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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **REHEARING SUMMARY**
11) **CORPORATION FRANCHISE TAX APPEAL**
12 **DANIEL V, INC.**) Case No. 342609
13

<u>Years Ended</u>	<u>Proposed Penalties¹</u>
Dec. 31, 1997	\$ 18,341.65 ²
Dec. 31, 1998	168,002.06 ³

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17 Representing the Parties:

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

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20 For Franchise Tax Board: William Gardner, Tax Counsel III
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22 **QUESTIONS:** (1) Whether the accuracy-related penalties imposed by the Franchise Tax Board (FTB
23 or respondent) should be abated.

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27 ¹ Respondent should provide at the hearing the amount of interest that has accrued by the date of the hearing.

28 ² This amount includes the proposed accuracy-related penalty (\$8,151.85) and late filing penalty (\$10,189.80).

³ This amount is the proposed accuracy-related penalty (\$168,002.06).

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

3 HEARING SUMMARY

4 Background

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

18 Accuracy-Related Penalty

19 Both parties apparently agree that the following three statutory “exceptions” to the
20 imposition of the accuracy-related penalty should be addressed here: (1) Internal Revenue Code (“IRC”)
21 section 6662(d)(2)(B)(i) provides that the amount of the understatement of tax is reduced by the portion
22 of the understatement that is attributable to the tax treatment of any item by the taxpayer if there is or
23 was “substantial authority” for such treatment; (2) IRC section 6662(d)(2)(B)(ii) provides, in pertinent
24 part, that the amount of the understatement of tax is also reduced by the portion of the understatement
25 that is attributable to any item if (I) the relevant facts affecting the item’s tax treatment are adequately
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28 ⁴ The discussion of each penalty will address basically relevant legal issues and the contentions of the parties regarding them. Such discussion will sometimes contain extensive treatment of legal authorities, while a statement of the law will at other times appear in the Law section of this hearing summary.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

16 Late Filing Penalty

17 Appellant contends that it had "reasonable cause" for filing a late tax return for 1997
18 because the accountant responsible for appellant's financial and tax matters during that year had an
19 episode of mental illness, manifested in part by an attack by the accountant on a judicial official that
20 resulted in his incarceration, which prevented him from filing appellant's return for 1997 in a timely
21 manner. Appellant alleges that it was unaware of the accountant's psychological problems until
22 sometime after the return was due and that it then promptly engaged appellant's attorneys to prepare the
23 returns for both appeal years. Appellant has provided newspaper articles, dated November 1, 1998,
24 regarding the arrest of the accountant on October 1, 1998. (App. Reh'g Reply Br., Exhibit 3.)
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26 ¹⁰ Staff notes that Treasury Regulation 1.6664-4(c)(ii) provides, in pertinent part, that advice received by a taxpayer,
27 including advice from a professional tax advisor, must not unreasonably rely upon representations by the taxpayer or any
28 other person. The regulation further provides, as an example, that the advice may not be based on a representation that the
taxpayer knows, or has reason to know, is unlikely to be true. The parties may wish to discuss at the hearing the declaration
of February 23, 2009, in the context of the foregoing regulation.

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

13 Law

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

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

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

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

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

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

3 STAFF COMMENTS

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

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

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

5 Attachments: Exhibits I-III

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9 Daniel V. Inc._cdd

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