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

12 In the Matter of the Appeal of:) **HEARING SUMMARY**
 13) **PERSONAL INCOME TAX APPEAL**
 14 **MATT T. KNUDSTRUP AND**) Case No. 342390
 15 **DEBORAH E. KNUDSTRUP¹**)

<u>Years</u>	<u>Claims For Refund Amounts</u>
1999	\$483,766 ²
2000	\$ 32,358 ³

16 Representing the Parties:

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 19 For Appellants: Dennis Brager, Esq.
 20 For Franchise Tax Board: Greg W. Heninger, Staff Operation Specialist
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 23 ¹ Appellants reside in Ventura County, California. This appeal was deferred pending a final decision in the litigation
 24 appealing the Board’s decision in *Appeal of Benjamin R. Du and Carmela L. Du*, 2007-SBE-001, July 17, 2007 (hereinafter
 25 “*Appeal of Du*”). After the completion of briefing in this appeal, the Board’s determination in *Appeal of Du* was affirmed by
Shimmon v. Franchise Tax Board (2010) 189 Cal.App.4th 688, review denied (*Du v. Franchise Tax Board* (Cal., Feb. 2,
 2011) 2011 Cal. LEXIS 1011). As a result, this appeal was reactivated and placed back on calendar.

26 ² In its opening brief, the Franchise Tax Board (FTB or respondent) asserts that the actual amount on appeal for 1999 is
 27 \$483,765.27, which the FTB states includes the interest accrued on the additional tax reported on appellants’ 1999 return
 from October 15, 2001 to April 9, 2004. (FTB OB, fn 1.)

28 ³ In its opening brief, the FTB asserts that the actual amount on appeal for 2000 is \$32,357.64, which the FTB states includes
 the interest accrued on the additional tax reported on appellants’ 2000 return from February 15, 2003 to April 9, 2004. (FTB
 OB, fn 2.)

1 QUESTIONS: (1) Whether this Board has jurisdiction to hear this appeal, given that the Voluntary
2 Compliance Initiative (VCI) bars certain taxpayers from claiming a refund of
3 amounts paid under the VCI.

4 (2) If the Board decides that it has jurisdiction to hear this appeal, whether appellants
5 are entitled to interest suspension under R&TC section 19116.

6 (3) If the Board decides that it has jurisdiction to hear this appeal, whether appellants
7 are entitled to recover their fees and expenses.

8 HEARING SUMMARY

9 Background—The Voluntary Compliance Initiative and appellants’ participation therein

10 In 2003, the California Legislature enacted the “Voluntary Compliance Initiative,”
11 (hereinafter, VCI) which allowed taxpayers to file amended returns, disclose potentially abusive tax
12 shelter transactions, pay the resulting tax and interest, and avoid the application of penalties.
13 (Rev. & Tax. Code, § 19751 et seq.) Taxpayers were allowed to file amended VCI returns during the
14 period from January 1, 2004, through April 15, 2004, inclusive. (Rev. & Tax. Code, § 19751, subd. (b).)

15 Taxpayers who participated in the VCI could elect either of two options. Under the first
16 VCI option (“Option 1”):

- 17 • The state would waive all penalties attributable to the abusive transactions (Rev. & Tax.
18 Code, § 19752, subd. (a)(1));
- 19 • The taxpayer would be immune to criminal prosecution in connection with the abusive
20 transactions (*Id.*, subd. (a)(2)); and
- 21 • The taxpayer would give up the right to “file a claim for refund for the amounts paid in
22 connection with” the abusive transactions. (*Id.*, subd. (a)(4).)

23 Under the second VCI option (“Option 2”):

- 24 • The state would waive all penalties attributable to the abusive transactions except the
25 accuracy penalty (Rev. & Tax. Code, § 19752, subd. (b)(1));
- 26 • The taxpayer would be immune to criminal prosecution in connection with the abusive
27 transactions (*Id.*, subd. (b)(2)); and
- 28 • The taxpayer would retain the right to file a claim for refund. (*Id.*, subd. (b)(4).)

1 Appellants filed a timely joint 1999 California return, reporting, among other items,
2 substantial capital losses from “OPIS” and a California taxable income of \$272,640. (App. Reply
3 Br., 8/21/06, p 1; FTB OB p 1.) In addition, appellants filed a timely joint 2000 California return
4 reporting, among other items, substantial capital losses from OPIS and a California taxable income of
5 \$1,337,520. (App. Reply Br., p 2; FTB OB p 3.)

6 After appellants filed their 1999 and 2000 California returns, according to the FTB, it
7 mailed a letter to appellant-husband, inviting him to participate in the VCI program.⁴ (App. Reply Br.
8 p 2.)

9 In April 2004, appellants participated in the VCI and filed amended 1999 and 2000
10 California returns. (*Id.*) Along with their amended returns, appellants submitted VCI Forms, which
11 stated in part: “I elect to participate in the VCI under Option 1. I understand that I waive my right to
12 appeal or file a claim for refund for any amounts paid under this VCI.” (FTB OB, Exs E and G.) The
13 amended returns “reversed out the OPIS losses.” (App. Reply Br., p 2.) The amended 1999 return
14 reported California taxable income of \$28,141,136 and an additional tax of \$2,591,770. (FTB OB, p 2.)
15 The amended 2000 return reported California taxable income of \$6,476,443 and an additional tax of
16 \$452,265. (*Id.* p 3.) Concurrently with filing the amended returns, appellants paid the full amounts of
17 additional taxes; in addition, appellants paid interest of \$353,411 for 1999 and \$66,206 for 2000. (See
18 *id.* pp 2-3.) Subsequent to the filing of the amended returns, appellants paid additional interest of
19 \$483,766 for 1999 and \$32,358 for 2000.⁵ (App. Reply Br. , p 2.) Thereafter, the FTB sent a small
20 refund in the amount of \$18.21 to appellants for the 2000 tax year. (FTB OB, p 3.)

21 Later, appellants filed timely Requests for Abatement of Interest, asserting that, under the
22 interest suspension provisions of R&TC section 19116, they were entitled to refunds of a portion of the
23 interest paid on the tax liability reported in the previous amended returns that had been filed under the
24 VCI Option 1 elections. (*Id.*) The FTB denied each claim for refund. (*Id.*) In response, appellants filed
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27 ⁴ In its opening brief, the FTB states that it did not retain a copy of the actual letter. However, the FTB provided a copy of
28 the form letter. (See FTB OB, Ex. C.) Appellants assert that they have been unable to locate any evidence that such a letter
was sent to them. (App. Reply Br., 8/22/06, p 2.)

⁵ The numbers are rounded. The FTB asserts that appellants actually made payments of \$483,765.50 for 1999 and
\$32,357.63 for 2000. (FTB OB pp 2-3.)

1 this timely appeal. (*Id.*)

2 QUESTION (1): Whether this Board has jurisdiction to hear this appeal, given that the VCI bars
3 certain taxpayers from claiming a refund of amounts paid under the VCI.

4 Applicable Law

5 Voluntary Compliance Initiative

6 As noted above, taxpayers had the option of electing to participate in the VCI without a
7 right to appeal (Option 1) or with a right to appeal (Option 2). (Rev. & Tax. Code, § 19751, subs. (a)
8 and (b).) Appellants in this appeal chose Option 1). Option 1 provides that:

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- 10 • The state waives all penalties imposed for underreporting tax liabilities attributable to abusive
tax avoidance transactions (Rev. & Tax. Code, § 19752, subd. (a)(1));
 - 11 • The Taxpayer is immune from criminal prosecution in connection with the abusive transactions
12 for the taxable years for which the taxpayer voluntarily complies (*Id.*, subd. (a)(2)); and,
 - 13 • The taxpayer “may not file a claim for refund for the **amounts paid** in connection with” the
14 abusive tax avoidance transactions. (*Id.*, subd. (a)(4) [emphasis supplied].)

15 In *Appeal of Du, supra*, the Board considered whether taxpayers could bring a claim for
16 refund for a portion of the *interest paid* under a VCI Option 1 election. In that appeal, appellants argued
17 that (i) tax and interest are distinct concepts (*citing, inter alia, Flora v. United States* (1960 362 U.S.
18 145)) and (ii) the phrase “amounts paid” only required them to pay the *correct amount* of taxes and
19 interest, not to overpay. The Board, however, rejected the taxpayers’ arguments, noting that subdivision
20 (a)(4) provides that a taxpayer “may not file a claim for refund for the **amounts paid** in connection with”
21 an Option 1 election. (R&TC § 19752, subd. (a)(4) [emphasis supplied].) The Board held that the
22 phrase “amounts paid,” included not only the tax assessed—but also interest paid. Accordingly, the
23 Board held that the taxpayers’ claim for refund for a portion of the interest paid on the tax paid under
24 their VCI Option 1 election was barred and invalid due to their waiver of their right to claim a refund in
25 their VCI Option 1 election, and for those reasons, the Board concluded that it did not have jurisdiction
26 to hear the appeal.

27 After the Board issued its decision in *Appeal of Du, supra*, the taxpayers, Mr. and
28 Mrs. Du, filed a claim for refund in California Superior Court. However, the California Superior Court

1 rejected their claim for refund. Subsequently, Mr. and Mrs. Du filed an appeal, which was recently
2 considered and decided by a California Court of Appeal in *Shimmon v. Franchise Tax Board, supra*.
3 The California Court of Appeal ruled that the Mr. and Mrs. Du voluntarily elected to participate in
4 California's VCI by making an election (and making payments) under VCI Option 1, and therefore, their
5 claim for refund for a portion of the interest paid on the tax paid under the VCI was properly barred.
6 Although Mr. and Mrs. Du sought review by California Supreme Court, their request for review was
7 denied on February 2, 2011. (*Du v. Franchise Tax Board, supra.*)

8 Contentions

9 Appellants

10 Appellants acknowledge that the Board's decision in *Appeal of Du, supra*, would, if
11 followed, bar appellants' claims for refund in this appeal and, therefore, result in the Board lacking
12 jurisdiction to hear this appeal. (App. Reply Br., 7/30/08, p 2.) Yet, here, appellants are not trying to
13 distinguish their facts from those in *Appeal of Du*. Instead, appellants argue that the Board should place
14 this appeal in "suspense" pending a judicial resolution of the issue the set forth in *Appeal of Du*. (*Id.*)

15 The FTB

16 The FTB argues that the Board lacks jurisdiction to hear this appeal. (FTB Reply Br.,
17 7/7/08, pp 1-2.) Specifically, the FTB states that under the Board's decision in *Appeal of Du, supra*, a
18 taxpayer who elects and makes payments under California's VCI Option 1 is barred from later bringing
19 a claim for a refund for the interest paid on the tax paid under the VCI, and consequently, any such
20 claim for refund is invalid, and for that reason, the Board lacks jurisdiction to hear such an appeal. (*Id.*)
21 The FTB argues that the Board's decision in *Appeal of Du* applies to this appeal and, consequently, each
22 claim for refund in this appeal is barred and invalid—and for those reasons, the Board lacks jurisdiction
23 to hear and decide this appeal. (*Id.*)

24 STAFF COMMENTS

25 The legal issue of whether the Board has jurisdiction to hear this appeal has been
26 resolved by the Board in *Appeal of Du, supra*, and was subsequently affirmed by a Court of Appeal's

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1 decision in *Shimmon v. Franchise Tax Board, supra*. which is now final.⁶ Staff believes that these
2 decisions are controlling, and consequently that the Board has no jurisdiction to hear or consider this
3 appeal. At the oral hearing, appellants should be prepared to explain whether the Court of Appeal's
4 decision can be distinguished.

5 QUESTION (2): If the Board decides that it has jurisdiction to hear this appeal, whether appellants are
6 entitled to interest suspension under R&TC section 19116.

7 Applicable Law

8 R&TC section 19116

9 California law imposes interest from the date on which any personal or corporate income
10 tax is due until the date the entire balance is paid in full. (Rev. & Tax. Code, § 19101, subd. (a).)
11 Interest is paid, assessed, and collected in the same manner as the underlying tax. (*Id.*, subd. (c).) The
12 Board has long recognized that the assessment of interest on any unpaid tax is mandatory. (*Appeal of*
13 *Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) The Board has also recognized that interest is not a
14 penalty, but is simply compensation to the state for the lost time-value of money received after the due
15 date. (*Appeal of Alan F. and Rita K. Shugart*, 2005-SBE-001, July 1, 2005.) As such, the law provides
16 no reasonable cause exception to the imposition of interest. (*Id.*)

17 While there is no general reasonable cause exception to the imposition of interest, the
18 Legislature has enacted four provisions that provide limited relief from interest under specified
19 circumstances. Only one exception, R&TC section 19116,⁷ is at issue here. Section 19116 protects
20 taxpayers from paying for the state's failure to provide prompt notice of a tax liability by suspending the
21 imposition of interest in certain cases. The FTB must suspend the imposition of interest if it does not
22 "provide a notice to the taxpayer specifically stating the taxpayer's liability and the basis of the liability"
23 within a "notification period." (Rev. & Tax. Code, § 19116, subd. (a).) Interest suspension does not
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26 ⁶ *Shimmon v. Franchise Tax Board* (2010) 189 Cal.App.4th 688, review denied (*Du v. Franchise Tax Board* (Cal.,
Feb. 2, 2011) 2011 Cal. LEXIS 1011).

27 ⁷ This hearing summary contains numerous references to R&TC section 19116 and its various subdivisions. To avoid
28 repetition and improve readability, the hearing summary will often refer to R&TC section 19116 simply as "section 19116"
in the text and "§ 19116" in parenthetical citations. Similarly, all further references in the text to subdivisions are too
subdivisions of section 19116.

1 apply to any interest, penalty, addition to tax, or additional amount with respect to any tax liability
2 shown on the return. (*Id.* at subd. (d)(4).) The notification period means the 18-month period beginning
3 on the later of either the date the return is filed or the due date of the return without regard to extensions.
4 (*Id.*, subd. (b)(1).) The period of interest suspension begins the day after the notification period and
5 ends 15 days after the mailing of the notice of liability. (*Id.*, subd. (b)(2).)

6 The notification period is extended where a taxpayer is required by R&TC section 18622,
7 subdivision (a), to report a change or correction by the Commissioner of Internal Revenue. If the
8 taxpayer or the Internal Revenue Service (IRS) notifies the FTB of the federal adjustments within six
9 months of the final federal determination, the notification period ends one year after the FTB receives
10 such notice. (Rev. & Tax. Code, § 19116, subd. (e)(1)(A).) If the taxpayer or the IRS notifies the FTB
11 of the federal adjustments more than six months after the final federal determination, the notification
12 period ends two years after the FTB receives such notice. (*Id.*, subd. (e)(1)(B).) In such cases, interest
13 suspension does not begin until after the end of the extended notification period. (*Id.*, subd. (e)(2).)

14 There are instances where interest suspension will not be permitted. First, section 19116,
15 subdivision (d)(7), provides that for notices issued on or after January 1, 2005, no interest is to be
16 suspended on amounts related to any “reportable” or “listed” transactions:

17 [Section 19116] shall not apply to any of the following:

18 Any interest, penalty, addition to tax, or additional amount relating to any reportable
19 transaction with respect to which the requirements of Section 6664(d)(2)(A) of the
20 Internal Revenue Code are not met, and any listed transaction, as defined in Section
21 6707A(c) of the Internal Revenue Code. (§ 19116, subd. (d)(7).)

22 Second, section 19116 was modified by SB 614 to add an exception to interest
23 suspension for taxpayers with income greater than \$200,000 that have been contacted by the FTB
24 regarding the use of a potentially abusive tax shelter. Thus, section 19116, subdivision (f) provides:

25 For notices sent after January 1, 2004, this section does not apply to taxpayers with
26 taxable income greater than two hundred thousand dollars (\$200,000) that have been
27 contacted by the Franchise Tax Board regarding the use of a potentially abusive tax
28 shelter [within the meaning of the VCI].

FTB Notice 2005-4

Section 19116 and its federal counterpart, Internal Revenue Code (IRC) section 6404(g),

1 allow for interest suspension when the government fails to notify the taxpayer of a liability in a timely
2 manner. Those statutes do not, on their face, allow for interest suspension when the taxpayer voluntarily
3 notifies the government of an additional liability (i.e., the taxpayer files an amended return). In Revenue
4 Ruling 2005-4, the IRS recognized the potential for inequity when taxpayers voluntarily report
5 additional tax on an amended return, as opposed to waiting for the government to notify them.
6 Specifically, the IRS posed the question of whether interest suspension applies when a taxpayer reports
7 additional tax on an amended return after having filed a timely return. In answering that question, the
8 IRS first observed that the bar to suspending interest on self-assessed liabilities applies only to the
9 original return, and not to liabilities shown on an amended return. The IRS next observed that a
10 taxpayer who files an amended return and reports additional tax is aware of the basis for the liability,
11 which renders a notice by the IRS unnecessary. To correct the inequity, the IRS concluded that interest
12 suspension would apply to the additional tax reported on an amended return only where: (1) the taxpayer
13 filed a timely original return, (2) the IRS did not notify the taxpayer of an additional liability within the
14 notification period (i.e., 18 months from the original return), and (3) after the notification period, the
15 taxpayer files an amended return reporting additional tax. The period of interest suspension would run
16 from the end of the notification period to the date the amended return is filed (if the tax is paid with the
17 amended return), or until 21 days after the amended return is filed (if the tax is not paid with the
18 amended return).⁸

19 In FTB Notice 2005-4, the FTB announced that it would follow Revenue Ruling 2005-4
20 to the extent applicable under California law. Specifically, the FTB stated that it would suspend interest
21 on amounts self assessed on amended returns where: (1) the taxpayer is an individual, (2) the taxpayer
22 filed a timely original return for a tax year ending after October 10, 1999, and (3) the taxpayer filed an
23 amended return increasing the taxpayer's liability more than 18 months after filing the original return.
24 The period of interest suspension would run from the end of the notification period to 15 days after the
25 amended return is filed. Giving effect to the provisions of subdivision (f), FTB Notice 2005-4 also
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28 ⁸ Revenue Ruling 2005-4 was overturned by a statutory amendment. Effective December 21, 2005, section 303(b) of the
Gulf Opportunity Zone Act of 2005 amended section 6404(g)(1) so the notification period begins after the taxpayer files an
amended return. Thus, the interest accrued between the filing of the original return and the filing of the amended return can
no longer be suspended under federal law. California has not conformed to that change.

1 stated:

2 Interest suspension does not apply to an amended return filed by a taxpayer on or after
3 January 1, 2004, reporting additional tax as the result of the use of a potentially abusive
4 tax shelter where the taxpayer was contacted by FTB about the use of a potentially
5 abusive tax shelter and the taxpayer has taxable income greater than \$200,000.

6 Appeal of Paul L. Mickelsen and Patricia Mickelsen

7 In the *Appeal of Paul L. Mickelsen and Patricia Mickelsen*, 2007-SBE-003, decided by
8 the Board on December 12, 2007 (*Mickelsen*), the taxpayers, Mr. and Mrs. Mickelsen, filed an amended
9 return (and made payments) under a VCI Option 2 election. Later, Mr. and Mrs. Mickelsen filed a claim
10 for refund, arguing, among other things, that interest should have been suspended under the provisions
11 of R&TC section 19116. Because the Mickelsens' amended return had been filed under a VCI Option 2
12 election, the Board's decision in *Appeal of Du, supra*, was not controlling; thus, the Board did not
13 dismiss the Mickelsens' appeal based on lack of jurisdiction, as it did in the *Appeal of Du*. Instead, the
14 Board went on to address, among other things, the Mickelsens' argument that the term "notice" under
15 R&TC section 19116 means a "notice" issued by the FTB and, consequently, an amended return could
16 not be a notice for purposes of section 19116.

17 The Board noted that the Mickelsens' argument seemed to present a no-win situation for
18 the Mickelsens. The Board stated that, on one hand, if the Mickelsens' amended return is not treated as
19 a notice under R&TC section 19116(b)(2), then the general rule of subdivision (a) would not apply and,
20 accordingly, interest would not be suspended under that general rule. On the other hand, the Board
21 stated that if the Mickelsens' amended return is treated as a notice under R&TC section 19116, then the
22 exception of subdivision (f) would apply to their particular circumstances and, thus, interest would not
23 be suspended under the general rule because (this time) the exception to the general rule would apply.
24 The Board expressed no opinion on the validity or persuasive nature of FTB Notice 2005-4 (as set forth
25 above) because the Board stated that it did not affect the outcome of the Mickelsens' appeal. (*Id.* pp 14-
26 15.) Ultimately, the Board concluded that interest suspension did not apply to the additional tax
27 reported on the Mickelsens' amended VCI return pursuant to subdivision (f) of section 19116. (*Id.*
28 p 15.)

After the Board issued its decision in *Mickelsen, supra*, Mr. and Mrs. Mickelsen, filed a

1 claim for refund in California Superior Court. In that proceeding, the FTB moved for judgment on the
2 pleadings, requesting that the Superior Court dismiss the Mickelsens' complaint without leave to amend.
3 After considering the matter, the Superior Court granted the FTB's motion. Subsequently, Mr. and Mrs.
4 Michelsen filed an appeal, which was recently considered and decided by a California Court of Appeal
5 in *Shimmon v. Franchise Tax Board, supra*, an appeal in which Mr. and Mrs. Mickelsen were sub
6 nominees. The Court of Appeal held that the FTB's motion for judgment on the pleadings should have
7 been denied. Accordingly, the Court of Appeal reversed the Superior Court's decision in relation to the
8 Mickelsens—but the portion of the Court of Appeal's decision in relation to the Mickelsens was not
9 certified for publication. Mickelsens' arguments are currently being litigated in Los Angeles County
10 Superior Court, Central District, Case No. BC 385197.⁹

11 Contentions

12 Appellants

13 Appellants argue that they overpaid interest when they filed their amended returns under
14 their VCI Option 1 elections, and therefore, the Board should now grant their claims for refund, which
15 seek return of a portion of the interest they allegedly overpaid when they filed their prior amended
16 returns. (App. Reply Br., pp 1-3.) In support of this argument, appellants note that section 19116,
17 subdivision (a), generally suspends interest for a period of 18 months after a return is filed, and
18 appellants argue that they did not properly take this provision into account when they paid the interest
19 along with their amended returns under the VCI Option 1 elections. Accordingly, appellants want a
20 portion of the interest paid refunded. (*Id.*) Appellants acknowledge that the general rule under
21 subdivision (a), which suspends interest, does not apply "for notices issued after January 1, 2004"
22 pursuant to section 19116, subdivision (f). (*Id.* pp 3-11.) But appellants argue the FTB never issued a
23 notice after January 1, 2004, and therefore, appellants argue that the general rule under subdivision (a)
24 applies and, thus, interest should have been suspended under subdivision (a) and, thus, must now be
25 refunded. (*Id.*)

26 Appellants recognize that in FTB Notice 2005-4, the FTB took the official position that a
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28 ⁹ As confirmed by staff in a telephone call with Judge Miller's clerk on May 5, 2011.

1 taxpayer's amended return is a "notice" for purposes of 19116, subdivision (f). (*Id.* pp 3-11.) But
2 appellants argue that the FTB's legal reasoning in FTB Notice 2005-4 is incorrect. (*Id.*) Specifically,
3 appellants argue that the term "notice" as it is used in subdivision (f), means a notice issued by the FTB,
4 and therefore, an amended return cannot act as a notice under subdivision (f). (*Id.*) Also, appellants
5 argue that the FTB Notice 2005-4 was issued by the FTB in anticipation of litigation to "buttress" the
6 FTB litigation position. (*Id.* p 11.) And appellants assert the FTB's interpretation cannot violate the
7 "clear meaning" of the statute. (*Id.* p 6.)

8 Next, appellants address IRC section 6404(g), which is the federal counterpart to R&TC
9 section 19116. (App. Reply Br., pp. 10-11.) Appellants note that effective December 21, 2005, section
10 303(b) of the Gulf Opportunity Zone Act of 2005 amended IRC section 6404(g)(1) so the notification
11 period begins after the taxpayer files an amended return—thus, the interest accrued between the filing of
12 the original return and the filing of the amended return can no longer be suspended under federal law.
13 (*Id.*) But appellants note that (i) the federal change only applies to documents provided after December
14 21, 2005, and (ii) California has not conformed to that federal change. (*Id.*)

15 In addition, appellants assert that (i) R&TC section 19116(f) "applies only where a
16 taxpayer has been previously contacted by the FTB regarding the use of a potentially abusive tax
17 shelter", and (ii) although the FTB claims it mailed a letter to appellant-husband, "[t]he FTB does not
18 indicate where it sent this letter, nor by what means; nor does it include any evidence demonstrating that
19 the letter was actually sent." (App. Reply Br., p 12) Based on the foregoing, appellants argue that
20 "[e]ven assuming that the letter was sent to [appellant-husband], it should not be construed as the
21 statutorily required contact." (*Id.* p 12.) Specifically, appellants note:

22 [t]he letter starts out by asking the question: 'Have you participated in an abusive tax
23 shelter to avoid paying state income tax?' In the penultimate paragraph it states: 'If you
24 did not invest in any abusive tax shelter or transaction, please disregard this letter.' (App.
25 Reply Br. 8/21/06, p 12.)

26 Appellants argue that "[a] generic letter that does not even purport to identify the taxpayers as having
27 invested in a potentially abusive tax shelter should not be deemed to be a 'contact' by the FTB." (*Id.*
28 pp 12-13.)

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1 The FTB

2 The FTB argues that “the substantive arguments raised by appellants were considered,
3 addressed and rejected by your Board in its published opinion in the *Mickelsen* appeal.” (FTB Reply
4 Br., p 2.) The FTB states a that “[i]n the *Mickelsen* case, the Board determined that a taxpayer who filed
5 a VCI Option 2 amended return was not entitled to interest suspension for various reasons.” (*Id.*) And
6 the FTB contends that “[t]he *Mickelsen* opinion should control for the interest suspension issue, and [the
7 FTB’s] position must be sustained.” (*Id.*)

8 STAFF COMMENTS

9 As noted above in staff’s comments to Question No. 1, under the holdings of *Appeal of*
10 *Du, supra*, and *Shimmon v FTB, supra*, taxpayers making VCI Option 1 elections have waived their
11 right to appeal. Unless appellants can demonstrate that these decisions can be distinguished, it is staff’s
12 view that the Board cannot reach appellants’ interest refund arguments in Question No. 2.

13 QUESTION (3): If the Board decides that it has jurisdiction to hear this appeal, whether appellants are
14 entitled to recover their fees and expenses.

15 Applicable Law

16 R&TC section 21013 provides for the reimbursement of reasonable fees and expenses in
17 an appeal before the Board. To recover reimbursement under R&TC section 21013, a taxpayer must
18 show, among other things, that the FTB’s actions were unreasonable and not substantially justified.
19 (Rev. & Tax. Code, § 21013, subds. (a) and (b).) The amount of fees and expenses reimbursed under
20 R&TC section 21013 are limited to, in relevant part, the amount of fees and expenses incurred after the
21 date of a Notice of Proposed Assessment or jeopardy assessment, or a denial of a claim for refund.
22 (Rev. & Tax. Code, § 21013, subd. (c).) However, a taxpayer’s request for reimbursement for
23 reasonable fees and expenses can only be made *after* the Board has issued its decision and the decision
24 has become final. (Cal. Code Regs., tit. 18, § 5093, subd. (b).)

25 Contentions

26 Appellants

27 Appellants contend that the FTB’s denials of their claims for refund are unreasonable
28 and, therefore, they are entitled to recover their fees and expenses under R&TC section 21013.

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The FTB

The FTB argues that appellants’ request for reimbursement of fees and expenses is premature because the Board has not issued a final determination.

STAFF COMMENTS

As noted above in staff’s comments to Question No. 1, under the holdings of *Appeal of Du, supra*, and *Shimmon v FTB, supra*, taxpayers making VCI Option 1 elections have waived their right to appeal. In addition, staff notes that requests for compensation for fees and expenses must show that the FTB’s actions were unreasonable and not substantially justified, and can only be made *after* the Board has issued its decision and the decision has become final. (Rev. & Tax. Code, § 21013, subs. (a) and (b); Cal. Code Regs., tit. 18, § 5093, subd. (b).)

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