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10 **BOARD OF EQUALIZATION**  
 11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeals of: ) **HEARING SUMMARY**  
 13 ) **PERSONAL INCOME TAX APPEAL**  
 14 **GERBER MARITAL TRUST (NON-** ) **Case Nos. 513082, 513083, 513084**  
 15 **EXEMPT), GERBER MARITAL TRUST** )  
 16 **(EXEMPT), GERBER MARITAL TRUST** )  
 17 **(EXEMPT)<sup>1</sup>** )

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|  | <u>Year</u> | <u>Claim<br/>for Refund<sup>2</sup></u> |
|--|-------------|---|
|  | 2007        | \$9,398.55                              |
|  | 2007        | \$17,372.86                             |
|  | 2007        | \$190.36                                |

18 Representing the Parties:

19 For Appellants: Janet L. Everson, Attorney at Law

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 23  
 24 <sup>1</sup> The appeals in the instant matter were consolidated under California Code of Regulations, title 18, section 5522.4, subdivision (a).

25  
 26 <sup>2</sup> Respondent states that the amount of \$9,398.55 at issue here for the first appellant is comprised of a late payment penalty of \$6,305.86 and interest accrued to the date of appeal of \$3,093.19. Respondent also states that the amount of \$17,372.86 at issue for the second appellant is comprised of a late payment penalty of \$11,655.20 and interest accrued to the date of appeal of \$5,717.66. Finally, respondent states that the amount at issue for the third appellant is \$190.36. However, respondent further states that the amount at issue for the third appellant is comprised of a late payment penalty of \$126.48 and accrued interest of \$190.40. Respondent does not explain the discrepancy in the claimed refund amount by the third appellant and respondent's statement regarding its composition.

1 For Franchise Tax Board: Jane Perez, Tax Counsel  
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3 QUESTION: Whether appellants have shown that they had reasonable cause for late payment of  
4 their tax liabilities for 2007.

5 HEARING SUMMARY

6 Background

7 In their briefs, appellants state that, upon the death of Mr. Robert F. Gerber in 2004, the  
8 Gerber Family Trust was created. They further state that, as part of the Gerber family estate plan,  
9 Gerber Family Investments, LLC (the LLC) was created in 2006. Appellants allege that the members of  
10 the LLC were four trusts whose beneficiaries were apparently members of the Gerber family. Only  
11 three of those trusts are appellants in this matter.<sup>3</sup> Appellants state that one of the appellant trusts  
12 became irrevocable when Caroline C. Gerber, the widow of Mr. Robert F. Gerber, died on April 22,  
13 2007. Appellants and respondent appear to agree that the LLC is a “pass through” entity and the income  
14 of the LLC would properly be reported by its members in proportion to their interests in the entity.

15 Appellants state that, during the administration of Mrs. Gerber’s estate, they engaged  
16 Ashley Quinn, CPA’s, (the CPA’s) “to prepare all relevant income tax returns and to advise as to  
17 projected Federal and state income tax payments that were to be paid by April 15, 2008, in connection  
18 with filing extensions for all relevant income tax returns.” (App. Ltr., pp. 2-3.) Appellants further state  
19 that they provided the CPA’s “with all necessary and relevant information needed to prepare the income  
20 tax returns.” (App. Ltr., p. 3.) Appellants also state that Mrs. Gerber’s federal estate tax return was filed  
21 in July 2008 but do not state who prepared that return or when information from that return was received  
22 by appellants.

23 Appellants apparently made income tax payments on or before April 15, 2008, the due  
24 date for the final estimated payment of their tax liability. They allege that those tax payments were  
25 based upon the initial determination by the CPA’s that the total amount of taxable income passing  
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27  
28 <sup>3</sup> Appellants do not explain the relationship of the Gerber Family Trust to the four trusts which were members of the LLC. Appellants also do not state whether the one of those four trusts that is not an appellant in the instant matter had a late payment penalty imposed upon it or explain why, if such a penalty was imposed, that trust is not an appellant here.

1 through to those trusts from the LLC was \$1,234,227. Appellants state that “[a]fter asset basis  
2 measurements used in Caroline Gerber’s Form 706 estate tax return were determined and upon CPA’s  
3 completion of the final tax returns in October 2008, [the CPA’s] discovered that [they] had incorrectly  
4 determined income tax extension payments.” (App. Ltr., p. 3.) Finally, appellants state that the CPA’s  
5 ultimately determined the total taxable income at issue was actually \$4,096,474, rather than \$1,234,227,  
6 and included corresponding additional tax payments when they filed their tax returns on or before  
7 October 15, 2008, the extended due date of those returns. The Franchise Tax Board (the FTB or  
8 respondent) accepted appellants’ returns as filed and issued Return Information Notices, and later  
9 collection notices, demanding the payment of late payment penalties plus interest. After appellants  
10 made the payments demanded by respondent, they filed claims for refund of those payments. When  
11 respondent denied the refund claims for failure to show reasonable cause for late payment, these timely  
12 appeals followed.

### 13 Contentions

14 Appellants essentially contend that they had reasonable cause for late payment of their  
15 tax liability because they reasonably relied upon the CPA’s to determine their tax liability correctly,  
16 after considering complicated and technical issues of law, before the due date for payment of that  
17 liability. Appellants allege that, in making their initial determinations of the amount of appellants’ final  
18 extended payment of their tax liability, the CPA’s made two errors of substantive law “associated with  
19 the measurement of the tax basis in various assets of the Caroline C. Gerber estate as of the date of her  
20 death and the implications of selling those assets between the date of death and December 31, 2007.”  
21 (App. Ltr., p. 3.) Appellants state that “[t]he first error concerns adjustments to the basis of partnership  
22 assets under IRC §§ 754, 743, and 734 applicable to the LLC as a pass-through entity.”<sup>4</sup> (App. Ltr., p.  
23 3.) Appellants then give possible reasons (not including, staff notes, the death of Mrs. Gerber) for those  
24 basis adjustments and how they might be accomplished under Internal Revenue Code (IRC) section 743  
25 and other provisions of the IRC. However, appellants do not address specifically how the CPA’s failed  
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28 <sup>4</sup> Staff notes that although appellants cite IRC section 734, they never explain its applicability to the facts here. In particular, appellants do not identify any distributions to which IRC section 734 might apply. At the hearing, appellants should clarify their position with respect to whether IRC section 734 is applicable to the facts in this matter and identify any distributions to which that section might apply.

1 to properly make the basis adjustments in this matter. Appellants do state that “[a]s a result of CPA’s  
2 erroneous analysis, CPA misconstrued IRC § 743(b) and mistakenly deducted \$1,526,596 in gain from  
3 the sale of LLC assets from the total taxable income to the trusts.” (App. Ltr., p. 4.)

4 With regard to the second error, appellants state that the LLC was subject to a 30 percent  
5 discount on Mrs. Gerber’s estate tax return. They state further that “[s]uch discount was required to be  
6 allocated among the assets on hand at her death under IRC § 754” and that “an additional amount of  
7 \$1,349,686, representing additional gain on assets sold after Ms. Gerber’s date of death, was required to  
8 be included in income.” (App. Ltr., p. 4.) However, appellants do not explain whether the second error  
9 occurred because the CPA’s (1) were unaware of the 30 percent discount taken on Mrs. Gerber’s estate  
10 tax return, (2) were unaware of the rule allegedly requiring the allocation of the discount among her  
11 assets, or (3) made some other mistake.

12 In support of their contention, appellants rely heavily upon *United States v. Boyle* (*Boyle*)  
13 (1985) 469 U.S. 241, and a number of other cases. In *Boyle*, the United States Supreme Court held that  
14 the reliance by a taxpayer on an agent to file a return in a timely manner is not “reasonable cause” for  
15 filing a late return but also stated that when an attorney or accountant advises a taxpayer on a matter of  
16 tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. (*United*  
17 *States v. Boyle, supra*, 469 U.S. at pp. 251-252.) One of the cases cited with approval in *Boyle* regarding  
18 reliance upon professional tax advice and its relationship to “reasonable cause” is *Haywood Lumber &*  
19 *Mining Co. v. Commissioner* (*Haywood Lumber*) (2nd Cir. 1950) 178 F.2d 769. In *Haywood Lumber*,  
20 the Second Circuit Court of Appeals (Second Circuit) rejected the conclusion of the Tax Court that a  
21 corporate taxpayer did not have “reasonable cause” for not filing personal holding company returns after  
22 asking a certified public accountant to prepare the proper corporate tax returns for the years at issue  
23 there. In rejecting the conclusion of the Tax Court, the Second Circuit stated that “[w]hen a corporate  
24 taxpayer selects a competent tax expert, supplies him with all the necessary information, and requests  
25 him to prepare proper tax returns, we think that taxpayer has done all that ordinary business care and  
26 prudence can reasonably demand.” (*Haywood Lumber & Mining Co. v. Commissioner, supra*, 178 F.2d  
27 at pp. 770-771.) Appellants essentially take the position that the facts of the instant matter fall squarely  
28

1 within the foregoing rule stated in *Haywood Lumber* as well as within the language in *Boyle* regarding  
2 reliance upon professional tax advice when they are applied to a late payment of tax.

3 In that regard, appellants point out that the Board has characterized the statement in *Boyle*  
4 regarding reliance upon professional tax advice as a general rule for determining whether a taxpayer had  
5 “reasonable cause” for either filing a late return or making a late payment of tax. (*Appeal of Philip C.*  
6 *and Anne Berolzheimer (Berolzheimer)*, 86-SBE-172, Nov. 19, 1986.) Citing *Berolzheimer*, appellants  
7 state that “[r]easonable cause has been found where the taxpayer is unaware of the amount of a tax  
8 liability and relies on the advice of a tax professional to determine the amount of tax due.” (App. Ltr.,  
9 p. 7.) However, staff notes that the Board in *Berolzheimer* declined to abate for reasonable cause the  
10 late payment penalty imposed on the taxpayer there because the late payment of tax resulted essentially  
11 from a simple computational error.

12 Finally, appellants allege that the Internal Revenue Service (IRS) abated the  
13 corresponding federal late payment penalties imposed against them because of their favorable federal  
14 tax compliance history. Appellants argue that those abatements by the IRS support their position that  
15 they had “reasonable cause” for late payment of California tax.

16 Respondent contends that appellants have not shown “reasonable cause” for late payment  
17 of tax. Respondent argues that both *Boyle* and *Berolzheimer* require an error by a tax professional in  
18 interpreting substantive law to establish “reasonable cause” for late payment of tax and alleges that the  
19 errors by the CPA’s shown by appellants are merely computational. Respondent also takes the position  
20 that it will not follow the abatements by the IRS because California does not have provisions  
21 corresponding to the federal provisions abating a late payment penalty if the taxpayer has a favorable  
22 federal tax compliance history. However, respondent states that “[i]f appellants can provide a statement,  
23 signed under penalty of perjury, from [the CPA’s] showing the documents [they were] provided by  
24 appellants and when the documents were provided, the steps [the CPA’s] took and the substantive law  
25 interpretation[s] [the CPA’s] made in preparing the estimated tax liabilities for each appellant,  
26 respondent will review that statement and make any appropriate adjustments.” (Resp. Br., p. 4.)

### 27 Applicable Law

28 Revenue and Taxation Code (R&TC) section 19132, subdivision (a)(1)(A), provides

1 generally that a penalty is imposed in the case of failure to pay the amount shown as tax on any return  
2 on or before the date prescribed for payment of that tax determined with regard to any extension of time  
3 for payment, unless it is shown that the failure is due to reasonable cause and not due to willful neglect.  
4 R&TC section 18567, subdivision (b), provides that an extension of time for filing a tax return is not an  
5 extension of time for payment of tax required to be paid on or before the due date of the return without  
6 regard for extension. R&TC section 18567, subdivision (c), provides that a reasonable extension for  
7 payment of tax may be granted by respondent whenever in its judgment good cause exists.

8           The Board has specifically stated that the imposition of a penalty for late payment is  
9 proper unless the late payment was due to reasonable cause and not due to willful neglect. The taxpayer  
10 bears the burden of proving that both of those conditions existed. In order to establish “reasonable  
11 cause,” the taxpayer must show that his failure to pay timely the proper amount of tax occurred despite  
12 the exercise of ordinary business care and prudence. (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26,  
13 1983.)

14           The United States Supreme Court has held that the reliance by a taxpayer on an agent to  
15 file a return in a timely manner is not “reasonable cause” for filing a late return but also stated that when  
16 an attorney or accountant advises a taxpayer on a matter of tax law, such as whether a liability exists, it  
17 is reasonable for the taxpayer to rely on that advice. (*United States v. Boyle*, *supra*, 469 U.S. at pp. 251-  
18 252.) The Board has characterized the statement in *Boyle* regarding reliance upon professional tax  
19 advice as a general rule for determining whether a taxpayer had “reasonable cause” for either filing a  
20 late return or making a late payment of tax. The Board also stated that a question of law requiring a tax  
21 expert’s opinion does not arise by the mere fact that a putative tax expert completes a taxpayer’s return.  
22 The Board further stated there that an error in a simple computational problem, not in a legal  
23 interpretation, by a putative expert would not constitute “reasonable cause” for failure to make a tax  
24 payment in a timely manner. In that regard, the Board stated that a taxpayer has the imputed knowledge  
25 and ability to perform those tasks required of him by the tax code, such as filing a return by the proper  
26 due date. (*Appeal of Philip C. and Anne Berolzheimer*, *supra*.)

27           IRC sections 734 (a)-(e) provide as follows:

28           **Sec. 734 adjustment to basis of undistributed partnership property where section  
754 election or substantial basis reduction.**

1           **(a) General rule.**

2           The basis of partnership property shall not be adjusted as the result of a distribution of  
3           property to a partner unless the election, provided in section 754 (relating to optional  
4           adjustment to basis of partnership property), is in effect with respect to such partnership  
5           or unless there is a substantial basis reduction with respect to such distribution.

6           **(b) Method of adjustment.**

7           In the case of a distribution of property to a partner by a partnership with respect to which  
8           the election provided in section 754 is in effect or with respect to which there is a  
9           substantial basis reduction, the partnership shall –

10           (1) increase the adjusted basis of partnership property by-

11           (A) the amount of any gain recognized to the distribute partner with respect to  
12           such distribution under section 731 (a)(1), and

13           (B) in the case of distributed property to which section 732(a)(2) or (b) applies,  
14           the excess of the adjusted basis of the distributed property to the partnership  
15           immediately before the distribution (as adjusted by section 732(d)) over the basis  
16           of the distributed property to the distribute, as determined under section 732, or

17           (2) decrease the adjustment basis of partnership property by –

18           (A) the amount of any loss recognized to the distribute partner with respect to  
19           such distribution under section 731(a)(2), and

20           (B) in the case of distribution property to which section 732(b) applies, the excess  
21           of the basis of the distributed property to the distribute, as determined under  
22           section 732, over the adjusted basis of the distributed property to the partnership  
23           immediately before such distribution (as adjusted by section 732(d)).

24           Paragraph (1)(b) shall not apply to any distributed property which is an interest in  
25           another partnership with respect to which the election provided in section 754 is not  
26           in effect.

27           **(c) Allocation of basis.**

28           The allocation of basis among partnership properties where subsection (b) is  
29           applicable shall be made in accordance with the rules provided in section 755.

30           **(d) Substantial basis reduction.**

31           (1) In general. For purposes of this section, there is a substantial basis reduction with  
32           respect to a distribution if the sum of the amounts described in subparagraphs (A) and  
33           (B) of subsection (b)(2) exceeds \$250,000.

34           (2) Regulations. For regulations to carry out this subsection, see section 743(d)(2).

35           **(e) Exception for securitization partnerships.**

36           For purposes of this section, a securitization partnership (as defined in section 743(f))  
37           shall not be treated as having a substantial basis reduction with respect to any distribution  
38           of property to a partner.

39           IRC sections 743(a)-(c) provide as follows:

40           **Sec. 743. Special rules where section 754 election or substantial built-in loss.**

41           **(a) General rule.**

42           The basis of partnership property shall not be adjusted as the result of a transfer  
43           of an interest in a partnership by sale or exchange or on the death of a partner  
44           unless the election provided by section 754 (relating to optional adjustment to  
45           basis of partnership property) is in effect with respect to such partnership or  
46           unless the partnership has a substantial built-in loss immediately after such  
47           transfer.

48           **(b) Adjustment to basis of partnership property.**

49           In the case of a transfer of an interest in a partnership by sale or exchange or  
50           upon the death of a partner, a partnership with respect to which the election  
51           provided in section 754 is in effect or which has a substantial built-in loss  
52           immediately after such transfer shall-

- 1 (1) increase the adjusted basis of the partnership property by the excess of the  
2 basis to the transferee partner of his interest in the partnership over his  
3 proportionate share of the adjusted basis of the partnership property, or
- 4 (2) decrease the adjusted basis of the partnership property by the excess of the  
5 transferee partner's proportionate share of the adjusted basis of the  
6 partnership property over the basis of his interest in the partnership.

7 Under regulations prescribed by the Secretary, such increase or decrease shall  
8 constitute an adjustment to the basis of partnership property with respect to the  
9 transferee partner only. A partner's proportionate share of the adjusted basis of  
10 partnership property shall be determined in accordance with his interest in  
11 partnership capital and, in the case of property contributed to the partnership by a  
12 partner, section 704(c) (relating to contributed property) shall apply in  
13 determining such share. In the case of an adjustment under this subsection to the  
14 basis of partnership property subject to depletion, any depletion allowable shall be  
15 determined separately for the transferee partner with respect to his interest in such  
16 property.

17 **(c) Allocation of basis.**

18 The allocation of basis among partnership properties where subsection (b) is  
19 applicable shall be made in accordance with rules provided in section 755.

20 IRC section 754 provides as follows:

21 **Sec. 754. Manner of electing optional adjustment to basis of partnership property.**

22 If a partnership files an election, in accordance with regulations prescribed by the  
23 Secretary, the basis of partnership property shall be adjusted, in the case of a distribution  
24 of property, in the manner provided in section 734 and, in the case of a transfer of a  
25 partnership interest, in the manner provided in section 743. Such an election shall apply  
26 with respect to all distributions of property by the partnership and to all transfers of  
27 interests in the partnership during the taxable year with respect to which such election  
28 was filed and all subsequent taxable years. Such election may be revoked by the  
partnership, subject to such limitations as may be provided by regulations prescribed by  
the Secretary.

IRC section 755 provides as follows:

**Sec 755. Rules for allocation of basis.**

**(a) General rule.**

Any increase or decrease in the adjusted basis of partnership property under section 734(b)  
(relating to the optional adjustment to the basis of undistributed partnership property) or section  
743(b) (relating to the optional adjustment to the basis of partnership property in the case of a  
transfer of an interest in a partnership) shall, except as provided in subsection (b), be allocated –

- (1) in a manner which has the effect of reducing the difference between the fair market value  
and the adjusted basis of partnership properties, or
- (2) in any other manner permitted by regulations prescribed by the Secretary.

**(b) Special rule.**

In applying the allocation rules provided in subsection (a), increases or decreases in the  
adjusted basis of partnership property arising from a distribution of, or a transfer of an interest  
attributable to, property consisting of –

- (1) capital assets and property described in section 1231(b), or
- (2) any other property of the partnership,

shall be allocated to partnership property of a like character except that the basis of any such  
partnership property shall not be reduced below zero. If, in the case of a distribution, the  
adjustment to basis of property described in paragraph (1) or (2) is prevented by the absence  
of such property or by insufficient adjusted basis for such property, such adjustment shall be  
applied to subsequently acquired property of a like character in accordance with regulations  
prescribed by the Secretary.

1 (c) **No allocation of basis decrease to stock of corporate partner.**

2 In making an allocation under subsection (a) of any decrease in the adjusted basis of  
3 partnership property under section 734(b) –

4 (1) no allocation may be made to stock in a corporation (or any person related (within the  
5 meaning of sections 267(b) and 707(b)(1) to such corporation) which is a partner in the  
6 partnership, and

7 (2) any amount not allocable to stock by reason or paragraph (1) shall be allocated under  
8 subsection (a) to other partnership property.

9 Gain shall be recognized to the partnership to the extent that the amount required to be allocated  
10 under paragraph (2) to other partnership property exceeds the aggregate adjusted basis of such  
11 other property immediately before the allocation required by paragraph (2).

12 STAFF COMMENTS

13 Appellants should be prepared to explain in detail, or simply to state if appropriate, at the  
14 hearing (1) the qualifications of the CPA's to prepare trust income tax returns with complex legal issues,  
15 like the adjustment of basis issues here, and to determine the amounts of associated tax payments, (2)  
16 the reasons appellants engaged the CPA's, (3) the exact terms of the engagement of the CPA's by  
17 appellants, (4) the relevant information appellants provided to the CPA's before payment of tax by  
18 appellants on or before April 15, 2008, and (5) the identity of the preparer of Mrs. Gerber's estate tax  
19 return. In that regard, appellants should provide any engagement agreement between appellants and the  
20 CPA's and any documentation establishing the date appellants provided Mrs. Gerber's estate tax return,  
21 or relevant information about the return, to the CPA's if someone other than the CPA's prepared the  
22 return.

23 With regard to the first error allegedly made by the CPA's, appellants should also be  
24 prepared to discuss in detail (1) whether the CPA's were aware of IRC section 743(b) and associated  
25 sections when they erroneously determined appellants' tax liability, (2) whether the CPA's did not  
26 interpret those sections correctly if they were aware of the sections, and (3) whether the CPA's made  
27 errors of calculation or other applications of the sections if they were aware of the sections. With regard  
28 to the second error allegedly made by the CPA's, appellants should be prepared to discuss in detail (1)  
whether the CPA's were aware of the 30 percent discount taken on Mrs. Gerber's estate tax return when  
they erroneously determined appellants' tax liability, (2) whether the CPA's were aware of the rule  
allegedly requiring the allocation of the discount among her assets, and (3) whether the failure to take  
the 30 percent discount properly into account was related to any mistake in calculation or other form of  
application. Appellants should provide any documentation supporting their responses regarding the two

1 alleged errors, including the statements under penalty of perjury by the CPA's previously requested by  
2 respondent, relevant working papers of the CPA's, and a copy of any election made by appellants under  
3 IRC section 754.

4 Finally, the parties should be prepared to discuss at the hearing the applicability of the  
5 *Boyle, Berolzheimer, and Haywood Lumber* cases or other authority to the facts of the instant matter and  
6 the relationship of those cases or other authority to each other. In that regard, the parties should also be  
7 prepared to discuss what would be the correct result under each of *Boyle, Berolzheimer, and Haywood*  
8 *Lumber* if the two errors by the CPA's were errors in making complex computations that only skilled tax  
9 professionals are accustomed to making rather than errors of legal analysis or in making simple  
10 computations.

11 Appellants should mail requested documentary evidence 14 days before the hearing in  
12 this matter, with a copy to respondent, to:

Claudia Madrigal  
State Board of Equalization  
Board Proceedings Division  
P.O. Box 942879 (MIC:80)  
Sacramento, CA 94279-0081

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