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

10 In the Matter of the Appeal of: ) **HEARING SUMMARY**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **KAMLESHWAR C. GUNSAGAR AND** ) Case No. 484764<sup>2</sup>  
13 **ANITA GUNSAGAR**<sup>1</sup> )

	<u>Years</u>	<u>Proposed</u> <u>Assessments</u> <sup>3</sup>	<u>Tax</u>	<u>Penalties</u> <sup>4</sup>
	2001		\$72,369.00	\$22,471.85
	2003		\$53,370.00	\$13,342.50

17 Representing the Parties:

19 For Appellants: Jeffrey B. Khan  
20 For Franchise Tax Board: Raul A. Escatel, Tax Counsel

23 <sup>1</sup> Appellants list an address in Santa Clara County, California.

24 <sup>2</sup> As discussed further below, this appeal has been delayed numerous times to allow further briefing and to allow appellants  
25 time to obtain a new tax representative. Appellants were previously represented by Naresh Arora, CPA, and Harpreet  
26 Chaudhary.

27 <sup>3</sup> Staff notes that both parties have made concessions in this matter, relating to the first and second issues. The effect of these  
28 concessions is not reflected in the tax and penalty amounts above.

<sup>4</sup> For 2001, the penalties are comprised of a failure to furnish information penalty of \$18,092.25 and a proposed post-amnesty  
penalty of \$4,379.60. For 2003, the penalty is composed of a failure to furnish information penalty of \$13,342.50.

- 1 QUESTIONS: (1) Whether appellants have established that they are entitled to their claimed  
2 worthless stock deductions for 2001 and/or 2003.  
3 (2) Whether appellants have established that they are entitled to exclude gains under  
4 Revenue and Taxation Code (R&TC) section 18152.5 (50 percent gain exclusion).  
5 (3) Whether appellants have provided reasonable cause for relief from the failure to  
6 furnish information penalties issued for 2001 and/or 2003.  
7 (4) Whether the Board has jurisdiction to consider a proposed post-amnesty penalty  
8 issued for 2001.

9 HEARING SUMMARY

10 Procedural Matters

11 This appeal was originally set for oral hearing on the Board's December 14-16, 2010  
12 calendar. It was removed from that calendar and scheduled as a nonappearance item for the Board's  
13 January 26-28, 2011 calendar because appellants failed to respond to the hearing notice. Later, at  
14 appellants' request, this matter was placed on the Board's February 22-24, 2011 oral hearing calendar.  
15 Subsequently, appellants obtained a new representative and, to allow time for appellants' new  
16 representative to prepare for the oral hearing, appellants requested that the appeal be rescheduled.  
17 Accordingly, the appeal was rescheduled to the Board's May 24-26, 2011 oral hearing calendar.  
18 Subsequently, a Board member inquiry was sent to appellants and the FTB. In response, appellants and  
19 the FTB provided additional arguments and/or documentation. Afterwards, the Appeals Division staff  
20 (staff) determined that, in light of the additional documentation submitted, further briefing was  
21 appropriate. Accordingly, on May 31, 2011, staff requested further briefing. The responses of  
22 appellants and the FTB to the above-listed requests are incorporated into this hearing summary.

23 Background

24 2001

25 Appellants filed a joint 2001 California tax return, reporting a California taxable income  
26 of \$8,352,430. Subsequently, the Franchise Tax Board (FTB or respondent) audited appellants' 2001

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1 return, and on February 10 and June 21, 2006, the FTB issued requests for further information.<sup>5</sup> Later,  
2 on August 11, 2006, the FTB issued a demand for further information.<sup>6</sup> And, on May 31, 2007, the FTB  
3 issued a Notice of Proposed Assessment (NPA).<sup>7</sup>

4 Appellants timely protested the NPA. However, the FTB asserts that, during the protest  
5 stage of the proceedings, appellants failed to provide sufficient evidence to support all of the  
6 deductions/exclusions reported on their 2001 return.<sup>8</sup> Later, the FTB issued a Notice of Action (NOA)  
7 dated March 2, 2009. The NOA reflected the following adjustments to appellants' 2001 California  
8 taxable income: (a) the disallowance of a worthless securities deduction of \$568,000; (b) the  
9 disallowance of an Internal Revenue Code (IRC) section 1202 (R&TC section 18152.5) gain exclusion  
10 of \$101,405; (c) the disallowance of an IRC section 1045 (R&TC section 18038.5) rollover of \$72,500;  
11 and (d) the addition of \$36,253 due to an adjusted gross income (AGI) itemized deduction limitation.  
12 The NOA included the imposition of additional tax of \$72,369.00, a failure to furnish information  
13 penalty of \$18,092.25, a proposed post-amnesty penalty of \$4,379.60, and interest. After receiving the  
14 NOA, appellants filed this timely appeal.

#### 15 2003

16 Appellants filed a joint 2003 California tax return, reporting a California taxable income  
17 of \$451,033. Subsequently, the FTB audited appellants' 2003 return, and on February 10 and June 21,  
18 2006, the FTB issued the previously-mentioned requests for further information. Later, on August 11,  
19 2006, the FTB issued a demand for further information.<sup>9</sup> And, on May 31, 2007, the FTB issued an

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23 <sup>5</sup> Copies of the FTB's requests for further information are not provided in the appeal file. However, a demand letter (attached  
24 as Exhibit F to the FTB's opening brief) states that the FTB's requests were issued on February 10 and June 21, 2006.

25 <sup>6</sup> The demand letter does not set forth the further information requested; instead, it refers to the information requested in the  
26 FTB's letters dated February 10 and June 21, 2006, which, as mentioned, are not provided in the appeal file.

27 <sup>7</sup> A copy of the NPA was provided on appeal, but the copy is not legible because the words "Rep Copy" are stamped across  
28 the document so that key words and numbers are not known.

<sup>8</sup> Details of the protest stage of the proceedings are not provided in the appeal file.

<sup>9</sup> The demand letter does not set forth the further information requested; instead, it refers to the information requested in the  
FTB's letters dated February 10 and June 21, 2006, which are not provided in the appeal file.

1 NPA.<sup>10</sup> Appellants timely protested the NPA. However, the FTB asserts that during the protest stage of  
 2 the proceedings, appellants failed to provide sufficient evidence to support all the deductions/exclusions  
 3 reported on their 2003 return.<sup>11</sup> Later, the FTB issued an NOA dated March 2, 2009. The NOA  
 4 reflected the following adjustments to appellants' 2003 California taxable income: (a) the disallowance  
 5 of a worthless securities deduction of \$60,000; (b) the disallowance of an IRC section 1202 (R&TC  
 6 section 18152.5) gain exclusion of \$556,459; (c) the disallowance of an IRC section 1045 (R&TC  
 7 section 18038.5) rollover of \$90,000; and (d) the addition of \$42,388 due to an AGI itemized deduction  
 8 limitation. The NOA included the imposition of additional tax of \$53,370.00, a failure to furnish  
 9 information penalty of \$13,342.50, and interest. After receiving the NOA, appellants filed this timely  
 10 appeal.

11 **ISSUE (1): Whether appellants have established that they are entitled to their claimed worthless**  
 12 **stock deductions for 2001 and/or 2003.**

13 Introduction

14 The following worthless stock deductions are represented in the NOAs:

15 2001 Tax Year

16 STOCK	Amount Disallowed in NOA	Adjustment by FTB on appeal	Conceded by appellants on appeal	Amount still at issue on appeal
17 Kavtech	\$ 28,000.00	\$ 0.00	\$0.00	\$ 28,000.00
18 Planet Mirth	\$500,000.00	\$ 72.50	\$0.00	\$ 499,927.50
19 Conversion Industries	\$ 15,000.00	\$ 0.00	\$0.00	\$ 15,000.00
20 ECS Web, Inc.	\$ 25,000.00	\$ 25,000.00	\$0.00	\$ 0.00

21 2003 Tax Year

22 STOCK	Amount Disallowed in NOA	Adjustment by FTB on appeal	Conceded by appellants on appeal	Amount still at issue on appeal
23 Infodream	\$ 25,000	\$0	\$25,000	\$ 0
24 Divio	\$ 30,000	\$0	\$ 0	\$30,000
25 Global Comm. Partners II	\$ 5,000	\$0	\$ 5,000	\$ 0

26  
 27 <sup>10</sup> A copy of the NPA was provided on appeal, but the copy is not legible because the words "Rep Copy" are stamped on the document.

28 <sup>11</sup> Details of the protest stage of the proceedings are not provided in the appeal file.

1 With the above concessions in mind, we proceed with the parties' contentions for the items remaining at  
2 issue.

3 Contentions

4 *Kaytech - 2001*

5 *Appellants:* Appellants assert that Kaytech was a startup company that was entirely  
6 funded by appellants. Appellants allege that they invested funds for the purchase of computer  
7 equipment and abandoned the project (Kaytech) in 2001. Appellants state that Kaytech should not be  
8 confused with the company named "Kaytech Industries Corporation," which appellants allege is a public  
9 company that is currently in business.

10 *The FTB:* The FTB asserts that, other than appellants' unsupported assertions in their tax  
11 returns and on appeal, appellants have provided no evidence (i.e., receipts, stock records, purchase  
12 agreements, letters, declarations from third parties, etc.) establishing (i) their basis in the Kaytech stock,  
13 or (ii) when their Kaytech stock allegedly became worthless. The FTB also questioned whether  
14 "Kaytech" is "Kaytech Industries Corporation," which the FTB asserts is a public company that is  
15 currently in business.

16 *Planet Mirth, Inc. - 2001*

17 The only issue which remains in dispute in relation to Planet Mirth is whether appellants  
18 have provided sufficient evidence establishing the basis in their Planet Mirth stock.

19 *Appellants:* Appellants argue that their basis in the Planet Mirth stock is \$500,000. In  
20 support, appellants provided the following documents with their appeal letter and/or their first  
21 supplemental brief:

- 22 • A Planet Mirth stock certificate, dated December 16, 1988, certifying that appellant-husband  
23 is the holder of 500,000 shares, with a par value of \$.0001 per share.
- 24 • A Planet Mirth stock certificate, dated December 16, 1988, certifying that appellant-husband  
25 is the holder of 200,000 shares, with a par value of \$.0001 per share.
- 26 • A Planet Mirth stock certificate, dated December 16, 1988, certifying that appellant-husband  
27 is the holder of 25,000 shares, with a par value of \$.0001 per share.
- 28 • A Planet Mirth stock agreement, dated June 15, 1998, granting appellants 25,000 shares for

1 an unspecified amount of consideration in the form of cash, check, wire transfer, or the  
2 cancellation of debt.

- 3 • A Planet Mirth stock agreement, dated June 15, 1998, granting appellants 200,000 shares for  
4 an unspecified amount of consideration in the form of cash, check, wire transfer, or the  
5 cancellation of debt.
- 6 • A Planet Mirth stock purchase agreement, dated October 28, 1995, granting appellant-  
7 husband 500,000 shares at a price of \$.0001 per share, for a total purchase price of \$50.00.
- 8 • A statement from Mr. Ishwar Jain, who claims to be the founder and past president of Planet  
9 Mirth, and who asserts, among other things, that (a) appellant-husband spent over \$500,000  
10 in his attempt to make Planet Mirth viable, and (b) Planet Mirth ceased to be functional in  
11 2001. The statement is not signed under penalty of perjury.
- 12 • Various statements from appellant-husband (attached to appellants' reply brief) stating,  
13 among other things, that when Planet Mirth was established in June 1998, cumulative losses  
14 prior to the formal establishment of Planet Mirth, had reached \$500,000, which were  
15 transferred to Planet Mirth, and Planet Mirth ceased to exist on December 31, 2001. The  
16 statements are not signed by appellant-husband.

17 Later, on May 20, 2011, appellants provided the following 14 additional exhibits to the Board  
18 Proceedings Division:

- 19 1. Invoices from Keck, Mahin & Cate totaling \$45,642.87;
- 20 2. Invoices from Wilson Sonsini totaling \$32,619.52;
- 21 3. A copy of a check to Wilson Sonsini dated July 30, 2000, for \$10,000;
- 22 4. A copy of a United States patent for a subcompact florescent lamp;
- 23 5. A copy of a patent from the World Intellectual Property Organization;
- 24 6. An invoice dated November 28, 1998, from "KJD" Lighting for the manufacture of 2000  
25 units of "Energy-Saving Lamps" for \$6,800 (Hong Kong Dollars);
- 26 7. An invoice from Global Engineering Documents for \$182.77;
- 27 8. An invoice and cancelled check to Area Financial Services Inc., for tax preparation for the  
28 years 1998 and 1999, totaling \$1,500;

- 1 9. A bill from Adaptive Electronics dated September 1, 1998, for services totaling \$38,275;
- 2 10. Invoices from Intertek Testing Services totaling \$15,662.50;
- 3 11. Test reports from Intertek Testing Services dated August 15, 2000, and March 2, 2001;
- 4 12. A partnership agreement between Energy Star and Planet Mirth, dated December 17, 2001;
- 5 13. Payments made to State of Delaware totaling \$4,812; and
- 6 14. Credit card payments made to ETL Testing Lab totaling \$15,188.

7 *The FTB:* As noted above, the only issue which remains in dispute in relation to Planet  
8 Mirth is whether appellants have provided sufficient evidence establishing their basis in the Planet Mirth  
9 stock. In relation to this issue, the FTB makes twelve arguments.

10 First, the FTB asserts that (a) the stock certificates appellants provided on appeal show  
11 that appellants owned 725,000 shares of Planet Mirth, and (b) based on the 1995 stock purchase  
12 agreement, it can be assumed that appellants paid consideration of \$.0001 per share, for a total basis in  
13 the 725,000 shares of \$72.50. Thus, the FTB argues that, out of the claimed basis of \$500,000.00,  
14 appellants have established a basis of only \$72.50.

15 Second, the FTB argues that appellants have not provided any evidence showing that the  
16 \$500,000 Mr. Jain refers to in his letter (above) was not a loan (as opposed to an investment in stock).

17 Third, the FTB states that the expenses/costs set forth in the 14 exhibits appellants  
18 provided to the Board Proceedings Division on May 20, 2011, total only \$170,682.66, which is less than  
19 the \$500,000 appellants claim as their basis in the Planet Mirth shares.

20 Fourth, the FTB notes that the invoices from Keck, Mahin & Cate show legal expenses  
21 totaling \$45,642.87 incurred in a lawsuit in which Mr. Ishwar D. Jain (the alleged founder and president  
22 of Planet Mirth) was a party. The FTB asserts, however, that appellants fail to explain how these legal  
23 expenses for litigation costs in which Planet Mirth was not a party increase appellants' basis in the  
24 Planet Mirth shares. Similarly, the FTB argues that there is no explanation as to how appellants'  
25 offering of financial assistance to Mr. Jain in a lawsuit against a third party increases appellants' basis in  
26 the Planet Mirth shares. Furthermore, the FTB argues that even if appellants assisted Mr. Jain, Planet  
27 Mirth was not a party to the litigation, as it appears that Mr. Jain filed suit in his individual capacity.  
28 Finally, the FTB states that appellants have not provided any loan documents showing whether the funds

1 allegedly transferred to Mr. Jain were loaned or gifted.

2 Fifth, as to the legal invoices from Wilson Sonsini for amounts billed to Planet Mirth, the  
3 FTB argues that the invoices do not indicate the purpose of the billings. The FTB asserts that the  
4 invoices state that the amounts billed are for “General Corporate Matters.” Also, the FTB states that the  
5 check made out to Wilson Sonsini in the amount of \$10,000 does not indicate that appellants made that  
6 \$10,000 payment.

7 Sixth, as to the patent information that appellants provided, the FTB asserts that  
8 appellants have given no explanation as to how this patent information increases the basis in their Planet  
9 Mirth shares.

10 Seventh, in relation to the invoice from KJD Lighting (which shows that Planet Mirth  
11 owed \$6,800 to KJD Lighting) the FTB argues that appellants fail to demonstrate how this invoice  
12 relates to their basis in the Planet Mirth shares.

13 Eighth, as to the invoice from Area Financial Services and the check by Planet Mirth, the  
14 FTB argues that those documents fail to demonstrate how amounts paid for tax services increase  
15 appellants’ basis in the Planet Mirth stock.

16 Ninth, in relation to the invoices from Intertek Testing Services, the FTB argues that  
17 although some of the invoices show appellant-husband’s name, the invoices are billed to Planet Mirth  
18 and are a liability to Planet Mirth (not appellants). Also, the FTB asserts that there is no evidence  
19 appellant-husband was liable for the amounts invoiced.

20 Tenth, as to the invoice from Adaptive Electronics, the FTB contends that appellants  
21 failed to show how the invoice from Adaptive Electronics increased appellants’ basis in the Planet Mirth  
22 stock. Also, the FTB argues that there is no evidence that the amount listed on the invoice was a  
23 liability of appellant-husband.

24 Eleventh, the FTB notes that appellants provided (a) a partnership agreement between  
25 Energy Star and Planet Mirth, (b) information from the Delaware Secretary of State relating to Planet  
26 Mirth’s incorporation, and (c) copies of Planet Mirth’s tax reports. However, the FTB argues that  
27 appellants fail to explain the relevance of those documents to the basis calculation for the Planet Mirth  
28 shares.

1 Finally, the FTB states that “[i]t is not clear whether appellants intended any alleged  
2 financial assistance given to Planet Mirth go toward their ‘investment’ in Planet Mirth.”

3 Conversion Industries, Inc. - 2001

4 *Appellants:* Appellants state in their reply brief that the Conversion Industries stock was  
5 purchased “10 years ago” for \$15,000 from a broker named Mina K. Furo and that the stock became  
6 worthless in 2001. In support of their arguments, appellants provided a broker’s statement from Mina  
7 K. Furo for the period of December 1, 2001, through December 31, 2001, showing 1,000 shares of  
8 Conversion Industries stock with a price reported as “unpriced” and a market value listed as \$0.00.  
9 Appellants state that the FTB can verify the cost of the stock by calling the broker.

10 *The FTB:* The FTB argues that the broker’s statement from Mina K. Furo does not show  
11 the initial value that appellants paid for the shares of Conversion Industries; thus, the FTB asserts that  
12 based on the broker’s statement, it cannot determine appellants’ basis in the shares of Conversion  
13 Industries. Likewise, the FTB states that appellants failed to produce any documents showing how  
14 many shares of Conversion Industries stock they allegedly obtained for \$15,000. In addition, the FTB  
15 argues that it managed to find a company report (a copy of which is attached to the FTB’s opening  
16 brief), which indicates that Conversion Industries is a penny stock that is active on the over-the-counter  
17 market. Thus, the FTB states that appellants have not shown the Conversion Industries shares have  
18 become worthless.

19 Divio - 2003

20 It appears that the FTB does not dispute that appellants had a basis of \$30,000 in their  
21 Divio stock. Thus, it appears that the only issue remaining as to appellants’ Divio stock is whether  
22 appellants have provided sufficient evidence showing that the Divio stock became worthless in 2003.

23 *Appellants:* In an attempt to prove that the Divio stock became worthless in 2003,  
24 appellants refer to a letter dated November 12, 2003, from Jerry Chan of AEC, Inc. A copy of the letter  
25 was not provided on appeal. In that letter, Mr. Chan allegedly states that he heard Divio was in deep  
26 financial trouble, despite several rounds of investments.

27 *The FTB:* The FTB states that Mr. Chan’s letter only mentions that Divio was in  
28 “trouble,” which is not enough to show that Divio became worthless in 2003. In addition, the FTB

1 apparently argues that a statement from Mr. Chan would not, by itself, be sufficient to prove that Divio  
2 became worthless in 2003.

### 3 Applicable Law

4 Income tax deductions are a matter of legislative grace, and a taxpayer who claims a  
5 deduction has the burden of proving by competent evidence that he or she is entitled to that deduction.  
6 (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Michael E. Myers*,  
7 2001-SBE-001, May 31, 2001.)<sup>12</sup> Unsupported assertions cannot satisfy a taxpayer's burden of proof.  
8 (*Appeal of James C. and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975.)

9 IRC section 165(g)(1) allows a taxpayer to claim a capital loss deduction for any security  
10 that becomes worthless during the taxable year.<sup>13</sup> IRC section 165(g)(2) clarifies that the term  
11 "security" includes stock in a corporation. The worthlessness of the stock must be fixed by an  
12 identifiable event that furnishes a reasonable basis for abandoning any hope of future recovery. (*Appeal*  
13 *of Southwestern Development Company*, 85-SBE-104, Sept. 10, 1985; *Appeal of Lambert-California*  
14 *Corporation*, 80-SBE-155, Dec. 9, 1980.) In order to be worthless, the stock must have no liquidating  
15 value and no reasonable hope of regaining value in the future. (*Austin Co. v. Commissioner* (1979) 71  
16 T.C. 955, 970.) A corporation's liquidation is an "identifiable event" to fix the worthlessness of the  
17 stock. (*Austin Co. v. Commissioner, supra*, at p. 970.) The burden is on the taxpayer to establish that  
18 the stock became totally worthless during the tax year for which the deduction is claimed. (*Appeal of*  
19 *Lambert-California Corporation, supra*.)

### 20 STAFF COMMENTS

#### 21 Kaytech - 2001

22 Other than appellants' unsupported assertions, appellants have not provided any evidence  
23 (i.e., receipts, stock records, purchase agreements, letters, declarations from third parties, etc.)  
24 establishing their basis in the Kaytech stock or when the Kaytech stock allegedly became worthless. As  
25 noted above, appellants' unsupported assertions are not sufficient to carry an appellant's burden of  
26

27 <sup>12</sup> Board of Equalization cases are generally available for viewing on the Board's website ([www.boe.ca.gov](http://www.boe.ca.gov)).

28 <sup>13</sup> California generally conforms to IRC section 165 at R&TC section 17201.

1 proof. (*Appeal of James C. and Monablance A. Walshe, supra.*)

2 **Planet Mirth, Inc. (PMI) – 2001**

3 Appellants should be prepared to show that how the documents they provided on appeal  
4 in relation to Planet Mirth (as listed above), in addition to any statements provided at the oral hearing,  
5 are sufficient to overcome the FTB’s determination that appellants have a basis of only \$72.50 in this  
6 stock.

7 **Conversion Industries, Inc. - 2001**

8 Staff questions whether the evidence provided on appeal is sufficient to establish (i)  
9 appellants’ basis in the Conversion Industries stock, and (ii) when the Conversion Industries stock  
10 allegedly became worthless. First, the broker’s statement for the period ending December 31, 2001,  
11 indicates that the shares are “unpriced” and have a market value of \$0.00. This evidence, by itself, does  
12 not appear to support a finding that appellants had a basis of \$15,000 in the Conversion Industries stock  
13 and, other than appellants’ unsupported assertions, staff finds no other evidence in the appeal file to  
14 support such a finding. Second, although the broker’s statement indicates that the shares are “unpriced”  
15 and have a market value of \$0.00 for the period ending December 31, 2001, this evidence does not  
16 appear to foreclose the possibility that the shares became worthless in an earlier year, or even in a later  
17 year.

18 **Divio - 2003**

19 A copy of Mr. Chan’s letter has not been provided as part of the appeal record.  
20 Nevertheless, appellants cite to this letter, in which Mr. Chan allegedly states that Divio was “in trouble”  
21 in 2003. Here, even if the Board were to assume that Mr. Chan made such a statement, Mr. Chan’s  
22 statement would not necessarily imply that Divio stopped operations or became worthless in 2003.  
23 Accordingly, staff questions whether appellants have provided sufficient evidence showing that Divio  
24 became worthless in 2003.

25 **QUESTION (2): Whether appellants have established that they are entitled to exclude gains**  
26 **under R&TC section 18152.5 (50 percent gain exclusion).**

27 **Introduction**

28 Before analyzing the parties’ contentions, it should be noted that in their opening briefs

1 both appellants' former representative<sup>14</sup> and the FTB seemed to be under the mistaken impression that to  
2 qualify under the rollover provision of R&TC section 18038.5, a taxpayer must show that the applicable  
3 stock was held for "more than five years." That is not the law. As discussed in greater detail below,  
4 R&TC section 18038.5 allows for a rollover of the gain (i.e., a deferral of gain) on any qualified small  
5 business stock (QSBS) that is held for "more than six months" from the date of acquisition. In short, the  
6 holding period for the rollover provision of R&TC section 18038.5 is simply "more than six months."

7 In comparison, R&TC section 18152.5 provides for a 50 percent gain exclusion on any  
8 gain from the sale or exchange of QSBS held for "more than five years" from the date of acquisition.  
9 Thus, a holding period of "more than five years" is applicable to the 50 percent gain exclusion under  
10 R&TC section 18152.5 (but not for the rollover provision under R&TC section 18038.5). With this  
11 understanding in mind, staff summarizes the parties' contentions below.

12 In addition, staff notes the following. On their 2001 return, appellants sought (1) to  
13 exclude gain of \$101,405 from the sale of stock in Manufacturing Resource Corp. (MRC) (pursuant to  
14 R&TC section 18152.5) and (2) to exclude gain of \$72,500 from the sale of stock in Lara Technologies  
15 (pursuant to R&TC section 18038.5). Appellants now concede the disallowance of the gain exclusion of  
16 the Lara Technologies stock—in other words, that the \$72,500 gain is includable in their income.

17 On their 2003 return, appellants sought (1) to exclude gain of \$556,459<sup>15</sup> from the sale of  
18 stock in Lara Technologies (or "Lara Networks") (\$431,625) and from the sale of stock in MRC  
19 (\$124,834) (pursuant to R&TC section 18038.5) and (2) to exclude gain of \$90,000 from the sale of  
20 stock in Lara Technologies (pursuant to R&TC section 18038.5). The FTB now concedes that  
21 appellants are entitled to exclude the \$431,625 gain relating to the sale of the Lara Technologies stock.  
22 In addition, appellants now concede the disallowance of the \$90,000 gain exclusion of the Lara  
23 Technologies stock—in other words, that the \$90,000 gain is includable in their income.

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27 <sup>14</sup> Appellant is now represented by Jeffrey B. Khan.

28 <sup>15</sup> \$431,625 + \$124,834 = \$556,459.

1 Contentions2 Manufacturing Resource Corp. (MRC)— 2001

3 *Appellants:* In their 2001 Schedule D, appellants represent that (i) the sale of their MRC  
4 stock in 2001 generated a gain of \$202,809, and (ii) they are entitled to exclude gain of \$101,405 from  
5 income (i.e., 50 percent of \$202,809). As noted above, the NOA for 2001 disallowed this exclusion of  
6 \$101,405. On appeal, appellants seem to argue that the sale of the MRC stock in 2001 met the  
7 requirements of R&TC section 18152.5 and, therefore, they are entitled to exclude the gain of \$101,405  
8 from their 2001 California income. On appeal, appellants state that in the FTB's supplemental brief  
9 dated January 20, 2010, the FTB concedes that appellants' stock, in MRC met the asset and payroll tests  
10 set forth for QSBS. With this concession in mind, appellants apparently argue that the only issue  
11 remaining in dispute is whether they held their MRC stock for "more than five years" from the date of  
12 acquisition. Appellants argue that when they sold their MRC stock in 2001, they had held their MRC  
13 shares for more than five years. In support of that argument, appellants provided the following  
14 documents:

- 15 • A 2001 Form 1099-B, which states that appellant-husband received gross proceeds of \$202,909  
16 from the sale of MRC stock.
- 17 • A copy of a letter dated September 3, 2008, from Veereendra Gupta indicating that "[appellant-  
18 husband] was issued 2,080,000 common shares of MRC for cash consideration of \$260 on  
19 March 31, **199**." (Emphasis supplied.) Further, the letter states that "[u]nder an agreement dated  
20 April 6, 2000 [appellant-husband] elected to sell all his shares back to MRC" and the proceeds  
21 were "paid to him over a period beginning April 6, 2001 and sometime in 2003." The letter is  
22 not signed under penalty of perjury.
- 23 • A copy of a *revised* letter dated September 3, 2008, from Veereendra Gupta indicating that  
24 "[appellant-husband] was issued 2,080,000 common shares of MRC for cash consideration of  
25 \$260 on March 31, **1994**." (Emphasis supplied.) Further, the letter states that "[u]nder an  
26 agreement dated April 6, 2000 [appellant-husband] elected to sell all his shares back to MRC"  
27 and the proceeds were "paid to him over a period beginning April 6, 2001 and sometime in  
28 2003." The letter is not signed under penalty of perjury.

1           *The FTB:* The FTB appears to argue that the evidence appellants provided on appeal  
2 (i.e., the 2001 Form 1099-B and the letters from Veereendra Gupta) does not support a finding that  
3 appellants held the MRC stock for more than five years. For example, the FTB notes that the 2001  
4 Form 1099-B does not state the exact date when the MRC stock was sold, and the FTB states that an  
5 alleged sale in 2001 conflicts with Mr. Gupta’s letter, which states that appellant-husband elected to sell  
6 his shares on April 6, 2000. In addition, the FTB notes that the first version of the letter from Mr. Gupta  
7 provides incomplete information, in that the letter states “[appellant-husband] was issued 2,080,000  
8 common shares of MRC for cash consideration of \$260 on March 31, 199.” (Emphasis supplied.) (The  
9 FTB does not address the revised letter from Mr. Gupta.) Finally, the FTB argues that appellants did not  
10 provide evidence showing that the MRC stock was acquired as original issue stock.

#### 11           MRC—2003

12           *Appellants:* In their 2003 Schedule D, appellants represent that the sale of their MRC  
13 stock in 2003 generated gains totaling \$249,667 and they are entitled to exclude gain of \$124,834 from  
14 income (i.e., 50 percent of \$249,667) from that sale. On appeal, appellants seem to argue that the sale of  
15 the MRC stock in 2003 met the requirements of R&TC section 18152.5 and, therefore, they are entitled  
16 to exclude the gain from their income in 2003. Appellants assert that, in the FTB’s supplemental brief  
17 dated January 20, 2010, the FTB concedes that appellants’ stock in MRC met the asset and payroll tests  
18 set forth for QSBS.

19           *The FTB:* The FTB seems to argue that the evidence appellants provided on appeal is  
20 insufficient to prove that appellants’ sales of the MRC stock in 2003 met the requirements of R&TC  
21 section 18152.5 and, therefore, appellants are not entitled to exclude \$124,834 from income in 2003.

#### 22           Applicable Law

23           In order to stimulate investments in small businesses, the federal government enacted  
24 IRC sections 1202 and 1045, which provide tax relief to investors who are willing to invest funds in  
25 certain small businesses. California enacted similar—but not identical—rules, which provide tax relief to  
26 investors who are willing to invest funds in certain small businesses, provided the small businesses  
27 conduct a substantial portion of business in California.

28    ///

1                    R&TC section 18152.5

2                    R&TC section 18152.5 allows certain taxpayers to exclude 50 percent of the gain on the  
3 sale of QSBS held for “more than five years” from the date of acquisition.

4                    Definition of QSBS

5                    QSBS is defined in R&TC section 18152.5 as any stock in a C corporation, originally  
6 issued after August 10, 1993, if both of the following requirements are met:

- 7                    (A) As of the date of issuance, the corporation is a qualified small  
8                    business.
- 9                    (B) Except as provided in subdivisions (f) and (h), the stock is  
10                    acquired by the taxpayer at its original issue (directly or  
11                    through an underwriter) in either of the following manners:
- 12                    i. In exchange for money or other property (not including  
13                    stock).
- 14                    ii. As compensation for services provided to the  
15                    corporation (other than for services performed as an  
16                    underwriter of the stock).

(Rev. & Tax Code § 18152.5, subd. (c)(1).)

17                    R&TC section 18152.5, subdivision (d)(1), provides that a “qualified small business”  
18 means any domestic corporation which is a C corporation, provided it meets various asset and payroll  
19 tests, as follows:

- 20                    (A) The aggregate gross assets of the corporation (or any  
21                    predecessor thereof) at all times on or after July 1, 1993, and  
22                    before the issuance did not exceed fifty million dollars  
23                    (\$50,000,000);
- 24                    (B) The aggregate gross assets of the corporation immediately  
25                    after the issuance (determined by taking into account  
26                    amounts received in the issuance) do not exceed fifty million  
27                    dollars (\$50,000,000);
- 28                    (C) At least 80 percent of the corporation’s payroll, as measured  
by total dollar value, is attributable to employment located  
within California; and
- (D) The corporation agrees to submit those reports to the  
Franchise Tax Board and to shareholders as the Franchise  
Tax Board may require to carry out the purpose of this  
section.

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1 STAFF COMMENTS

2 MRC—2001

3 In relation to whether appellants' sale of MRC stock in 2001 met the requirements of  
4 R&TC section 18152.5, which would allow appellants to exclude gain of \$101,405 from income, staff  
5 questions whether the evidence provided on appeal (i.e., the 2001 Form 1099-B and the letters from  
6 Veereendra Gupta) is sufficient to support a finding that appellants held the MRC stock for more than  
7 five years. First, Mr. Gupta's original letter and his *revised* letter are not signed under penalty of  
8 perjury, which goes to the issue of credibility. Second, it appears that Mr. Gupta's *revised* letter may  
9 have been backdated, as appellants do not explain how they obtained a revised letter with the same date  
10 (September 3, 2008) as the original letter. Again, this goes to the issue of credibility. Third, appellants  
11 provided no receipts, checks, brokerage statements, stock certificates, etc. to support Mr. Gupta's  
12 statement that appellant-husband was issued MRC stock in 1994.<sup>16</sup> Here, given the deficiencies in  
13 Mr. Gupta's letters, staff questions the reliance which should be placed on Mr. Gupta's letters without  
14 further evidence to corroborate that appellant-husband was issued MRC stock in 1994. Finally,  
15 Mr. Gupta's letters do not clearly state that appellant-husband acquired the MRC stock as original issue  
16 stock. Accordingly, at the oral hearing, appellants should be prepared to address staff concerns and  
17 provide evidence and/or arguments that their sale of MRC stock in 2001 met the requirements of R&TC  
18 section 18152.5, which would allow appellants to exclude gain of \$101,405 from income.

19 MRC—2003

20 In their 2003 Schedule D, appellants represent that the sale of their MRC stock in 2003  
21 generated gains totaling \$249,667 and they are entitled to exclude gain of \$124,834 from income (i.e.,  
22 50 percent of \$249,667) from that sale. First, staff questions whether appellants have provided sufficient  
23 evidence showing that they held their MRC stock for "over five years" when they sold it in 2003.  
24 Specifically, as stated above, Mr. Gupta's letters are not signed under penalty of perjury and it appears  
25 to staff that Mr. Gupta's *revised* letter may have been back dated. Again, these concerns go to the issue  
26 of credibility. Likewise, appellants provided no receipts, checks, brokerage statements, etc. to support  
27

28 <sup>16</sup> In this respect, staff notes that the 2001 Form 1099-B does not state when the MRC stock was purchased.

1 Mr. Gupta's statement that appellant-husband was issued MRC stock in 1994.<sup>17</sup> Here, given the  
2 deficiencies in Mr. Gupta's letters, staff questions the reliance that the Board should place on Mr.  
3 Gupta's letters without further evidence to corroborate that appellant-husband was issued MRC stock in  
4 1994.

5 Second, staff notes that Mr. Gupta's letters do not clearly state that appellant-husband  
6 acquired the MRC stock as original issue stock, which is a requirement for an exclusion under section  
7 18152.5. Accordingly, at the oral hearing appellants should be prepared to address staff's concerns  
8 and/or provide analysis showing that appellants are entitled to exclude gain of \$124,834 from sale of  
9 appellants' MRC stock in 2003.

10 **QUESTION (3): Whether appellants have provided reasonable cause for relief from the failure**  
11 **to furnish information penalties issued for 2001 and/or 2003.**

12 Contentions

13 *Appellants:* It is not clear to staff whether appellants are disputing the failure to furnish  
14 information penalties for 2001 and/or 2003. On appeal, appellants do not make any arguments for relief  
15 of such penalties.

16 *The FTB:* The FTB seems to assert that appellants are not disputing the failure to furnish  
17 information penalties for 2001 and 2003.

18 Applicable Law

19 R&TC section 19133 provides that the FTB may impose a penalty when a taxpayer fails  
20 or refuses to furnish information requested by the FTB in writing. Unless the failure is due to  
21 reasonable cause, the penalty is 25 percent of the deficiency of tax. On appeal, the taxpayer bears the  
22 burden of proving that his/her failure to respond to the FTB was due to reasonable cause and not willful  
23 neglect. (*Appeal of W. L. Bryant*, 83-SBE-180, Aug. 17, 1983.) For purposes of R&TC section 19133,  
24 "reasonable cause" means the taxpayer's circumstances prevented him/her from complying with the  
25 FTB's demand, despite the exercise of ordinary care. (*Appeal of Elmer R. and Barbara Malakoff*,  
26 83-SBE-140, June 21, 1983; *Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982.)

27  
28 <sup>17</sup> Staff notes that the 2001 Form 1099-B does not state when the sock was purchased.

1 STAFF COMMENTS

2 Here, it appears to staff that appellants have not requested relief from the failure to  
3 furnish information penalties. Furthermore, it appears to staff that the evidence set forth on appeal does  
4 not provide reasonable cause for relief from such penalties.

5 **QUESTION (4): Whether the Board has jurisdiction to consider a proposed post-amnesty penalty**  
6 **issued for 2001.**

7 Contentions

8 *Appellants:* On appeal, it is not clear to staff whether appellants are disputing the  
9 proposed post-amnesty penalty for 2001.

10 *The FTB:* The FTB does not address the proposed post-amnesty penalty.

11 Applicable Law

12 In 2004, the Legislature enacted the income tax amnesty program. (Rev. & Tax. Code,  
13 §§ 19730-19738.) Eligible taxpayers could participate by filing an amnesty application and paying their  
14 outstanding liabilities of tax and interest, or entering into an installment plan, during the period of  
15 February 1, 2005, through March 31, 2005, inclusive. (Rev. & Tax. Code, §§ 19730 & 19731.) For  
16 liabilities that remained outstanding after the last day of the amnesty period, a penalty was imposed  
17 equal to 50 percent of the accrued interest payable. (Rev. & Tax. Code, § 19777.5, subd. (a).)

18 The Board's jurisdiction to review the amnesty penalty is extremely limited. For  
19 example, a taxpayer has no right to an administrative protest or appeal of an unpaid amnesty penalty.  
20 (*Id.*, subd. (d).) A taxpayer also has no right to file an administrative claim for refund of a paid amnesty  
21 penalty, except upon the basis that the penalty was not properly computed. (*Id.*, subd. (e).) Therefore,  
22 the Board's jurisdiction to review the amnesty penalty is limited to situations where the penalty is  
23 assessed and paid, the taxpayer files a timely appeal from a denial of a refund claim, and the taxpayer  
24 attempts to show a computational error in the penalty.

25 STAFF COMMENTS

26 The Board does not have jurisdiction to consider the proposed post-amnesty penalty,  
27 given, among other things, that the penalty has not yet been paid and appellants have not filed an appeal  
28 from a denial of a claim for refund.