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

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **CHARLES R. SCHWAB AND**) Case No. 450981
13 **HELEN O. SCHWAB¹**)

	<u>Years</u>	<u>Proposed Assessments</u>
	2000	\$149,336 ²
	2001	\$336,637

17 Representing the Parties:

18 For Appellants: Jeffrey M. Weiss, Attorney at Law
Weiss & Weissman, Inc.
19 For Franchise Tax Board: William Gardner, Tax Counsel III

21 **QUESTIONS:** (1) Whether appellants substantiated charitable contributions in excess of \$982,273
22 for the 2000 tax year and \$232,482 for 2001.
23 (2) Whether appellants substantiated their basis in Yazam/U.S. Technologies stock
24 and whether this stock became worthless in 2001.

26 ¹ Appellants' representative is located in the City and County of San Francisco.
27 ² Respondent explains in its opening brief at footnote 2 that it has agreed to abate the \$37,334 penalty for failure to furnish
28 information upon demand. Respondent should also be prepared at the oral hearing to provide the interest calculations on these proposed assessments.

1 (3) Whether appellants substantiated their basis in Novell stock and the amount of
2 their capital loss on the sale of this stock in 2001.

3 (4) Whether this Board has jurisdiction to review the post-amnesty penalty in the
4 context of a deficiency appeal.

5 HEARING SUMMARY

6 Background

7 Appellants claimed \$1,993,082 and \$869,615 in contributions to charity on their 2000
8 and 2001 California Resident Income Tax Returns, respectively. (Resp. Opening Br. at p. 2.) For 2001,
9 appellants claimed a capital loss of \$3,000,000 based on the worthlessness of their stock in Yazam/U.S.
10 Technologies (hereafter, Yazam) and capital losses of \$1,697,034 from separate sales of Novell stock.
11 In November of 2003, respondent began examining appellants' returns and over the following two and a
12 half years, respondent made numerous requests for information to support appellants' contributions and
13 losses. Specifically, respondent requested

- 14 • evidence that appellants advanced \$3,000,000 to Yazam and that such Yazam stock
15 became worthless during the 2001 tax year,
- 16 • an explanation of the discrepancy between appellants' claimed cost basis of \$3,042,114 in
17 153,400 shares of Novell stock sold in 2001, and appellants' brokerage statements from
18 the prior year showing appellants' basis of \$2,477,714, and
- 19 • information supporting claimed cash contributions for both tax years at issue.

20 (Resp. Opening Br. at p. 3.)

21 On March 22, 2006, respondent informed appellants that, based on their failure to comply
22 with the requests for information, respondent would disallow all claimed charitable contributions, the
23 \$3,000,000 claimed capital loss for Yazam stock and a portion of the claimed capital loss for Novell
24 stock associated with the unsubstantiated portion of cost basis in that stock. (Resp. Opening Br. at pp. 3-
25 4.)

26 Appellants subsequently provided information supporting a portion of the charitable
27 contributions, which respondent determined substantiated additional contributions of \$398,622 and
28 \$232,482 for 2000 and 2001, respectively. On June 16, 2006, respondent informed appellants that some

1 of the claimed contributions would be denied because appellants failed to provide brokerage statements
2 showing that gifts of stock were transferred from appellants' personal accounts and failed to provide
3 documentation showing that the gifts were received by qualified charitable organizations. In addition,
4 respondent stated that appellants submitted numerous acceptance letters from charitable organizations
5 receiving donations from the Schwab Family Foundation, rather than directly from appellants. On
6 July 20, 2006, respondent issued a Notice of Proposed Assessment (NPA) for 2000 disallowing itemized
7 charitable deductions in the amount of \$31,180,753 which resulted in additional tax of \$2,293,904, and
8 an NPA for 2001 disallowing the worthless stock deduction for Yazam stock of \$3,000,000, the partial
9 loss disallowance on the Novell stock in the amount of \$564,220, and itemized deductions in the amount
10 of \$13,323,078, which resulted in additional tax of \$1,575,020. The NPAs also imposed penalties for
11 failure to furnish information and post-amnesty penalties. (Resp. Opening Br., Exhibit A.)

12 Appellants timely protested the NPAs and respondent prepared a case development plan
13 and made four Information Document Requests (IDRs). Appellants responded only to the IDR that
14 requested information regarding claimed charitable contributions with evidence substantiating
15 appellants' charitable contributions of appreciated securities but did not address the cash contributions
16 claimed. Respondent scheduled a protest hearing and requested that appellants be prepared to address
17 the issues raised in the NPAs and in the four IDRs with supporting documentation. On October 11,
18 2007, respondent informed appellants that they substantiated most of their charitable contributions of
19 appreciated securities, but had not substantiated all of their charitable contributions of cash or losses
20 related to the Yazam and Novell stock. (Resp. Opening Br. at pp. 5-6.)

21 Respondent then provided appellants with a draft determination of protest findings and in
22 a subsequent letter respondent addressed the denial of claimed charitable contributions of cash.
23 Respondent explained that the auditor's determination was based on a lack of substantiation of some of
24 the claimed contributions and that some documentation indicated that contributions came from
25 appellants' family foundation, rather than directly from appellants. Respondent made an additional
26 request for information and provided appellants with an explanation of the auditor's analysis of the cash
27 contributions. In a letter dated April 11, 2008, respondent notified appellants that the protest was
28 complete and provided a revised determination that discussed the claimed charitable contributions of

1 cash and an explanation of respondent's determination increasing the substantiated cash contributions to
2 \$412,822. On May 12, 2008, respondent issued Notices of Action (NOAs) reflecting the revised
3 determinations. (Resp. Opening Br. at pp. 6-7.)

4 This timely appeal followed. Subsequent to the filing of this appeal, appellants provided
5 respondent with additional information regarding the claimed charitable contributions of cash for the
6 2000 tax year. Respondent reviewed that information and in a letter dated November 13, 2008,
7 determined that appellants substantiated an additional \$569,451 in cash contributions for 2000. (Resp.
8 Opening Br. at p. 9 & Exhibit I.) Respondent claims that a large portion of the remaining denial for
9 2000 was related to (a) litigation expenses incurred with respect to a Picasso painting (hereafter, the
10 Picasso litigation) which was eventually not donated to the San Francisco Museum of Modern Art
11 (SFMOMA), and (b) the failure to substantiate a \$500,000 gift to the American Fund for the Tate
12 Gallery.

13 **QUESTION (1):** Whether appellants substantiated charitable contributions in excess of \$982,273
14 for the 2000 tax year and \$232,482 for 2001.³

15 Contentions

16 Appellants' Contentions

17 Appellants contend they made charitable contributions of cash to qualified charitable
18 recipients in the amount of \$1,993,082 in 2000 and in the amount of \$869,615 in 2001 and presented
19 verifying documentation of those contributions to respondent. (Appellants' App. Ltr. at pp. 1-2.) In
20 appellants' reply brief dated January 7, 2009, appellants state that they are "gathering and compiling the
21 documentation and substantiation" for the 2000 and 2001 charitable contributions of cash in excess of
22 the amounts allowed by respondent. (Appellants' Reply Br. at p. 2.) Appellants also state that "[t]o the
23 extent that [a]ppellants fail to substantially meet [the record keeping] requirements, generally speaking,
24 [a]ppellants will concede any deductions that are not effectively substantiated." (Appellants' Reply Br.
25 at p. 2, lines 16-18.)

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28 ³ This is the amount at issue stated by respondent; however, from the amounts provided above (original deduction of
\$1,993,082) minus protest amount allowed, \$412,822, minus \$569,451 allowed in November 2008, the remaining amount in
contention for 2000 would appear to be \$1,010,809. Therefore, at the oral hearing, respondent should clarify the total amount
of contributions still in dispute.

1 Appellants also assert that for 2000 they claimed a charitable contribution deduction for
2 \$441,567 paid to two law firms and for \$25,543 paid for the Picasso litigation. Appellants state that
3 they made these payments "to protect the right to art donated by appellants to the San Francisco
4 Museum of Modern Art...." Appellants explain that they entered into a binding agreement to purchase a
5 Picasso painting and had a contractual commitment to donate the work to SFMOMA. Appellants claim
6 they were "going to purchase 60% interest in the painting; and, ... were going to give [SFMOMA]
7 sufficient funds to purchase the other 40% of the painting. (Appellant's Add'l Br. at p. 2.) Appellants
8 contend that the sellers refused to complete the sale and that a lawsuit was filed to enforce the sale.
9 Appellants assert that SFMOMA had a significant right to protect because the work of art is very
10 valuable and would have been a prized addition to SFMOMA's collection. Appellants contend that the
11 amounts would be allowed as a charitable contribution, if appellants had made the contribution directly
12 to SFMOMA and SFMOMA had then paid the Picasso litigation expenses with the money. (Appellants'
13 Reply Br. at pp. 2-3.) Appellants also point out that in the Picasso litigation, the only named party
14 plaintiff to the lawsuit was SFMOMA, citing *San Francisco Museum of Modern Art v. Alice Russell-*
15 *Shapiro, Christine H. Russell, Charles P. Russell and Robert Mellin*, San Francisco Sup. Ct. Case No.
16 CGC-00-311285). (Appellant's Reply Br. to Add'l Br. at p. 4.)

17 Finally, appellants contend that since the NOA for 2001 only identifies \$7,133 in
18 itemized deductions (charitable deductions) that have been disallowed, respondent has made an error in
19 listing the charitable deductions in the NOA and that this means appellants only have to justify \$7,133 in
20 charitable deductions for 2001. (Appellants' Reply Br. (Jan. 7, 2009) at p. 3.)

21 Respondent's Contentions

22 Respondent contends that appellants' failure to provide contemporaneous written
23 acknowledgements evidencing appellants' claimed charitable contributions of cash requires that
24 respondent deny their claimed charitable contributions. Respondent asserts that the law generally
25 requires taxpayers to keep records to substantiate their deductions. In the event that a taxpayer does not
26 meet these requirements, respondent contends that a deduction cannot be allowed. In addition to these
27 general deduction requirements, respondent states that charitable deductions have additional specific
28 record keeping rules that require a contemporaneous and written acknowledgement from the charitable

1 organization regarding the contribution. Respondent asserts that some of appellants' evidence indicated
2 that appellants' family foundation made \$150,000 and \$179,854 of the claimed charitable contributions
3 and not appellants for 2000 and 2001, respectively. Respondent contends that appellants have not
4 refuted respondent's determinations and that appellants have not provided any documentation for the
5 portion of the contributions respondent has disallowed. (Resp. Opening Br. at pp. 7-9.)

6 Respondent concedes that during this appeal appellants provided additional
7 documentation of claimed contributions of \$569,451 for the 2000 tax year, which respondent is now
8 conceding as substantiated. As for the remaining disallowed contributions, respondent contends that it
9 provided an explanation for these disallowed contributions and that appellants have not provided any
10 response to the specific denials set forth in respondent's letters of March 6, 2008, and November 13,
11 2008, or in Respondent's Revised Determination. Finally, respondent contends that appellants have not
12 met their burden of establishing that the deductions should be allowed. (Resp. Opening Br. at p. 9.)

13 With respect to Picasso litigation payments, respondent states that it appears the lawsuit
14 was filed on behalf of appellants rather than SFMOMA. Respondent notes that appellants have
15 represented that they had a "binding agreement" to purchase the art so that an action for breach of the
16 agreement would have been filed on appellants' behalf, even if they intended to donate the work to
17 SFMOMA later. In response to appellants' assertion that a charitable contribution deduction would have
18 been allowed if they had contributed the same amount of cash to SFMOMA, respondent contends that
19 the form of a transaction affects the tax treatment. Respondent points out that SFMOMA would not
20 have standing to bring the action in its own name because, according to appellants' representation, the
21 binding agreement existed between appellants and the seller of the art work. Finally, respondent states
22 that appellants' version of events seem to be contradicted by contemporaneous newspaper accounts of
23 the lawsuit which state that SFMOMA claimed to have an agreement with the seller whereby appellants
24 were to purchase a 60 percent interest in a \$45 million painting and to provide SFMOMA with the funds
25 to purchase the other 40 percent interest. Respondent contends that under these circumstances in which
26 appellants paid the litigation expenses for a breach of contract action and allegedly was a party to the
27 contract, a charitable contribution deduction is not allowable for the payment of those expenses. (Resp.
28 Add'l Br. at pp. 2-3.)

1 Finally, with respect to appellants' allegation of respondent's purported error of only
2 listing \$7,133 in itemized deductions for 2001, respondent states that the listed \$7,133 amount is not
3 specifically the result of the denial of charitable contributions, but is rather the cumulative effect of all
4 adjustments and carryover amounts and is a result of limitations on the amount of itemized deductions
5 under California law. Respondent states that the issue before the Board is whether the charitable cash
6 contributions were in fact made, how this issue is resolved may or may not reduce the net adjustment to
7 the itemized deduction phase-out totaling \$7,133.

8 Applicable Law

9 Revenue and Taxation Code (R&TC) section 17201 adopts Internal Revenue Code (IRC)
10 section 170, relating to deductions for charitable contributions. Subject to certain limitations, IRC
11 section 170(a)(1) provides for a deduction for charitable contributions described under IRC section
12 170(c), payment of which is made within the taxable year. IRC section 170(c)(2) states, in part, that the
13 term "charitable contribution" means a contribution or gift to or "for the use of" a valid charitable
14 organization.⁴

15 In order for a donation to be considered a gift for charitable deduction purposes, it must
16 proceed from a detached and disinterested generosity, and the term "charitable contribution" is
17 synonymous with the term "gift." (*Seed v. Comm'r* (1971) 57 T.C. 265, 275; *De Jong v. Comm'r* (1961)
18 36 T.C. 896, 899, *aff'd*. (9th Cir. 1962) 309 F.2d 373, 376-79; *see also Comm'r v. Duberstein* (1960) 363
19 U.S. 278.) A gift to a charitable organization must be a voluntary transfer of money or property without
20 the receipt of adequate consideration, made with charitable intent. (*Hernandez v. Comm'r* (1980) 490
21 U.S. 680, 690.) In *McConnell v. Comm'r*, T.C. Memo 1988-307, *aff'd without opinion*, (3rd Cir. 1989)
22 870 F. 2d 651, a real estate developer was denied a charitable deduction for the gift of streets and sewers
23 of a subdivision to a municipality, because the transfer was motivated by some anticipated benefit
24 beyond the mere satisfaction flowing from the performance of a generous act. The *McConnell* court
25 found that the benefits to the taxpayer and therefore his motives in the donation were twofold: to avoid
26 responsibility for future maintenance of the donated property and to enhance the value of his interest in
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28 ⁴ Respondent does not contest SFMOMA's charitable standing.

1 the remaining property. On the other hand, in *Seldin v. Comm'r*, T.C. Memo 1969-233, a developer
2 donated property to the local school district for which a charitable deduction was denied by the Internal
3 Revenue Service apparently on the grounds that the surrounding properties held by the developer would
4 be benefited by the presence of schools. The *Seldin* court disagreed with the IRS's disallowance stating
5 that to contend on this reason alone that the conveyances of the land were not "contributions" would
6 "stretch credulity." (*Id.* at p. 27.) Finally, in *U.S. v. Transamerica Corp.* (9th Cir. 1968) 392 F. 2d 522,
7 524, the Ninth Circuit held that an indirect business benefit, "such as one incidental to the public use or
8 to public recognition of its act of generosity," would not disqualify a transfer as a charitable contribution
9 but that a direct economic benefit would. Therefore, if a payment proceeds primarily from the incentive
10 of anticipated benefit to the payor beyond the satisfaction which flows from the performance of a
11 generous act, it is not a gift. (*De Jong, supra*).

12 IRC section 170(f)(8)(A) provides that, generally, no deduction shall be allowed under
13 subsection (a) for any contribution of \$250 or more "unless the taxpayer substantiates the contribution
14 by a contemporaneous written acknowledgment of the contribution by the donee organization that meets
15 the requirements of subparagraph (B)." Subparagraph (B) provides, in relevant part, that an
16 acknowledgement is required to include the amount of cash and a description of any property other than
17 cash contributed.⁵ Subparagraph (C) provides that an acknowledgement shall be considered to be
18 contemporaneous "if the taxpayer obtains the acknowledgment on or before the earlier of -- (i) the date
19 on which the taxpayer files a return for the taxable year in which the contribution was made, or (ii) the
20 due date (including extensions) for filing such return" (the acknowledgement documentation required
21 from the charitable organization will be referred to hereafter as Contemporaneous Receipt(s).) Finally,
22 Subparagraph (D) provides that the substantiation process above is not required for contributions
23 reported by the donee organization, "if the donee organization files a return on a form and in accordance
24 with such regulations as the Secretary may prescribe, which includes the information described in
25 subparagraph (B) with respect to the contribution." The donee reporting option of subparagraph (D) will
26 be referred to as a Donee Report, and this entire substantiation requirement of substantiating a
27

28 ⁵ It appears that this provision may require a written statement from SFMOMA regarding contributions of Picasso litigation expenses paid "for the use of" SFMOMA in order to substantiate that SFMOMA received the contribution.

1 contribution of \$250 or more through a Contemporaneous Receipt or Donee Report will be referred to as
2 the Substantiation Test. Board staff reviewed Treasury Regulation 1.170A-13(f), and IRS Publications
3 1771 "Charitable Contributions Substantiation and Disclosure Requirement" and 526 "Charitable
4 Contributions" to obtain additional information on the mechanics of the Donee Report method. It
5 appears that regulations have not yet been drafted nor a reporting form prescribed allowing charities to
6 use the Donee Report substantiation method. One commentator explained the situation as follows back
7 in 1996:

8 Under IRC 170(f)(8)(D), charities need not substantiate donations if, in accordance with
9 Treasury regulations, they report directly to the Service the information required to be
10 provided in the written statements. There are no regulations at present establishing such
11 reporting procedure, nor will there be any in the foreseeable future. Hence, charities may
12 not report to the Service on behalf of contributors the information in the written
13 statements. In practice, since good donor relations are in charities' interest, most, if not
14 all, charities will provide contributors written statements with the proper information.⁶

12 Exempt organizations described under IRC section 501(c)(3) are precluded from allowing
13 any part of their net earnings (*e.g.*, donations) from inuring to the benefit of any private individual (such
14 activity will be referred to hereafter as private inurement).

15 In resolving an issue on appeal, respondent's determination is presumed correct. (*Todd v.*
16 *McColgan* (1949) 89 Cal. App. 2d 509, 514; *Appeal of Pearl R. Blattenberger*, 52-SBE-002, Mar. 27,
17 1952.) This presumption is, however, a rebuttable one, which appellants must produce sufficient
18 evidence to overcome. (*Wiget v. Becker* (1936) 84 F.2d 706,707-708; *Appeal of Joseph J. and Julia A.*
19 *Battle*, 71-SBE-011, Apr. 5, 1971.) It is well settled that deductions are a matter of legislative grace and
20 appellants bear the burden of proving their entitlement to those deductions. (*INDOPCO, Inc. v. Comm'r*
21 (1992) 503 U.S. 79, 84.)

22 Staff Comments Regarding Issue (1): the Charitable Contributions

23 It appears that the Substantiation Test and its required Contemporaneous Receipts or
24 Donee Report provisions were intended to provide certainty to taxpayers and to the taxing authorities
25 regarding the propriety of claimed charitable contributions. It appears that unless the Substantiation
26 Test requirements are satisfied, no charitable deduction is allowable. (Int. Rev. Code § 170(f)(8).)

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28 ⁶ "IRS Exempt Organization CPE Technical Instruction Program Textbook: Part I, Chapter G: Updates on Disclosure and Substantiation Rules" by Seto and Jones, available on Lexis at 96 TNT 198-27 (release date Sep. 23, 1996).

1 With respect to the claimed charitable deduction of litigation expenses paid on behalf of
2 SFMOMA, there appears to be a question as to whether the payments constituted a "gift to or for the use
3 of" SFMOMA within the meaning of IRC section 170(c), and if so, whether this contribution must meet
4 the Substantiation Test through means of a Contemporaneous Receipt or Donee Report.

5 With respect to whether the payments were a gift, appellants state that they were "going
6 to purchase 60% interest in the painting; and, [a]ppellants were going to give [SFMOMA] sufficient
7 funds to purchase the other 40% of the painting." (Appellants' Add'l Br., Aug. 8, 2009.) According to
8 the news articles provided by respondent, appellants planned to make their share of the painting a
9 "promised gift" to the museum upon their deaths. (Resp. Reply Br., Exhibit C at p. 1). Another article
10 states that the painting would have hung in the museum much of the time, but that appellants planned to
11 keep it some of the time and give it to the museum after they died. (*Id.* at p. 2). It appears to Board staff
12 that if litigation payments were made on behalf of SFMOMA to obtain a painting that would be jointly
13 held by appellants and SFMOMA, with appellants retaining partial ownership and benefits in the
14 property throughout their lifetimes (including 100 percent possession at various times), then the
15 disinterested and detached nature of the donation would be in question. (*De Jong v. Comm'r, supra*).

16 In addition, unlike both the *McConnell* and *Seldin* cases discussed above, where the
17 donative intent was in dispute, the underlying property in both of those cases was (1) actually donated,
18 and (2) no interest in the donated property appeared to be retained by the taxpayers. It appears to Board
19 staff that the painting at issue in this case never made it into SFMOMA's possession, and that even if
20 this is irrelevant (based on the argument that the painting and the Picasso litigation expenses should be
21 analyzed as separate and independent contributions), the Picasso litigation expenses may have indirectly
22 benefited appellants in their joint acquisition venture with SFMOMA. During the briefing of this appeal
23 by the parties, Board staff requested appellants to provide legal support for the proposition that legal
24 expenses made under the facts of this case qualified as a charitable deduction. Appellants responded by
25 contending that if the payments had been made directly to SFMOMA and then SFMOMA paid its
26 litigation expenses, such expenses would have been a charitable deduction. Board staff believes that a
27 payment to a charity with no indirect benefits to the donor (*i.e.*, no agreement or understanding that
28 some of the litigation expenses would assist the contributor in obtaining a 60 percent interest in the

1 property subject to the litigation) could qualify as a charitable deduction. Board staff also notes that
2 amounts paid directly to a charity would also be documented with a Contemporaneous Receipt or by a
3 Donee Report filing by the donee organization in order to satisfy the Substantiation Test.

4 Accordingly, at the oral hearing the parties should be prepared to discuss the following:

- 5 1. For any contributions of property over \$250 that have not yet been substantiated by
6 Contemporaneous Receipts (including the Picasso litigation expenses) or a Donee Report
7 appellants should provide an exhibit substantiating such contributions 14 days prior to the
8 oral hearing or explain at the oral hearing how they are entitled to a deduction absent
9 such documentation.⁷ If appellants claim that no Contemporaneous Receipts exist
10 because charitable contributions of \$250 or more were substantiated directly by the donee
11 organization through a Donee Report, appellants should be prepared to demonstrate how
12 this method is currently allowed by the IRS and whether the applicable donee
13 organization indicated that a Contemporaneous Receipt would not be provided because
14 the organization provides Donee Reports to the IRS.
- 15 2. Whether the contribution of the Picasso litigation payments should be characterized as a
16 cash contribution or as a noncash contribution of legal services "to or for the use of"
17 SFMOMA. If appellants claim they were a noncash contribution, a copy of IRS Form
18 8283 "Noncash Charitable Contribution" that was completed and signed by appellants
19 and SFMOMA would support this contention.
- 20 3. Assuming the Picasso litigation expenses are substantiated through a Contemporaneous
21 Receipt or Donee Report, the parties should be prepared to discuss whether the economic
22 benefit to appellants in the Picasso litigation (*i.e.*, the quest to obtain a 60 percent
23 personal interest in the painting, as well as 100 percent possession at times)⁸ constituted a
24 direct economic benefit to appellants sufficient to disqualify the Picasso litigation

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27 ⁷ This exhibit should be sent to Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879
MIC: 80, Sacramento, CA 94279-0080. (*See* Cal. Code Regs., tit. 18 § 5523.6, subd. (b).)

28 ⁸ This information is obtained from the newspaper articles presented by respondent. To the extent appellants disagree with
these accounts, they should correct them for the Board.

1 expenses from contribution status under applicable case law.

- 2 4. To the extent necessary, appellants should be prepared to provide documentation and
3 affidavits/testimony regarding the following factual issues:
- 4 a. Details regarding SFMOMA and appellants' joint venture arrangement to acquire
5 the painting;
 - 6 b. Details regarding the negotiations of the sale of the painting and the roles
7 appellants and SFMOMA played in such negotiations; and
 - 8 c. Details regarding the breakdown of the sale negotiations and the decision to
9 pursue legal remedies (including who managed the day-to-day aspects with regard
10 to the attorneys pursuing the Picasso litigation and what applicable attorney-client
11 relationships existed.)
- 12 5. The parties should be prepared to discuss whether the Picasso litigation colorably assisted
13 appellants in obtaining some ownership rights in the Picasso painting and whether this
14 would or would not constitute private inurement, if the payments had been made directly
15 by SFMOMA. Appellants should explain whether SFMOMA recorded the Picasso
16 litigation expenses as a charitable contribution on its (SFMOMA's) books under
17 applicable exempt organization accounting and tax compliance rules (*e.g.*, whether
18 SFMOMA reported them as Noncash Contributions on their Form 990, Schedule M, if
19 required to file a Form 990).⁹

20 **QUESTION (2):** Whether appellants substantiated their basis in Yazam stock and whether this
21 stock became worthless in 2001.

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23 _____

24 ⁹ It appears that such preparation may require information from SFMOMA to support appellants' contribution position.
25 However, Board staff does not believe this request is unwarranted given: (1) appellants close relationship with SFMOMA
26 (appellant-husband is the Chairman of the Board of Trustees of SFMOMA, *see* http://www.sfmoma.org/pages/about_bot (last
27 visited Nov. 6, 2009)); and (2) appellants' evidentiary offer in their September 21, 2009 reply brief indicates that "members
28 of the museum staff responsible for orchestrating large gifts to the museum can attest to the pledge by Appellants to donate
an ownership interest in the art to the museum." Also, Board staff's request for a private inurement analysis relates to the
possibility that SFMOMA has an obligation to ensure that a contribution of litigation expenses does not inure to the benefit of
individuals; therefore, SFMOMA's position on whether the Picasso litigation expenses did or did not constitute private
inurement to appellants could weaken or strengthen appellants' charitable contribution claim.

1 Contentions

2 Appellants' Contentions

3 Appellants did not raise any arguments specific to this issue in any of their appeal briefs.

4 Respondent's Contentions

5 Respondent claims appellants have not provided any information related to their basis in
6 Yazam stock and that appellants during protest indicated that no such information could be provided.
7 (Resp.. Opening Br. at p. 11, lines 17-19.) Respondent also contends that appellants have failed to
8 provide evidence that the Yazam stock became worthless in 2001. Respondent contends that public
9 information shows that U.S. Technologies acquired Yazam and that Yazam continued in operations
10 throughout 2001 and received additional capital funding in 2002 (Respondent's Opening Br., n.49 and
11 accompanying text). Thus, respondent contends that appellants have failed to substantiate that their
12 Yazam stock became worthless in 2001.

13 Applicable Law

14 R&TC section 17201 provides that itemized deductions such as a worthless stock
15 deduction are allowable in conformity with IRC section 165. Under IRC section 165(g)(1), if a security
16 becomes worthless during the taxable year, the loss is treated as a loss from the sale or exchange of a
17 capital asset on the last day of that taxable year. A security for these purposes includes a share of stock
18 in a corporation. (Int. Rev. Code § 165(g)(2)(A).) In order to obtain a worthless stock deduction under
19 IRC section 165(g), the taxpayer has the burden of showing its basis in the stock (Int. Rev. Code
20 § 165(b)). The burden is on the taxpayer to establish her basis, and if the taxpayer fails to meet this
21 burden, the basis is deemed to be zero and the deduction will be denied. (*Coloman v. Comm'r* (9th Cir.
22 1976) 540 F. 2d. 427, *aff'g* (1974) T.C. Memo 1974-78.)

23 In addition to establishing basis, the taxpayer has the burden of showing that the security
24 was worthless in the year claimed. (*Osborne v. Comm'r*, T.C. Memo 1995-353.) To establish
25 worthlessness, the taxpayer must demonstrate: (1) balance sheet insolvency (liabilities exceeded assets
26 in the year of worthlessness (*Greenberg v. Comm'r*, T.C. Memo 1971-220.); and (2) a complete lack of
27 future potential value, usually through the occurrence of an identifiable event or series of events
28 showing both current and future worthlessness. (*E.g., Richards. v. Comm'r*, T.C. Memo 1959-64;

1 *Jessup v. Comm'r*, T.C. Memo 1977-289; *Egly v. Comm'r*, T.C. Memo 1988-223.) The mere fact that a
2 corporation ceased operations did not necessarily establish worthlessness of the corporation's underlying
3 stock. (*DeJoy v. Comm'r*, T.C. Memo 2000-162.) Stock may not be considered worthless even if there
4 is no liquidation value, if there is a reasonable hope and expectation that it will become valuable at some
5 future time. (*Morton v. Comm'r* (1938) 38 B.T. A. 1270, *aff'd* (7th Cir. 1940) 112 F. 2d 320.

6 Staff Comments Regarding Issue (2): the Yazam Worthless Stock Deduction

7 It is unclear to Board staff whether appellants, by not addressing the Yazam stock issue in
8 their briefs, have conceded this issue. To the extent appellants are appealing the Yazam basis and stock
9 issue, at the oral hearing appellants will have the burden of demonstrating:

- 10 1. what their basis was in the Yazam stock; and
- 11 2. how the Yazam stock became worthless in 2001 by providing balance sheet insolvency
12 information and by explaining the identifiable event that caused the stock to become
13 worthless in 2001.

14 **QUESTION (3):** Whether appellants substantiated their basis in Novell stock and the amount of
15 their capital loss on the sale of this stock in 2001.

16 Contentions

17 Appellants' Contentions

18 Appellants did not raise any arguments specific to this issue in their appeal briefs.

19 Respondent's Contentions

20 Respondent contends that appellants have failed to substantiate a portion of loss on the
21 sale of Novell stock, because appellants failed to substantiate their claimed basis of \$3,042,114 as
22 provided on their original return. Respondent contends that in the December 31, 2000 year-end
23 brokerage statements for the Novell stock, appellants' cost basis was \$2,477,714 for 153,400 shares of
24 Novell (Resp. Opening Br., Exhibit J); however, upon the sale of this stock in 2001, appellants claimed a
25 basis of \$3,042,114 on the return. Thus, respondent claims that it used the brokerage statement basis
26 which resulted in the disallowance of \$564,400 (*i.e.*, \$3,042,114 minus \$2,477,714) in losses related to

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1 the Novell stock.¹⁰ Respondent claims that the burden is on appellants to substantiate their cost basis
2 and that since the information provided shows a cost basis of \$2,477,714, this is the cost basis that
3 should be used to calculate appellants' Novel stock loss for 2001.

4 Applicable Law

5 California conforms to federal law related to gains or losses on the disposition of
6 property. (Rev. & Tax. Code, §§ 18031, 18151). Generally, a loss will occur to the extent a taxpayer's
7 adjusted cost basis in the property sold exceeds its sale price. (Int. Rev. Code § 1001(a).) In other
8 words, in loss transactions the greater the cost basis, the greater the potential loss. The basis of property
9 is generally its cost. (Int. Rev. Code § 1011(a).)

10 It is well settled that a presumption of correctness attends respondent's determinations as
11 to issues of fact (such as the determination of cost) and that appellants have the burden of proving such
12 determinations erroneous. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, June 29, 1980.)
13 This presumption is, however, a rebuttable one and will support a finding only in the absence of
14 sufficient evidence to the contrary. (*Id.*) Respondent's determination cannot, however, be successfully
15 rebutted when the taxpayer fails to present uncontradicted, credible, competent, and relevant evidence to
16 the contrary. (*Id.*) To overcome the presumed correctness of respondent's findings as to issues of fact, a
17 taxpayer must introduce credible evidence to support his assertions. When the taxpayer fails to support
18 his assertions with such evidence, respondent's determinations must be upheld. (*Id.*) A taxpayer's
19 unsupported assertions are not sufficient to satisfy his burden of proof. (*Appeal of James C. and*
20 *Monablanché A. Walshe*, 75-SBE-073, Oct. 20, 1975.)

21 Staff Comments Regarding Issue (3): the Novell Partial Loss Disallowance

22 It is unclear to Board staff whether appellants, by not addressing the Novell partial loss
23 disallowance in their briefs, have conceded this issue. Therefore, to the extent appellants are appealing
24 the Novell issue, at the oral hearing appellants will have the burden of showing what their cost basis was
25 for the Novell stock sold in 2001.

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28 ¹⁰ Board staff notes that the NOA and NPA identify the amount of loss disallowed to be \$564,220, not \$564,400. Board staff
is unsure of how this \$180 discrepancy developed; however, respondent should clarify at the oral hearing whether it is
limiting the disallowed loss in this appeal to the identified NOA amount or is attempting to disallow an additional loss of
\$180 above the NOA amount.

1 **QUESTION (4):** Whether this Board has jurisdiction to review the proposed post-amnesty
2 penalties.

3 Contentions

4 Appellants' Contentions

5 Appellants claim the Board has jurisdiction to review the post-amnesty penalty under
6 California Code of Regulation, title 18, (CCR) section 5412, which generally allows the Board to review
7 an NOA with respect to penalties, fees and interest. Since the post-amnesty penalty is a "penalty,"
8 appellants claim the Board has jurisdiction over the post-amnesty penalty pursuant to CCR section 5412,
9 subdivision (a)(1).

10 Respondent's Contentions

11 Respondent claims that the Board does not have jurisdiction to review the post-amnesty
12 penalty in the context of a deficiency proceeding and that even in situations where the Board does have
13 jurisdiction (in refund cases, where the penalty has been paid), the Board's jurisdiction is limited to
14 whether the penalty was properly computed. Since this is a deficiency appeal, respondent claims that
15 the Board does not have jurisdiction over the post-amnesty penalty in the context of this appeal.

16 Applicable Law

17 R&TC section 19777.5 generally provides that for each tax year that amnesty could have
18 been requested by the taxpayer, the post-amnesty penalty will be imposed in an amount equal to 50
19 percent of interest accrued on unpaid tax as of the last day of the amnesty period (March 31, 2005). The
20 amnesty provisions strictly limit the Board's ability to review respondent's imposition of the post-
21 amnesty penalty. Subdivision (d) of R&TC section 19777.5 states, "Article 3 (commencing with
22 Section 19031), (relating to deficiency assessments) shall not apply with respect to the assessment or
23 collection of [the post-amnesty penalty]." Article 3 sets forth the procedure for a taxpayer to protest a
24 proposed assessment. Thus, subdivision (d) of R&TC section 19777.5 provides that a taxpayer may not
25 contest the assessment of the post-amnesty penalty under the procedures applicable to deficiency
26 assessments. Because the protest provisions are not applicable to the post-amnesty penalty, there is no
27 action by respondent for the Board to review under R&TC section 19045 when a taxpayer challenges the
28 assessment of the post-amnesty penalty in a deficiency proceeding. Subdivision (e)(2) of R&TC

1 19777.5 grants the Board jurisdiction to review respondent's imposition of the post-amnesty penalty in
2 only a single circumstance: where a taxpayer paid the post-amnesty penalty, filed a refund claim
3 asserting that respondent failed to "properly compute" the amount of the penalty, and respondent denied
4 this refund claim.

5 Staff Comments Regarding Issue (4): the Post-Amnesty Penalty

6 At the oral hearing appellants should be prepared to explain how the Board has
7 jurisdiction over the post-amnesty penalty under R&TC section 19777.5 in the context of this appeal.

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