nevada without any input from Mr. Lane, and (3) sworn testimony by Mr. Lane that he did not
17 instruct Mr. Hehn from California regarding what Mr. Hehn should do. (App. Opening Reh’g Br., p. 6.)
18 Appellant argues that its reliance on advice from its attorneys that it had established a commercial
19 domicile in Nevada also establishes “reasonable cause.” In support of its argument, appellant has
20 provided with its opening rehearing brief a declaration under penalty of perjury by Mr. Hehn that he
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23 ⁷ It is not completely clear, but it appears that respondent’s statement refers to language in Treasury Regulation 1.6662-3(b)
24 providing that “[i]f a return position is reasonably based on one or more of the authorities set forth in § 1.6662-4(d)(3)(iii)
25 (taking into account the relevance and persuasiveness of the authorities and subsequent development), the return position will
26 generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in
27 § 1.6662-4(d)(2).” (Emphasis added.) Treasury Regulation 1.6662-4(d)(3)(iii) provides that such authorities are limited to
28 statutory provisions, regulations construing those provisions, revenue rulings and procedures, court cases, and other
authorities that are specifically enumerated there. Staff notes that Treasury Regulation 1.6662-4(d)(3)(iii) does not contain a
reference to administrative decisions.

⁸ As respondent observes, there is a difference between “reasonable basis” and “reasonable cause.” Treasury Regulation
1.6662-3(b)(3) states, in pertinent part, that “[t]he reasonable cause and good faith exception in § 1.6664-4 may provide relief
from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable
basis standard.”

1 provided appellant's attorneys with a number of the facts that appellant has alleged in this matter (such
2 as that as that he provided independent direction over appellant's operating decisions and that the
3 meetings of appellant's board of directors were held in Nevada) and, in turn, received from them advice
4 that appellant did not have a commercial domicile in California. (App. Opening Reh'g Br., Exhibit A.)
5 Finally, appellant quotes, in support of its position, language from Treasury Regulation 1.6664-4(b)(1)
6 to the effect that circumstances which may indicate "reasonable cause" include an honest
7 misunderstanding of fact or law that is reasonable in light of all the facts and circumstances. In that
8 regard, appellant argues that a statement allegedly made by Board staff at the hearing on May 28, 2008,
9 that this matter was one that "could go either way," as well as the vote by two members of the Board in
10 appellant's favor, show that appellant's understanding of the facts and the law was reasonable in light of
11 all the facts and circumstances here.⁹

12 Respondent rejects appellant's position that appellant has established "reasonable cause"
13 under IRC section 6664(c)(1). Respondent first argues that appellant has not shown, for purposes of
14 Treasury Regulation 1.6664-4(b), that appellant made a sufficient effort to assess its proper tax liability.
15 That regulation provides, in part, that "[g]enerally, the most important factor [in establishing "reasonable
16 cause"] is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability." However,
17 respondent's main focus is on appellant's reliance on the alleged advice of its attorneys. Respondent
18 states that appellant had not provided a written copy of the alleged advice and argues that, as a result,
19 neither respondent nor the Board is able to evaluate "whether the advice was reasonable, whether the
20 factual or legal assumptions were reasonable, whether the advice was premised on assertions of fact
21 which were not true or were incomplete, whether the advice was premised on facts which were assumed
22 would occur but which did not in fact occur, or whether the legal opinion was in some way qualified or
23 limited." (Resp. Reh'g Br., p. 12.) Respondent also points out that Mr. Hehn was an employee of
24 appellant's attorneys and argues that, in part for that reason, his declaration under penalty of perjury
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27 ⁹ After an examination of the transcript of the hearing on May 28, 2008, staff notes that the exact statement by staff to which
28 appellant refers is probably that "I think that kind of a problem with this case is there's probably enough evidence in the
record to kind of support either position, but there is not enough evidence in the record to compel a result." (Hearing
Transcript, p. 58, lines 2-5.) Staff notes further that it also stated that "[a]nother thing you have to focus on the credibility of
the evidence before you, including the credibility of the witnesses, how much weight you give to the various kinds of evidence
before you, the -the testimony of Mr. Lane." (Hearing Transcript, p. 62, lines 10-14.)

1 should be given little weight. Finally, respondent states that appellant did not answer respondent's letter
2 of September 12, 2007, requesting factual support for appellant's position that it had established
3 "reasonable cause" for purposes of IRC section 6664(c)(1).

4 Appellant replies that it did answer respondent's letter of September 12, 2007, and has
5 provided a copy of a letter dated September 20, 2007, from appellant's attorneys to respondent. (App.
6 Reh'g Reply Br., Exhibit 2.) Appellant states that, on advice of counsel, it did not produce its letter
7 during the litigation process because producing the letter might have waived various privileges of
8 appellant. As part of its reply, appellant has also attached a declaration under penalty of perjury by one
9 of appellant's attorneys, dated February 23, 2009, in which the attorney recapitulates advice allegedly
10 given by the attorneys to appellant at various times (including the period during which those attorneys
11 prepared appellant's California tax returns for the appeal years) regarding the commercial domicile of
12 appellant.¹⁰ (App. Reh'g Reply Br., Exhibit 1.)

13 With regard to appellant's contention that the imposition of the accuracy-related penalty
14 is contrary to public policy, appellant essentially reiterates a number of its previous arguments to support
15 that contention. Respondent does not explicitly address appellant's contention.

16 Late Filing Penalty

17 Appellant contends that it had "reasonable cause" for filing a late tax return for 1997
18 because the accountant responsible for appellant's financial and tax matters during that year had an
19 episode of mental illness, manifested in part by an attack by the accountant on a judicial official that
20 resulted in his incarceration, which prevented him from filing appellant's return for 1997 in a timely
21 manner. Appellant alleges that it was unaware of the accountant's psychological problems until
22 sometime after the return was due and that it then promptly engaged appellant's attorneys to prepare the
23 returns for both appeal years. Appellant has provided newspaper articles, dated November 1, 1998,
24 regarding the arrest of the accountant on October 1, 1998. (App. Reh'g Reply Br., Exhibit 3.)

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26 ¹⁰ Staff notes that Treasury Regulation 1.6664-4(c)(ii) provides, in pertinent part, that advice received by a taxpayer,
27 including advice from a professional tax advisor, must not unreasonably rely upon representations by the taxpayer or any
28 other person. The regulation further provides, as an example, that the advice may not be based on a representation that the
taxpayer knows, or has reason to know, is unlikely to be true. The parties may wish to discuss at the hearing the declaration
of February 23, 2009, in the context of the foregoing regulation.

1 Respondent contends that appellant has not carried its burden of proving that appellant
2 had "reasonable cause" for filing a late return for 1997. With regard to that contention, respondent relies
3 upon the *Appeal of Thomas K. and Gail G. Boehme* ("Boehme") (85-SBE-134) (citing *United States v.*
4 *Boyle* (1985) 469 U.S. 241 ("Boyle")), decided on November 6, 1985, to support the proposition that
5 every taxpayer has a personal, non-delegable duty to file its tax return by the due date. Respondent
6 further relies upon *Boehme* (citing *United States v. Boyle, supra*, 469 U.S. at pp. 248-249), as well as
7 other cases of the Board, to support the proposition that reliance by a taxpayer upon an accountant to file
8 its tax return is not considered "reasonable cause" for the failure of the taxpayer to file a timely return.
9 In reply, appellant takes the position that a reasonably prudent business person would not have foreseen
10 the need to inquire about the mental health of its tax preparer in the period before the due date of his tax
11 return. Therefore, appellant argues without citation to authority, that it had "reasonable cause" for filing
12 a late return for 1997.

13 Law

14 Revenue and Taxation Code ("R&T") section 19164, subdivision (a)(1)(A), provides that
15 an accuracy-related penalty shall be imposed under that part and shall be determined in accordance with
16 IRC section 6662, except as otherwise provided. IRC section 6662(a) provides that if that section
17 applies to any portion of an underpayment of tax required to be shown on a return, there shall be added
18 to the tax an amount equal to 20 percent of the portion of the underpayment to which it applies. IRC
19 section 6662(b) provides, in pertinent part, that the section will apply to any portion of the
20 underpayment that is attributable to (1) negligence or disregard of rules or regulation or (2) any
21 substantial understatement of income tax. IRC section 6662(c) provides that, for purposes of the
22 section, "negligence" includes any failure to make a reasonable attempt to comply with the provisions of
23 the IRC. IRC section 6662(d)(1)(A) provides that, in general, there is a "substantial understatement" of
24 income tax for any taxable year if the amount of the understatement for the taxable year exceeds the
25 greater of (i) 10 percent of the tax required to be shown on the return for the taxable year or (ii) \$5,000.
26 IRC section 6662(d)(1)(B) provides, in pertinent part, that, in the case of a corporation other than an S
27 corporation or a personal holding company, there is a substantial understatement of income tax for any
28 taxable year if the amount of the understatement for the taxable year exceeds the lesser of (i) 10 percent

1 of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000) or (ii)
2 \$10,000,000.

3 IRC section 6662(d)(2) provides, in pertinent part, that the term “understatement” means
4 the excess of (i) the amount of tax required to be shown on the return for the taxable year over (ii) the
5 amount of tax imposed which is shown on the return. IRC section 6662(d)(2)(B)(i) provides that the
6 amount of the understatement of tax is reduced by the portion of the understatement that is attributable
7 to the tax treatment of any item by the taxpayer if there is or was “substantial authority” for such
8 treatment. IRC section 6662(d)(2)(B)(ii) provides, in pertinent part, that the amount of the
9 understatement of tax is also reduced by the portion of the understatement that is attributable to any item
10 if (I) the relevant facts affecting the item’s tax treatment are adequately disclosed in the return or in a
11 statement attached to the return and (II) there is a “reasonable basis” for the tax treatment of such item
12 by the taxpayer. IRC section 6664(c)(1) provides, in pertinent part, that no penalty shall be imposed
13 under section 6662 on any portion of an underpayment if it is shown that there was a reasonable cause
14 for such portion and that the taxpayer acted in good faith with regard to that portion.

15 R&TC section 19164, subdivision (a)(1)(B)(i), provides, in pertinent part, that the penalty
16 specified in IRC section 6662(a) shall be “40 percent” rather than “20 percent.” R&TC section 19164,
17 subdivision (a)(3), modifies IRC section 6662(d)(1)(B) by substituting “\$2,500” for “\$10,000” and by
18 substituting “\$5,000,000” for “\$10,000,000.” California Code of Regulations, title 18, section 19503
19 (“Regulation 19503”) provides, in pertinent part, that, in the absence of regulations by respondent and
20 unless otherwise provided, in instances in which the Bank and Corporation Code conforms to the IRC,
21 regulations under the IRC shall, if possible, govern the interpretation of conforming California statutes.

22 R&TC section 19131, subdivision (a), provides that if a taxpayer fails to file a California
23 tax return on or before the regular or extended due date of the return, then a penalty shall be imposed,
24 unless the taxpayer show that the failure is due to reasonable cause and not due to willful neglect. The
25 Board has interpreted “reasonable cause” as such cause as would prompt an ordinarily intelligent and
26 prudent businessman to have acted in that manner under similar circumstances. (*Appeal of Thomas K.*
27 *and Gail G. Boehme, supra.*) The Board in *Boehme* followed the strict rule stated in *Boyle* that the
28 failure to file a timely return is not excused by a taxpayer’s reliance on an agent and held that the

1 taxpayers' reliance upon their accountant to file their tax return was not "reasonable cause" for late
2 filing. (*Appeal of Thomas K. and Gail G. Boehme, supra.*)

3 STAFF COMMENTS

4 With regard to the "substantial authority" issue, staff notes that Treasury Regulation
5 1.6662-4(d)(2)(ii) provides, in pertinent part, that "[t]he weight accorded an authority depends on the
6 relevance and persuasiveness, and the type of document providing the authority. For example, a case or
7 revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if
8 the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at
9 issue." In the context of whether "substantial authority" existed for purposes of the predecessor statute
10 to IRC section 6662(d)(2)(B)(i), the Ninth Circuit has indicated that the credibility of a witness is a
11 critical factor in determining whether substantial authority exists with regard to the tax treatment under
12 consideration in a matter. (See *Norgaard v. Commissioner* (1991) 939 F.2d 874, 880-881.) Therefore,
13 the parties should be prepared to discuss at the hearing the relationship between the credibility of
14 appellant's witnesses (testifying as to the location of its commercial domicile) and appellant's reliance
15 on such cases as *Vinnell* and *Rajaw Realty* as "substantial authority." In that regard, the parties should
16 be prepared to discuss whether the manipulation by a taxpayer of such allegedly "objective indicia" as
17 the location of a corporate office and the location of the meetings of the Board of Directors of the
18 corporation is more consistent with the establishment of a "paper domicile" than the establishment of an
19 actual commercial domicile.

20 With respect to the "adequate disclosure" issue, the parties should be prepared to discuss
21 whether appellant was required under Regulation 19503 to make its disclosures on IRS Form 8275. In
22 that regard, the parties should be prepared to address what appears to be respondent's administrative
23 practice of allowing such disclosures on IRS Form 8275. (See attached Exhibit III.) The parties should
24 also be prepared to discuss, with appropriate citation to authority, whether *Little* has continued vitality
25 after the enactment of IRC section 6662 and, if so, whether appellant has made adequate disclosure
26 under that case even if it was not required to make its disclosures on IRS Form 8275. With regard to the
27 "reasonable basis" issue, the parties should be prepared to discuss whether the opinions of the Board
28 qualify as "court cases" for purposes of Treasury Regulation 1.6662-4(d)(3)(iii).

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With respect to the “reasonable cause” for late filing issue, appellant should be prepared to explain why the mental illness of its accountant justifies an exception to the rule stated in *Boehme*, *Boyle*, and other cases that reliance upon a tax preparer to file a return is not “reasonable cause” for the failure of the taxpayer to file a timely return.

Attachments: Exhibits I-III

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Daniel V. Inc._cdd