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10 **BOARD OF EQUALIZATION**

11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:) **HEARING SUMMARY²**
 13)
 14) **CORPORATION FRANCHISE TAX APPEAL**
 15)
 16 **JK GROUP, LLC¹**) Case No. 448306

<u>Years</u>	<u>Claims For Refund³</u>
2001	\$10,254
2002	\$9,914
2003	\$9,278
2004	\$7,977
2005	\$7,337

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20 ¹ Appellant, a Limited Liability Company (LLC), was headquartered in San Diego County, California.

21 ² This appeal was pulled from the February 24, 2010 hearing calendar to allow the parties to enter settlement negotiations.
 22 The matter was placed on the April 24, 2012 oral hearing calendar and, after appellant waived appearance, it was rescheduled
 23 to the May 30, 2012 consent calendar. Appellant subsequently asked that the appeal to be reinstated for an oral hearing and
 the matter was scheduled for the Board's July 24-26, 2012 Culver City Board meeting.

24 ³ The amounts listed here are the amounts submitted by appellant on appeal. Respondent notes that the amounts are
 25 overstated, since those amounts include the annual \$800 LLC tax, penalties, and interest associated with that tax, and late
 26 filing penalties. (Resp. Op. Br., p. 1, fn. 1 & pp. 12-14.) Appellant concedes the \$800 LLC tax and related penalties and
 interest. (App. Add'l Br., p. 1.) Respondent contends that the appropriate amounts at issue are as follows (see Resp. Op. Br.,
 p. 1, fn. 1 & p. 14):

27 2001	\$9,400.69
28 2002	\$8,821.03
2003	\$8,376.67
2004	\$7,176.76
2005	\$6,482.16

1 Representing the Parties:

2 For Appellant: Edwin P. Antolin, Silverstein and Pomerantz, LLP

3 For Franchise Tax Board: Todd Watkins, Tax Counsel III

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5 QUESTIONS: (1) Whether appellant operated the Burger King restaurant businesses during the
6 taxable years 2001 through 2005, and therefore is obligated to pay LLC fees
7 based upon the total income generated from those businesses.

8 (2) Whether the proposed assessment of the LLC fees is unconstitutional.⁴

9 (3) Whether the refund amounts at issue are properly calculated.

10 HEARING SUMMARY

11 Procedural Background

12 Respondent collected LLC fees, and other related amounts, for 2001 through 2005
13 through a jeopardy assessment filed in 2006. (Resp. Op. Br., exhibit F.) After the assessment became
14 final, appellant filed claims for refund in the form of amended returns, asserting that it never operated
15 the restaurant businesses. (Resp. Op. Br., exhibit M.) Respondent denied appellant’s claims for refund
16 on the basis that it operated the businesses during those years and the gross receipts of the restaurant
17 businesses were therefore attributable to appellant. (Resp. Op. Br., p. 10; App. Op. Br., exhibit A.) This
18 timely appeal followed.

19 Factual Background

20 In January 1991, James Kozen began operating at least one Burger King restaurant
21 franchise as a sole proprietor under the d.b.a. of JK Group with a federal employer identification number
22 (EIN) beginning with “95”. On January 18, 1995, Mr. Kozen formed appellant, JK Group, LLC. (Resp.
23 Op. Br., exhibit A.) The articles of organization include an attachment that states, “The limited liability
24 company is a single-purpose limited liability company formed solely for the purpose of operating Burger
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27 ⁴ Staff requested additional briefing from the parties, specifically inquiring as to whether the parties desired to defer the oral
28 hearing in this matter for an appellate court decision in *Bakersfield Mall v. Franchise Tax Board* (currently pending in San Francisco Superior Court, case no. CGC-074627228, filed April 25, 2007) regarding the constitutionality of the LLC fee statute (R&TC section 17942) as applied to a taxpayer deriving income wholly from activity within California. Appellant responded that it did not wish to defer these proceedings for the *Bakersfield Mall* litigation and instead wished to proceed with the oral hearing.

1 King Restaurants.” (*Id.* at exhibit A, p. 2.) Statements filed by appellant with the Secretary of State’s
2 (SOS) office indicated the LLC’s type of business was operating a Burger King franchise. (*Id.* at exhibit
3 B.) Appellant’s operating agreement lists appellant’s first purpose as to “[a]cquire, own, buy, sell, trade,
4 operate, manage, exchange or otherwise dispose of Burger King restaurants, that the Managers may
5 from time to time deem to be in the best interests of the Company.” (Resp. Op. Br., exhibit D.) The
6 operating agreement notes on its opening disclaimer that “ownership of the company may be transferred
7 only after authorization by Burger King Corporation in accordance with the terms and conditions
8 outlined in the Franchise Agreement with Burger King Corporation.” (App. Add'l Br., exhibit C, p. 4.)
9 JK Group, LLC, operated until the company was dissolved on January 3, 2007. (Resp. Op. Br., exhibit
10 C.)

11 Respondent indicates that appellant filed California LLC tax returns from 1997 through
12 2000 reporting that it operated a restaurant business, using an EIN beginning with “33”. (Resp. Op. Br.,
13 exhibit E.) Respondent notes that appellant paid the reported LLC tax and LLC fee for tax years 1997
14 through 2000. (*Id.* at p. 3.) Mr. Kozen changed the formation of the LLC into a single-member LLC
15 effective January 1, 2000.⁵ (*Id.* at exhibit E, p. 17.) Respondent indicates that appellant became taxable
16 as a subchapter S corporation on June 26, 2005, and was therefore no longer required to pay the LLC tax
17 or LLC fee after that date. (*Id.* at p. 2.) Respondent indicates that appellant did not timely file its 2001,
18 2002, and 2003 returns. (*Id.* at p. 3.) Appellant subsequently filed a timely 2004 return, and untimely
19 returns for 2001 through 2003 and 2005.⁶ (*Id.* at exhibit G.) Appellant reported and paid only the \$800
20 annual LLC tax and no income, listing its principal business as “Service,” and product or service as
21 “Pension MGMT.” (*Ibid.*) Appellant reportedly informed respondent that the employee pension plan
22 was established and that such plan remains under the LLC. (*Id.* at exhibit J.)

23 A letter from an escrow company dated November 23, 2005, was received by respondent
24 and indicated that a Burger King in Montrose, California (the Montrose Burger King) was being sold
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26 ⁵ On appellant’s 2000 LLC tax return, it reported its principal business activity as “restaurant,” and its principal product or
27 service as “food & beverage.” (Resp. Op. Br., exhibit E, p. 17.) Appellant asserts that the LLC at this time, and always was,
28 only leasing land to Mr. Kozen’s sole proprietorship, which ran the restaurant business. (App. Op. Br., p. 1 & 2.)

⁶ Appellant also filed late returns for the 1995 and 1996 tax years, reporting its activity in the same manner as for the 2001
through 2005 returns. (Resp. Op. Br., exhibit H.)

1 with a reference to the taxpayer EIN beginning with “33” (the number associated with appellant).
2 (Resp. Op. Br., exhibit K.) A similar letter was received in regard to the sale of a different Burger King
3 restaurant on Airport Boulevard in Los Angeles (the LAX Burger King) to Mangen Group, Inc., on
4 May 5, 2006, also referencing appellant’s EIN.⁷ (*Id.* at exhibit L.) Respondent indicates that appellant
5 was attempting to sell its last known asset, the LAX Burger King, and therefore issued a jeopardy
6 assessment on May 30, 2006. (*Id.* at exhibit F.)

7 The jeopardy assessment was based on unpaid LLC fees, penalties, and interest for years
8 2001 through 2005, plus penalties and interest for the late paid 2005 LLC tax, a collection fee, related
9 penalties, plus other amounts not at issue here. (Resp. Op. Br., p. 5 & exhibit F.) Appellant did not
10 protest the assessment and it became final on June 30, 2006. Respondent collected the unpaid amounts
11 on August 4, 2006, pursuant to an Order to Withhold after the second Burger King sale closed.⁸ (*Ibid.*)

12 On July 24, 2006, appellant filed amended returns for tax years 1997 through 2005,
13 which were treated as claims for refund.⁹ (Resp. Op. Br., exhibit M.) The amended returns reflected
14 rental real estate income of between \$30,000 and \$57,000 for each year, still reported only the \$800
15 LLC tax as an amount due, and noted that previous payments of \$800 satisfied any liability. These
16 returns reflected a new principal business of “Leasing,” and a principal product or service of commercial
17 property. The returns were accompanied by the required federal Form 8825, regarding rental real estate
18 income. Appellant was not required to report such rental income or file a federal Form 8825 with the
19 Internal Revenue Service (IRS) for the years at issue. (*Id.* at p. 6.)

20 In a correspondence dated December 22, 2006, appellant summarized its view of Mr.
21 Kozen’s franchise operation for respondent, concluding that it never conducted the Burger King

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24 ⁷ Evidence provided by appellant appears to show that the Board of Equalization replied to a similar letter, regarding the
25 escrow on the LAX Burger King restaurant, on August 15, 2006, by stating that Mr. Kozen, d.b.a. JK Group, was current on
26 his taxes. (App. Add’l Br., exhibit F, p. 2.) The Board did not mention JK Group, LLC, in this letter.

27 ⁸ Respondent provides detailed statements of the items of tax, penalties, and interest collected from appellant for each of the
28 tax years at issue. (Resp. Add’l Br., exhibit A.)

⁹ Respondent notes that appellant’s amended returns for 1997 through 1999 classify its structure as a solely-owned LLC,
rather than as a partnership as was previously reported on the original returns for those years. (Resp. Op. Br., p. 6.)

1 restaurant business at any time.¹⁰ (Resp. Op. Br., exhibit N.) Appellant states in the letter that it was
2 formed with the intention of only holding the ground lease, which it subleased to Mr. Kozen or his sole
3 proprietorship which operated the Burger King restaurant. Appellant asserted in the letter that its
4 accountant misinformed Mr. Kozen of the proper filing requirements, and began reporting the activity of
5 the proprietorship under the EIN (beginning with “33”) of the LLC. Appellant stated that his current
6 accountant properly reported all Burger King restaurant income to Mr. Kozen, but still erred by using
7 appellant’s EIN rather than the sole proprietorship’s EIN. Appellant also noted that the use of the name
8 JK Group for the sole proprietorship and JK Group, LLC, for the LLC caused confusion during the sale
9 of the Burger King restaurant. (*Ibid.*)

10 In reviewing appellant’s claim, respondent obtained third party records in the form of
11 Minutes of the City of Los Angeles Board of Airport Commissioners for December 5, 2005, which
12 verify that appellant was the lessee for the property on Airport Boulevard where the LAX Burger King
13 restaurant was located. (Resp. Op. Br., exhibit P, p. 2; see also App. Add’l Br., exhibit D.) Records
14 from the same group on July 17, 2006, label appellant as the operator of the Burger King at that location.
15 (*Id.* at exhibit Q, p. 2.) Other records provided by respondent show that vendors of the LAX Burger
16 King restaurant business entered into legal relationships with appellant, rather than Mr. Kozen
17 individually or the sole proprietorship.¹¹ (Resp. Op. Br., exhibit W.)

18 Other documents provided show that a Wells Fargo Bank account was held in the name
19 of “J K Group, Burger King,” with no LLC label attached. (Resp. Op. Br., exhibit X.) Transaction
20 activity on this account shows payments were made to the Burger King Corporation and the Board of
21 Equalization (BOE), as well as payments to State Farm Insurance for a “J.K. Group LLC” account.
22 Information regarding the name and EIN under which the account was opened and used was not
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25 ¹⁰ During the protest period prior to this appeal, and the original briefing period on appeal, appellant and respondent appear to
26 only contest whether appellant operated the LAX Burger King. During the pre-hearing conference, discussed infra, it was
27 revealed that respondent calculated the fee under the presumption that appellant operated both the LAX Burger King and the
28 Montrose Burger King. As such, early contentions from the parties refer only to the LAX Burger King, but appear to apply,
generally, to the Montrose Burger King as well.

¹¹ These public records gathered from LexisNexis show appellant as a debtor in a secured arrangement with food and
beverage suppliers, among others. The arrangements were all active during at least a couple of the years at issue, if not all of
the years at issue. (Resp. Op. Br., exhibit W.)

1 provided. (*Ibid.*) Appellant provided a copy of a fax from the Burger King Corporation which states
2 that the franchise was started by Mr. Kozen, and was 100 percent owned by Mr. Kozen as of the July
3 2006 date on the fax. (Resp. Op. Br., exhibit Y.) A sales agreement for the LAX Burger King lists Mr.
4 Kozen and JK Group, LLC, collectively as the seller, but later designates that JK Group was the owner
5 and seller of the real property lease and building, and Mr. Kozen was the owner and seller of the
6 Franchise Agreement and all personal property transferred. The partial submission did not list or
7 describe all of the property transferred in the sale. (Resp. Op. Br., exhibit Z.) Appellant provided
8 permits and account information from the City of Los Angeles, the State of California, and the IRS
9 supporting the argument that the LAX Burger King restaurant business was held in the name of Mr.
10 Kozen, and not appellant. (App. Add'l Br., exhibit B.)

11 Appellant provided respondent copies of Mr. Kozen's federal Schedule C forms for the
12 years at issue. (Resp. Op. Br., exhibit R.) The Schedule C for 2002 reports the business name as JK
13 Group, LLC, and provides appellant's EIN. (*Id.* at exhibit R, p. 1.) Respondent states that Mr. Kozen
14 used this business name and number for 2002 through 2004, but subsequently submitted amended
15 federal returns changing the business name to JK Group, and providing his personal EIN beginning with
16 "95". (*Id.* at p. 8.) The Schedule C forms, in conjunction with and verified by quarterly sales tax
17 returns, report gross receipts for the years at issue.¹² (*Id.* at exhibits R & S.) Evidence shows that Mr.
18 Kozen applied for the seller's permits for the two Burger King restaurants in 1990 and 1994, and
19 appellant apparently never applied for new permits, which it would be required to do if it began
20 operating the restaurants. (*Id.* at pp. 8-9 & exhibits T & U; App. Add'l Br., exhibit F.) Appellant is
21 listed as the lead name on the quarterly sales tax returns for the LAX Burger King from at least
22 January 1, 2001, through the end of 2004.¹³ (*Id.* at exhibit S.) Respondent provided documents which
23 show that wages from the restaurant businesses were reported to the Employment Development
24 Department (EDD) under appellant's name and EIN from the beginning of 1997 into 2006. (*Id.* at
25 exhibit V; Resp. Add'l Br., exhibit B.)

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28 ¹² Respondent notes that there are discrepancies with the 2002 and 2005 tax years, but appears to follow the amounts listed on
the Schedule C forms whenever a discrepancy exists. (Resp. Op. Br., p. 8.)

¹³ The 2005 quarterly sales tax returns list the lead name as "J.C. Group." (Resp. Op. Br., exhibit S, pp. 18-19.)

1 Developments on Appeal

2 *Pre-hearing Conference*

3 At appellant's request, Appeals Division staff conducted a pre-hearing conference with
4 the parties on July 21, 2011. At the pre-hearing conference, appellant gave further background
5 information regarding Mr. Kozen's operation of Burger Kings prior to appellant's formation. The
6 parties also discussed in greater detail the evidence provided by the parties at that time, and evidence
7 respondent desired from appellant to show who the true owner of the Burger King businesses were for
8 the years at issue. Appeals Division staff was able to clarify that respondent included the income from
9 the Montrose Burger King location in calculating appellant's LLC fees. After the pre-hearing
10 conference, Appeals division staff issued an additional briefing request to gather pertinent evidence as
11 well as briefing on the Montrose Burger King.

12 Mr. Kozen indicated at the conference that he formed KP Partnership with a partner in
13 either 1980 or 1981 for the purposes of operating Burger King restaurants. Mr. Kozen asserted he
14 located, negotiated the price of, and maintained the real property for the restaurants. KP Partnership
15 opened the Montrose Burger King (store #4424) around 1985 on a 20 year lease for the land and
16 building, and built the building for the LAX Burger King (store #6941) on leased land in 1991. (App.
17 Aug. 3, 2011 Submission, exhibit 1.) The partners agreed to split in 1996, with Mr. Kozen taking the
18 Montrose and LAX locations and his partner taking three other locations.¹⁴ (*Id.* at exhibit 2; App. Post-
19 Conf. Br., exhibit 35.)

20 *Additional Evidence*

21 At the conference, appellant presented evidence not yet in the record, and the parties
22 expounded upon their contentions. To ensure that all available records were entered into the record for
23 this appeal, Appeals Division staff instructed appellant to provide specific additional documents and any
24 other relevant documentation. In addition to evidence provided prior to the pre-hearing conference
25 (App. July 15, 2011 Submission, exhibits), appellant provided additional exhibits on August 3, 2011,
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27 ¹⁴ At this time, it appears that the ground leases for the two locations may have remained in the KP Partnership name. The
28 next indication of when the ground lease was transferred is a resolution from the Board of Airport Commissioners dated
October 13, 1998, authorizing the transfer of the lease from the partnership to appellant. (App. Aug. 3, 2011 Submission,
exhibit 4.)

1 and with its post-conference brief on October 3, 2011. These documents are described in the parties'
2 contentions below.

3 Contentions

4 Appellant

5 *Mr. Kozen operated the LAX Burger King franchise*

6 Appellant contends that it never owned or operated the Burger King restaurant
7 businesses. Appellant provides the 1991 LAX Burger King Franchise Agreement to show that the
8 franchise was originally run by the partnership (App. Post-Conf. Br., exhibit 1), a 1996 letter from
9 Burger King showing the Montrose and LAX Burger Kings were transferred from the partnership to Mr.
10 Kozen (*Id.* at exhibit 2), and a 2006 letter from Burger King authorizing the assignment of the LAX
11 Burger King from Mr. Kozen to the Mangen Group. (*Id.* at exhibit 3). Appellant provides a year 2000
12 annual Administrative Report for the “JK Group Defined Benefit Pension Plan,” listing JK Group as the
13 employer and using the EIN beginning with “95”. (*Id.* at exhibit 6.) Appellant provides Workers’
14 Compensation papers referencing March of 2001 and January of 2003 which list the employer as JK
15 Group and are addressed to Mr. Kozen. (*Id.* at exhibit 7.) Appellant provides letters from utility
16 companies indicating Mr. Kozen was receiving service at the LAX Burger King location during or at the
17 end of the period in question, a Board of Equalization (BOE) seller’s permit from 1990, a 1995 letter
18 from the BOE regarding payment methods for sales and use tax, a 2006 BOE letter for escrow purposes,
19 and a June 2006 EDD quarterly wage report all listing either JK Group, Mr. Kozen, or both. (*Id.* at
20 exhibits 11-15, 20-21.) An EDD Certificate of Release of Buyer dated July 28, 2006, lists JK Group as
21 the seller. (*Id.* at exhibit 16.) Appellant provides various permits active during the years at issue that
22 include Mr. Kozen’s name. (*Id.* at exhibits 22-24.) Appellant provides JK Group financial statements to
23 support its theory that JK Group operated the restaurants. (*Id.* at exhibits 25-26.)

24 *Appellant only operated the LAX location ground lease*

25 Appellant states that it was created with the intention to pay the ground lease and collect
26 rent from the proprietorship that was operating the restaurant businesses. (App. Op. Br., p. 1.)
27 Appellant provides an excerpt from the LAX Burger King Unit Sale Agreement, apparently relating to
28 the sale to the Mangen Group in 2006, listing Mr. Kozen as the seller of the franchise and appellant as

1 the seller of the real property interest. (App. Post-Conf. Br., exhibit 4.) Appellant also provides a Bulk
2 Sale Certificate from FTB issued for escrow purposes during the sale to the Mangen Group that lists Mr.
3 Kozen and “JK Group” as the sellers of the LAX Burger King. (*Id.* at exhibit 5.) Appellant provides an
4 amended 2005 S Corporation return for appellant, which removes all the previously-recorded income
5 and includes \$30,000 of rental real estate income, indicating that the original return improperly reported
6 all the income from the sole proprietorship. (*Id.* at exhibit 19.) Appellant provides a Board of Airport
7 Commissioners resolution dated October 13, 1998, authorizing the transfer of the LAX Burger King
8 ground lease from the partnership to appellant, noting that the assignment “will have no effect on the
9 operation of [the] restaurant.” (*Id.* at exhibit 27.) Appellant also provides a second document assigning
10 the ground lease for the LAX Burger King to the Mangen Group, Inc., in June of 2006, around the time
11 the LAX Burger King was being sold. This document notes that the ground lease was assigned from the
12 partnership to appellant on October 13, 1998. (*Id.* at exhibit 28; see also *Id.* at exhibit 29.) Documents
13 from 1998 and 1999 show appellant as a loan holder with AT&T Commercial Financial Corporation and
14 show the LAX Burger King property listed as collateral. (*Id.* at exhibits 30-33.) Appellant also provides
15 the property tax bill for the LAX location, listing “JK Group LLC DBA” as the assessee, and provides a
16 copy of a check for the owed amount sent to the assessor on the account of “JK Group.”¹⁵ (*Id.* at exhibit
17 34.)

18 Appellant contends that the stated purpose of engaging in business dealings with Burger
19 King restaurants listed on its Articles of Organization and Operating Agreement filed with the Secretary
20 of State is not a binding purpose, and was permissive so as to allow it to conduct any business regarding
21 Burger King restaurants, if it so chose. (App. Add’l Br., “Summary of Facts and Exhibits,” p. 6.) The
22 business purpose of appellant holding the ground lease was to insulate the real property against the
23 operating business. (App. Post-Conf. Reply Br., p. 6.) Appellant asserts that the Montrose Burger King
24 was only operated by Mr. Kozen, doing business as JK Group. Appellant asserts that it had no

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28 ¹⁵ Appellant indicates that JK Group paid the bills of appellant because appellant “did not engage in any activities other than holding the ground lease.” (App. Post-Conf. Br., p. 8.)

1 connection with that restaurant location.¹⁶ Appellant asserts that the two Burger King franchises were
2 transferred to Mr. Kozen individually and that appellant had no authority to operate the franchises and,
3 in fact, did not do so. (App. Post-Conf. Br., p. 8.) Appellant contends that Mr. Kozen could not simply
4 declare through his tax returns that appellant operated the franchises. (App. Post-Conf. Reply Br., p. 2.)
5 Appellant contends that the reporting of the restaurants under the LLC returns was due to an
6 accountant's error, was corrected by amended returns, and did not net Mr. Kozen any gain. (*Id.* at p. 3.)
7 Appellant states that respondent's argument that Mr. Kozen assigned the franchise to appellant is based
8 on pure speculation and is not true. (*Id.* at p. 7.)

9 *Appellant was erroneously represented as operating the restaurants*

10 Appellant asserts that any prior listing of the restaurant's business income under
11 appellant's name or EIN was the result of data entry error, tax preparer mistakes, and confusion between
12 the sole proprietorship (JK Group) and appellant (JK Group, LLC). (App. Add'l Br., "Summary of
13 Facts and Exhibits," pp. 3-4; Resp. Op. Br., exhibit N.) Appellant alleges that the erroneous reporting of
14 the restaurant operations lasted from 1997 through 2000, and, when the error was discovered, Mr. Kozen
15 dismissed his accountant and hired a new accountant with the instructions to report the restaurant
16 business as a sole proprietorship. (App. Post-Conf. Reply Br., p. 1.) Appellant provides a copy of a
17 letter to Intuit, the payroll company used for at least the LAX Burger King, dated April 19, 2006, near in
18 time to the sale to the Mangen Group, stating that JK Group had requested a cancellation of payroll
19 services under EIN "33" and another letter from Intuit dated December 14, 2006, terminating services
20 under EIN "95". (*Id.* at exhibits 8 & 10.) Appellant also provides a letter to the Department of Treasury
21 dated August 4, 2006, explaining that JK Group had erroneously been using EIN "33" instead of EIN
22 "95". (*Id.* at exhibit 9.) Appellant asserts that these letters show that the EIN beginning with "33" had
23 been erroneously used and terminated, in order to correct the error by Intuit of erroneously using that
24 EIN. (*Id.* at p. 3.) Appellant indicates that it has copious amounts of evidence which supports the
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26 ¹⁶ Appellant notes that, in the case that respondent prevails on the LAX Burger King issue, and appellant prevails on the
27 Montrose Burger King issue, that the LLC fee should be computed on only the LAX location income. Appellant contends
28 that the LAX location accounted for approximately 50 percent of the income, but also states that the LAX location's sales
likely exceeded \$1 million for each year at issue, and thus the fee would still be \$6,000 for each year. (App. Post-Conf.
Reply Br., p. 9.)

1 conclusion that Mr. Kozen operated the Burger King restaurant business as a sole proprietorship since
2 1991.¹⁷ (App. Add'l Br., p. 2.) Appellant addresses respondent's contention that appellant reported the
3 restaurant income for the second half of 2005, after making its S election, and states that this was an
4 error by Mr. Kozen's accountant. (App. Post-Conf. Reply Br., p. 4.) Appellant also asserts the
5 preprinted sales tax returns and filings by creditors with the Secretary of State and other agencies listing
6 appellant as the operator or debtor on business transactions are errors made by the creditors and BOE.
7 (*Id.* at pp. 4-5.)

8 *LLC fee is unconstitutional*

9 Appellant contends that the LLC fee is unconstitutional. Appellant states that the
10 California Supreme Court concluded that the LLC fee is unconstitutional, and thus Revenue and
11 Taxation Code (R&TC) section 17942 is invalid. (App. Op. Br.) Appellant also asserts that respondent
12 committed double taxation on the Burger King restaurant income by assessing the LLC fees on the
13 income after Mr. Kozen already paid taxes on the income through his proprietorship. (App. Op. Br;
14 App. Add'l Br.) Appellant does not contend that the \$800 LLC tax and related penalties and interest
15 should be refunded, and concedes those amounts.¹⁸ (App. Add'l Br., p. 1.)

16 Respondent

17 *Amount at issue*

18 Respondent asserts that the amount at issue is misrepresented and should be reduced by
19 the \$800 LLC tax and associated penalties and interest, as conceded by appellant on appeal. (Resp. Op.
20 Br., pp. 12-14; App. Add'l Br., p. 1; see footnote 3.)

21 *Appellant operated the Burger King restaurant businesses*

22 Respondent contends that appellant conducted the Burger King restaurant businesses
23 during the years on appeal, as supported by the evidence provided in the briefing and described in the
24 Background section above. Respondent contends that the EDD evidence provided, in conjunction with
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26 ¹⁷ Appellant stated that the evidence is too bulky to submit by mail or fax, but it will bring the documentation to the hearing.
27 (App. Add'l Br., p. 2.) Subsequent to the pre-hearing conference, appellant provided additional evidence, as discussed
28 herein.

¹⁸ It is unclear from the record which penalties of those assessed constitute penalties related to the LLC tax. Appellant should be prepared to indicate which penalties for each year that it is not contesting.

1 the wages reported on Mr. Kozen’s Schedule C forms for 2002 through 2005, show that all wages from
2 the restaurant business were reported on appellant’s EDD account. (Resp. Add’l Br., pp. 2-3.)
3 Respondent contends that appellant was formed for the purpose of operating Burger King restaurants,
4 reported on tax returns that it was doing so, paid the LLC fee for years prior to the years at issue, and
5 continued to hold itself out to third parties as the entity operating the business but did not pay the LLC
6 fee for the years at issue. (Resp. Op. Br., pp. 1-2 & 19-20.) Respondent contends that Mr. Kozen
7 enjoyed the benefits of conducting his business through appellant, including the protection of limited
8 liability for the debts and obligations of the business, and therefore appellant must bear the
9 consequences, namely the filing of tax returns and the payment of the annual fee on the income of the
10 business. (*Id.* at pp. 20-21.) Respondent notes that appellant has not provided canceled checks, a
11 sublease agreement, or any other evidence to support its position that it merely leased the commercial
12 property to Mr. Kozen and was not involved in the operation of the Burger King restaurant.¹⁹ (Resp.
13 Op. Br., p. 7.)

14 Respondent provides documents showing that it contacted Mr. Kozen in January 2005
15 regarding appellant’s failure to file returns and pay the LLC fee, which predates Mr. Kozen’s request in
16 2006 to the IRS to change the EIN associated with the business from appellant’s EIN of “33”, which had
17 been used since 1997, to the EIN “95”. (Resp. Post-Conf. Reply Br., p. 1 & exhibit A.) Respondent
18 also provides a printout of appellant’s EDD account which shows a comment by an EDD agent
19 regarding the sale of the Montrose Burger King, indicating appellant was the seller of that business. (*Id.*
20 at exhibit B.) Respondent asserts that many of appellant’s documents submitted as exhibits regarding
21 the ownership of the Burger King businesses predate the existence of appellant or were created after the
22 close of the tax years at issue, and therefore are not convincing. (*Id.* at pp. 2-3.) Respondent contends
23 that the contemporaneous tax documents filed during the years at issue and the substance of the
24 transaction (i.e., which entity conducted the business) show that appellant operated the business. (*Id.* at
25 p. 3.) Respondent asserts that it was not informed that appellant had changed its federal classification to
26 a corporation, effective June 27, 2005, and therefore respondent treated appellant as a disregarded entity
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28 ¹⁹ Appellant subsequently provided a canceled check to show that JK Group paid the property tax liability of appellant. The parties should be prepared to discuss this payment arrangement.

1 on documents prepared during the sale of the business, explaining why Mr. Kozen was listed as the
2 seller on the Bulk Sale Certificate and other escrow documents. (*Id.* at p. 4.) Respondent assert that, as
3 a disregarded entity, appellant would be obligated to report its owner’s EIN on most federal tax
4 documents, explaining why EIN “95” was used on the retirement plan. (*Id.* at pp. 4-5.)

5 *Federal Employer Identification Numbers*

6 Respondent asserts that the Federal Insurance Contributions Act (FICA) requires
7 employers to withhold tax and unemployment tax and obtain an EIN. (Resp. Post-Conf. Br., pp. 2-5.)
8 Respondent notes that Mr. Kozen was required to acquire an EIN when he first operated the Burger
9 King restaurants, obtaining the EIN beginning with “95” in 1990, and then beginning the use of EIN
10 “33” in 1997. (*Id.* at p. 6.) Respondent indicates that the EDD issues its own state employer number
11 and that the EDD linked its own number, starting with “402”, with EIN “95” in 1994. Respondent states
12 that the “402” EDD number was later listed under appellant’s account and, in 1997, the EIN “33” was
13 associated with that EDD number. (*Ibid.*; Resp. Op. Br., exhibit V, p. 1.) Respondent contends that
14 appellant had to have filed an EDD form 24 in order to affirmatively change the EIN and EDD number
15 association. (Resp. Post-Conf. Br., p. 6 & exhibit B.) Appellant filed employment and withholding
16 returns for the Burger King restaurants for all of the years at issue, and the EIN “33” was obtained by
17 appellant when it became an employer of the Burger King restaurants. (*Id.* at p. 6.) Respondent asserts
18 that this analysis is consistent with Treasury Regulation section 301.6109-3(h)(2), IRS Notice 99-6, and
19 Revenue Ruling 2001-61 (situation 1), and that appellant continued to use EIN “33” after its S election.
20 (*Id.* at p. 7.) Respondent indicates that appellant’s name and EIN are on the escrow documents for both
21 Burger King locations and that Mr. Kozen didn’t change the EIN to “95” with the EDD and the IRS for
22 W-2 purposes until 2006. (*Id.* at p. 7 & exhibit D; Resp. Op. Br., exhibits K, L.) Respondent asserts
23 that Mr. Kozen had to personally sign federal and state employer identification number requests and
24 withholding returns, and finds it hard to believe that the reporting was a “mistake” as it persisted for
25 nine years with affirmative actions. (Resp. Post-Conf. Br., p. 8.)

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1 *Form 100S*

2 Respondent notes that appellant became an S corporation on June 27, 2005, and filed a
3 Form 100S which reported that it conducted the Burger King businesses.²⁰ (Resp. Post-Conf. Br., p. 8
4 & exhibit E.) Respondent asserts that, if appellant conducted the Burger King businesses for the second
5 half of 2005, the most likely conclusion is that appellant operated the businesses during the first half of
6 2005 and prior as a disregarded single-member LLC, and is therefore subject to the LLC fee. (*Id.* at pp.
7 8-9.)

8 *Creditors*

9 Respondent asserts that appellant entered into contractual relationships with suppliers and
10 lenders of the Burger King Businesses. (Resp. Post-Conf. Br., p. 9.) Respondent notes that Secretary of
11 State guidelines state that creditors must use their true name and not a trade name, and that filings during
12 the years at issue name appellant as the debtor for the Burger King business. (*Id.* at p. 10; Resp. Op. Br.,
13 exhibit W.) Respondent therefore contends that appellant legally entered into contracts with third
14 parties in operating the businesses, and Mr. Kozen received the benefit of LLC liability protection in the
15 businesses. (Resp. Post-Conf. Br., p. 10.)

16 *State Tax Returns*

17 State sales tax returns were filed under appellant's name from January 1, 2001, through
18 June 30, 2005. (Resp. Op. Br., exhibit S.) These returns bear the pre-printed name of appellant from
19 BOE from January 1, 2001, through December 31, 2004. Respondent notes that seller's permits were
20 issued to Mr. Kozen in 1990 and 1994 and that he must have at some point told BOE that appellant was
21 conducting the businesses and to change the name on the pre-printed returns. Respondent asserts that
22 Mr. Kozen was legally required to notify BOE of a change in business ownership, and apparently did.²¹
23 (Resp. Post-Conf. Br., pp. 10-11.)

24 _____
25 ²⁰ Although appellant's Form 100S states that its primary business is leasing commercial property, it appears to have listed all
26 of the sales income from the Burger King businesses on its form. (Resp. Post-Conf. Br., exhibit E, pp. 2-3.)

27 ²¹ Appellant asserts that Mr. Kozen was issued seller's permits, and appellant was never issued seller's permits and therefore
28 was not able to conduct the business. Respondent asserts that appellant must have notified BOE of the change in ownership,
prompting the otherwise unexplained change of the pre-printed name to appellant's name. The parties should discuss how
appellant's name became the pre-printed name on the returns.

1 Respondent contends that sellers reporting sales can use a consolidated report for
2 multiple locations, if there is the same ownership operating the businesses. (Resp. Post-Conf. Br., p.
3 20.) Respondent asserts that, in this instance, both the LAX and Montrose locations were reported on a
4 consolidated report and the owner of both locations was appellant. (*Id.* at p. 20 & exhibit H.)
5 Respondent indicates that Mr. Kozen’s Form 1040 includes only one Schedule C reporting all Burger
6 King income and, therefore, all of the income must have come through one single source, which was
7 appellant. (*Id.* at pp. 20-21.) Respondent states that the use of appellant’s EIN “33” for the sales of the
8 Burger King franchise businesses shows that appellant operated both locations. (*Id.* at p. 21; Resp. Op.
9 Br., exhibit K, L.)

10 Respondent asserts that the employment tax returns were filed under appellant’s “33”
11 EIN, and not Mr. Kozen’s “95” EIN. (Resp. Post-Conf. Br., p. 21.) Respondent contends that wages
12 reported on Mr. Kozen’s Form 1040 Schedule C roughly match or include all wages reported to the
13 EDD by appellant. (*Id.* at p. 22; Resp. Op. Br., exhibit R.) Respondent indicates that all wages for both
14 Burger Kings were reported for federal and state purposes on appellant’s EDD account.

15 *LAX Burger King location ground lease*

16 Respondent contends that appellant purposefully limited itself to being a single-purpose
17 LLC formed only to operate Burger King franchise businesses.²² (Resp. Post-Conf. Br., p. 12.)
18 Respondent asserts that limiting appellant’s activity to only rental activity is contrary to the self-asserted
19 limitation. (*Ibid.*) Respondent contends that there is no purpose in having the LLC own and rent back
20 the property. (*Id.* at p. 13.) Respondent notes that there is no sublease agreement provided, no
21 economic effect in the alleged arrangement, and no rental income reported on Mr. Kozen’s Form 1040
22 Schedule E. Respondent asserts that the income should have been separately reported and deducted on
23 the Schedule E or C, reporting the income on the amended Form 568s is inconsistent with the original
24 reporting, and Form 568 is only for net gain from real estate activity. (*Ibid.*) Respondent asserts that
25 appellant needs to provide a ground lease with LAX including amendments and subleases, as well as
26 banking records and cancelled checks showing that rent was paid. (*Id.* at pp. 13-14.)
27

28 ²² Respondent indicates that LLCs are general purpose unless a more specific limited purpose is listed. (Resp. Post-Conf. Br.,
p. 12.)

1 *Burger King Franchise Agreement*

2 Respondent contends that the franchise agreement is for the “business method,” including
3 service marks, etc., and not a goods distribution franchise. (Resp. Post-Conf. Br., p. 14.) Respondent
4 asserts that the gross receipts were generated by food production and sales, and not the franchise per se.
5 (*Id.* a p. 15.) Respondent contends that the value of the franchise is the difference between the income
6 of a franchise versus a non-franchise operation in the same business. In other words, respondent is
7 arguing that assigning all sales income to the franchise owner misrepresents who earned the income, and
8 instead a majority of the income should be attributed to the entity selling the hamburgers (i.e.,
9 appellant). Respondent therefore contends that the holder of the franchise is immaterial and that Mr.
10 Kozen contributed the intangible franchise asset to appellant for appellant’s use. In support of this
11 contention, respondent notes that appellant deducted the franchise fee and royalties on its Form 568 for
12 tax years 1997 through 1999, while it was classified as a partnership. Alternatively, respondent
13 contends that Mr. Kozen may have assigned the franchise to appellant. Respondent asserts that, despite
14 the clause prohibiting this in the Franchise Agreement, Mr. Kozen may have breached the contract by
15 the unauthorized assignment, but this does not mean that the entire Franchise Agreement was void, and
16 the Burger King Corporation may have allowed the assignment after the fact. (*Ibid.*)

17 *LAX Burger King sale agreement*

18 Respondent addresses the apparent excerpt of the purchase agreement of the LAX Burger
19 King to the Mangen Group. (Resp. Op. Br., exhibit 2.) Respondent contends that the agreement is not
20 relevant to what entity conducted the Burger King businesses from January 1, 2001, through June 26,
21 2005. (Resp. Post-Conf. Br., p. 16.) Respondent argues that the substance of the actions during those
22 years overrides the form of the operations as presented by the purchase agreement, and the
23 representation on the purchase agreement conflicts with the Form 100S filed in 2005. Respondent also
24 notes that there is no similar sales agreement provided for the Montrose Burger King. (*Ibid.*)

25 *JK Group trade name*

26 Respondent states that the continued use of the “JK Group” trade name for business
27 dealings is not inconsistent with appellant operating the business. (Resp. Post-Conf. Br., p. 17.)
28 Respondent references Business and Professions Code sections 17900 through 17930, asserting that a

1 fictitious business name is acceptable for an LLC. Mr. Kozen filed for the fictitious business name in
2 1991, and never updated the business name after it expired five years later. (*Id.* at p. 18.) Respondent
3 asserts, however, that the name may still be used even after the official filing expires, and that use of the
4 name by Mr. Kozen in some dealings, including prior to appellant’s formation, does not mean appellant
5 cannot use it. (*Id.* at p. 19.) Respondent asserts that, when entity had to be identified legally (i.e., UCC
6 filings), the name reported was appellant’s full name. (*Ibid.*) Respondent asserts that appellant may
7 have acted under its LLC name, its JK Group trade name, Burger King, or its owner’s name of Mr.
8 Kozen. Therefore, documents provided with only JK Group, Burger King, or Mr. Kozen’s name are not
9 persuasive in attempting to show that appellant did not operate the Burger King Businesses. (Resp.
10 Post-Conf. Reply Br., p. 6.)

11 *LLC fee calculation*

12 Respondent asserts that R&TC section 17942 provides for a \$6,000 LLC fee if total
13 income is \$1 million or more, and less than \$5 million. (Resp. Post-Conf. Br., p. 22.) Respondent states
14 that it used quarterly sales tax returns to compute gross sales for each year and to get gross income. (*Id.*
15 at p. 23.) Respondent notes that “total income” also includes non-business income, but respondent did
16 not include any non-business income in its calculations. Respondent compares the gross sales for each
17 year per the sales tax returns and Mr. Kozen’s Form 1040 Schedule C. (*Id.* at p. 24.) Respondent
18 asserts that under either method, total income is greater than \$1 million and less than \$5 million for each
19 year, and therefore the appropriate LLC fee amount for each year is \$6,000. (*Id.* at pp. 24-25.)

20 *LLC fee is constitutional as applied here*

21 Respondent notes that appellant never presented the argument that the LLC fee is
22 unconstitutional on amended returns or claims for refund. (Resp. Op. Br., p.7) Respondent contends
23 that the Board should abstain from deciding the constitutional issue of whether the LLC fee is
24 unconstitutional as applied in this appeal, in accordance with Article 3, Section 3.5, of the California
25 Constitution and the Board’s own regulations. (Resp. Op. Br., p. 11; see Cal. Code Regs., tit. 18,
26 § 5412, subd. (b)(1).) While respondent concedes that California appellate courts have held the LLC fee
27 unconstitutional in limited situations (where the LLC was conducting at least some business outside of
28 California), the courts have not found the fee to be unconstitutional where the LLC conducted all its

1 business within California, as is the situation proposed by respondent for the years at issue here. (Resp.
2 Op. Br., p. 11.)

3 Respondent contends that its assessment of the LLC fee does not constitute a double
4 taxation on the Burger King restaurant income. (Resp. Add'l Br., pp. 4-6.) Respondent states that even
5 when a LLC is treated as a disregarded single-owner LLC with all the income passing directly through
6 to the owner and taxed as a sole proprietorship, the LLC is still required to file a return, pay the LLC tax,
7 and pay the LLC fee based on the total income that passed through to the owner. (*Id.* at pp. 4-5; Treas.
8 Reg. § 301.7701-2; Cal. Code Regs. tit. 18, § 23038(b)-2.) Respondent asserts that the LLC fee is
9 imposed in return for the benefits conveyed to the LLC owner as a cost of conducting business in a
10 particular legal form, and not for the benefits of being a resident or receiving California source income
11 as normal income tax is. (Resp. Add'l Br., p. 6.) Respondent states that double taxation only exists
12 where two taxes of the same character are imposed on the same property for the same purpose, which is
13 not the case here. (*Ibid.*)

14 Applicable Law

15 Burden of Proof

16 It is well settled that a presumption of correctness attends respondent's determinations as
17 to issues of fact and that an appellant has the burden of proving such determinations erroneous.
18 (*Appeals of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Jun. 29, 1980.) This presumption is,
19 however, a rebuttable one and will support a finding only in the absence of sufficient evidence to the
20 contrary. (*Appeals of Oscar D. and Agatha E. Seltzer, supra.*) Respondent's determinations cannot,
21 however, be successfully rebutted when the taxpayer fails to provide uncontradicted, credible,
22 competent, and relevant evidence as to the issues in dispute. (*Appeals of Oscar D. and Agatha E.*
23 *Seltzer, supra.*)

24 LLC Fee

25 California imposes an annual tax on all LLC's, fixed at \$800. (Rev. & Tax. Code,
26 § 17941, subd. (a).) The annual LLC tax is due on or before the 15th day of the 4th month of the taxable
27 year, which in this case was April 15 of each year following the taxable year, since appellant filed its tax
28 returns on a calendar year basis. (Rev. & Tax. Code, § 17941, subd. (c).) California also imposes an

1 annual fee, based on total income, on those LLC's that elect not to be taxed as corporations. (Rev. &
2 Tax. Code, § 17942, subd. (a).) The annual LLC fee is due on the original due date of the LLC's
3 return.²³ (Rev. & Tax. Code, §§ 17942, subd. (c) & 18633.5.)

4 R&TC section 19131, subdivision (a), provides, in pertinent part, that a penalty shall be
5 imposed if a taxpayer fails to file a return before the regular or extended due date of the return, unless it
6 is shown that the failure is due to reasonable cause and not willful neglect. R&TC section 19132,
7 subdivision (a), provides, in pertinent part, that the failure to pay the amount of tax shown on a return
8 before the regular due date of the tax will result in a penalty, unless it is shown that the failure is due to
9 reasonable cause and not willful neglect. R&TC section 19172 provides, in pertinent part, that a penalty
10 shall be imposed upon a limited liability company, which is classified as a partnership, that fails to file a
11 return by the regular or extended due date of the return, unless it is shown that the failure is due to
12 reasonable cause.

13 “Double taxation occurs only when two taxes of the same character are imposed on the
14 same property, for the same purpose, by the same taxing authority within the same jurisdiction during
15 the same taxing period.” (*Associated Home Builders of the Greater East Bay, Inc. v. City of Walnut*
16 *Creek* (1971) 4 Cal. 3d 633, 642 (*Home Builders*) [internal quotes and citation removed].) In *Home*
17 *Builders*, the court decided that there was no double taxation when new residents paid for the cost of a
18 park through both property taxes and increased purchase prices on homes. The court reasoned that for
19 double taxation to exist, it must meet the elements listed above. (*Ibid.*) California law allows for the
20 assessment of the LLC tax, LLC fee, and LLC filing requirement even when there is a single-owner
21 LLC that is an otherwise disregarded entity. (Rev. & Tax. Code, § 23038, subd. (b)(2)(B)(iii); Cal.
22 Code Regs. tit. 18, § 23038(b)-2(c)(2).)

23 Federal Preemption

24 Section 3.5 of article III of the California Constitution states in relevant part:

25 An administrative agency, including an administrative agency created by the Constitution
26 or an initiative statute, has no power . . . (c) To declare a statute unenforceable, or to
27 refuse to enforce a statute on the basis that federal law or federal regulations prohibit the

28 ²³ Even if a LLC is disregarded for federal tax purposes, it must still file a return, pay the annual tax, and be subject to and pay the annual LLC fee. (Rev. & Tax. Code, § 23038, subd. (b)(2)(B)(iii).)

1 enforcement of such statute unless an appellate court has made a determination that the
2 enforcement of such statute is prohibited by federal law or federal regulations.

3 In addition, the Board has a long-established policy of declining to consider constitutional issues. In the
4 *Appeal of Aimor Corporation* (83-SBE-221), decided on October 26, 1983, the Board stated:

5 This policy is based upon the absence of any specific statutory authority which would
6 allow the Franchise Tax Board to obtain judicial review of a decision in such cases and
7 upon our belief that judicial review should be available for questions of constitutional
importance. Since we cannot decide the remaining issues raised by appellant,
respondent's action in this matter must be sustained.

8 This policy was in place long before the enactment of article III, section 3.5. As far back as 1930, the
9 Board stated:

10 It is true that we have occasionally asserted that right [to question the constitutionality of
11 a statute]. But this has been only under circumstances wherein such action on our part
12 was necessary in order to protect the revenues of the state and get the problem before the
13 Courts In the instant case, and in all others like it before us, the taxpayers will have
14 the opportunity of taking the question to the Courts for decision. . . . It might be argued
that, if the law is plainly unconstitutional, why should taxpayers be put to that trouble and
expense? However, there is diversity of opinion as to the constitutionality of the Act, and
it seems to us desirable that this controversy should be settled by the Courts, whose
authority to hold acts of the Legislature invalid cannot be questioned.

15 (*Appeal of Vortex Manufacturing Co.*, 30-SBE-017, Aug. 8, 1930 [internal citations omitted].)

16 **STAFF COMMENTS**

17 **Whether the refund amounts at issue are properly calculated**

18 The parties should clarify the amount at issue. Appellant has conceded the \$800 LLC tax
19 and related penalties and interest, but has not provided the amounts represented by these conceded
20 items.²⁴ The parties should be prepared to clarify whether the amounts listed in footnote 3 above are
21 accurate. Both parties should clarify which penalties, if any, are still at issue for each year. Should the
22 Board decide to adopt a motion other than sustaining respondent's action in this appeal, that motion
23 should incorporate appellant's concessions on appeal.

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26 ²⁴ It is not clear from the record which penalties are associated with the \$800 LLC tax. Regardless, appellant has not asserted
27 any arguments for the abatement of any of the penalties. Therefore, should the Board find that respondent erred in imposing
28 the LLC fees in this appeal, respondent will need to abate only the penalties resulting from the LLC fee amounts, and all
other penalties will not be abated unless appellant proves to the Board at the hearing that an abatement of these penalties is
appropriate.

1 Whether appellant conducted the Burger King restaurant businesses

2 Both parties agree that the main issue before the Board is a factual one; whether appellant
3 operated the Burger King businesses during the years at issue. Both parties should be prepared to list
4 and summarize in a concise manner the evidence that supports their conclusion that the Burger King
5 restaurant businesses were or were not conducted by appellant during the years at issue. Each party
6 should be prepared to explain in greater depth why the documents upon which it relies establish that its
7 position is correct. Appellant has indicated that the volume of documentation is too bulky to submit by
8 mail or fax, and that it is only practical to present this documentation through an oral hearing. Appellant
9 has since provided additional documentation in response to the pre-hearing conference. Any additional
10 evidence that the parties wish to provide should be submitted in an organized manner. Due to the
11 necessary time constraints of the Board Hearing, both parties should attempt to provide any additional
12 evidence at least two weeks prior to the hearing to allow time for the full consideration of such
13 evidence.²⁵

14 Determining whether the LLC fees in this appeal are properly imposed depends on
15 whether appellant operated the Burger King restaurant businesses and therefore earned the sales income,
16 which is a factual determination to be made by the Board after considering the facts and arguments
17 presented by the parties. When weighing the facts in an appeal like this, the most weight is generally
18 placed on contemporaneous evidence, showing how the businesses were run and who was represented as
19 operating the businesses during the years at issue. This evidence will include tax returns, any contracts
20 or amendments to contracts that were entered into during the years at issue, and documents evidencing
21 transactions and other interactions between the businesses and third parties. Evidence dated prior to or
22 after the time period at issue may be persuasive, but generally should not be given as much weight as
23 contemporaneous evidence. In particular, evidence that predates the January 18, 1995 creation of
24 appellant and evidence provided that was created after respondent informed appellant of the LLC fee
25 liability through the jeopardy assessment issued on May 30, 2006, should be considered with more
26 scrutiny as to the relevance and veracity of such evidence, compared to documents created during the
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28 ²⁵ Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of
Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.

1 tax years at issue. When reviewing contemporaneous evidence, such as tax returns, that appear to show
2 that appellant operated the Burger King franchise businesses, the parties should discuss appellant's
3 contention that the years of filings and other reporting documents were errors made by appellant's
4 accountant, and whether that contention conflicts with the evidence provided which suggests that
5 appellant was formed for the sole purpose of operating Burger King franchise businesses.

6 Aside from the partnership during the early years of the Burger King franchise
7 operations, Mr. Kozen is the sole operator of the businesses and ground leases under either his own
8 name, appellant's name, or the trade names of JK Group and Burger King. Documents provided bear
9 combinations of these names without a clear pattern. The parties should address the concern of how to
10 clarify from these documents whether actions were performed by appellant, a single-member
11 disregarded (for at least a portion of the years at issue) LLC ran by Mr. Kozen, or Mr. Kozen in his
12 personal capacity, particularly when documents refer only to JK Group or a Burger King location.²⁶ The
13 parties should address respondent's legal assertion that appellant could have been using the JK Group
14 trade name, despite never officially registering to use that trade name. Respondent should be prepared
15 to further discuss how appellant legally operated the Burger King franchise businesses without the
16 approval of an assignment from the Burger King Corporation. The parties should also be prepared to
17 discuss respondent's contention that appellant operated the businesses outside of the franchise
18 agreement, and should recognize all income from the sales generated by the Burger King restaurant
19 businesses, less the value of the franchise (e.g., service marks, good will, etc.), and what the value of the
20 franchise is under that theory.

21 Whether the LLC fee is unconstitutional

22 The question of double taxation in this instance centers on the LLC fee and the income
23 taxes paid by Mr. Kozen. These two taxes are imposed by the same taxing authority within the same
24 jurisdiction and during the same taxing period. However, the question appears to be whether the LLC
25 fee has a different purpose than the income tax (the benefit of operating under a specific business
26

27
28 ²⁶ Further ambiguity in the actions and obligations of the respective business forms is revealed in the documents. For
example, appellant provides documents that show appellant was liable for property taxes on the LAX location, yet also shows
that payments were made from the JK Group banking account, explaining that appellant's debts were paid by JK Group.
Appellant should explain the intermingling of funds and obligations among the respective business forms.

1 structure versus the benefits of being a citizen of the state or receiving income from sources within the
2 state), and whether the LLC fee is of a different character than the income tax based on its different
3 manner of calculation. (See Resp. Add'l Br., pp. 4-6.) The Revenue and Taxation Code and California
4 Code of Regulations allow for the assessment of the LLC fee when income taxes are paid by the single-
5 owner of an otherwise disregarded LLC. The Board may wish to decide whether this is a constitutional
6 issue, regarding the legality of R&TC section 23038, subdivision (b)(2)(B)(iii), and California Code of
7 Regulations, title 18, section 23038(b)-2(c)(2). If such is the case, then the Board may wish to abstain
8 from finding double taxation in this instance under the rules for federal preemption, described in the
9 applicable law section above. Both parties should be prepared to discuss the factors demonstrating
10 double taxation as they apply to these facts, and the implications of any taxes previously paid on the
11 Burger King restaurant income by Mr. Kozen as a sole proprietor. Both parties should be prepared to
12 explain how these taxes paid are taken into account if it is decided that the LLC operated the business,
13 and whether it changes any calculations for appellant's or Mr. Kozen's tax liability for the years at issue.

14 Should the Board find that appellant received income which triggers the application of
15 R&TC section 17942, it appears to staff that the question of whether the LLC fee imposed under R&TC
16 section 19742 is unconstitutional, as assessed in this appeal, is a federal preemption question. The issue
17 of whether a state statute is preempted by federal law is a constitutional issue. (U.S. Const., art. VI, cl.
18 2.) The California Constitution prohibits this Board from refusing to enforce a statute on the basis that it
19 is preempted by federal law, unless an appellate court has already made such a determination, and this
20 Board has a long-established policy of declining to consider such issues. (Cal. Const., art. III, § 3.5;
21 *Appeal of Aimor Corporation, supra.*) Here, appellant was a LLC operating entirely in California.

22 The parties should be prepared to discuss whether an appellate court decision prohibits
23 the enforcement of R&TC section 17942 under the circumstances present in this appeal such that the
24 Board could refuse to enforce that statute by granting this appeal. Should the Board determine that no
25 appellate court decision prohibits the enforcement of R&TC section 17942 under these facts, the Board
26 should not declare the LLC fee unconstitutional, in accordance with the principle of abstention from
27 deciding constitutional issues. Appellant could then file a refund suit so that the courts could decide the
28 issue. However, should the Board determine that there is an appellate court decision that prohibits the

1 enforcement of R&TC section 17942 under the circumstances present in this appeal, the Board could
2 then find that the LLC fee, if found to otherwise be applicable here, is unconstitutional.

3 Two recent California appellate court decisions held that the LLC fee is unconstitutional
4 as applied in those cases. (See *Northwest Energetic Services, LLC v. Franchise Tax Board* (2008) 159
5 Cal.App.4th 841, and *Ventas Finance I, LLC v. Franchise Tax Board* (2008) 165 Cal.App.4th 1207, cert.
6 den. (2009) 129 S. Ct. 1917.) However, these two cases dealt with LLC appellants who operated either
7 entirely or at least partially outside of California. There is no final appellate level decision known to the
8 Appeals Division which declares R&TC section 17942 to be unconstitutional when applied to a LLC
9 operating entirely within California. Current cases involving a LLC operating entirely within California
10 are still in the early stages of trial level proceedings in the Superior Court.²⁷ (See *Bakersfield Mall, LLC*
11 *v. Franchise Tax Board*, San Francisco Superior Court Case No. CGC-07462728, filed April 25, 2007;
12 *CA-Centerside II, LLC v. Franchise Tax Board*, Fresno Superior Court Case No. 10CECG00434, filed
13 February 4, 2010.)

14 In *Ventas Finance I, supra*, the court ruled that the LLC fee for a company operating both
15 in and out of California should be calculated based only on its California-sourced income. According to
16 that result, it appears as though the courts would find that the LLC fee is properly calculated on all the
17 income from an LLC which operates entirely in California. However, if the Board believes that the
18 issue presented is one of first impression, where there is no guiding appellate level decision, then the
19 Board may wish to deny the appeal in accordance with the policy of abstention.

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23 JK Group LLC_jj
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27 ²⁷ The Appeals Division requested additional briefing from the parties during the briefing process. An issue in the request
28 was whether the appeal should be deferred pending a result in the *Bakersfield Mall* case. In reply, appellant stated that it did
not want to defer and wanted to go forward with this appeal.