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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **MATT WARD¹**) Case No. 431775

	<u>Years</u>	<u>Proposed Assessments</u>
	1999	\$153,305
	2000	\$114,449

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17 Representing the Parties:

18 For Appellants: Jeffrey D. Davine, Esq.
19 For Franchise Tax Board: Jeanne M. Silbert, Tax Counsel III

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21 **QUESTIONS:** (1) Whether appellant has shown that his IRA distributions in 1999 and 2000 were
22 transferred in nontaxable transactions to a self-directed IRA and, thus, should not
23 be included in his taxable income.
24 (2) Whether appellant has proven that the IRA distributions in 1999 and 2000 are not
25 subject to an additional 2.5 percent tax that is otherwise imposed on early
26 distributions.

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28 ¹ During the audit period, appellant was a resident of California, with a mailing address in Los Angeles County.

1 (3) Whether appellant can claim a deduction in the 2000 tax year for worthless stock.

2 HEARING SUMMARY

3 Background

4 Appellant appeals the action of the Franchise Tax Board (FTB or respondent), assessing a
5 deficiency of \$153,305 for the 1999 tax year and a deficiency of \$114,499 for the 2000 tax year, on
6 alleged taxable early distributions from appellant's Individual Retirement Arrangement (IRA) at Bear,
7 Stearns Securities Corp. (Bear Stearns).

8 For the 1999 tax year, appellant received a Form 1099-R from Bear Stearns, reporting:

- 9
- 10 • a gross distribution of \$1,299,194 in box 1,
 - 11 • the entire amount was reported as taxable in box 2,
 - 12 • the distribution originated from an IRA/SEP/Simple as checked in box 7, and
 - 13 • that box 7 also contained distribution code "1," which stands for early distribution, no known
14 exemption.

15 As shown on the 1999 Form 1099-R, the distribution was made from Bear Stearns to "Matt Ward IRA
16 R/O", in California.

17 For the 2000 tax year, appellant received a Form 1099-R from Bear Stearns, reporting:

- 18
- 19 • a gross distribution of \$969,903.96 in box 1,
 - 20 • the entire amount was reported as taxable in box 2,
 - 21 • the distribution originated from an IRA/SEP/Simple as checked in box 7, and
 - 22 • that box 7 also contained distribution code "1," which stands for early distribution, no known
23 exception.

24 As shown on the 2000 Form 1099-R, the distribution was made from Bear Stearns to "Matt Ward IRA
25 R/O", in California.

26 Appellant did not report either of the above amounts as taxable in his federal or
27 California income tax returns for 1999 or 2000. Subsequently, respondent audited appellant's California
28 tax returns for the 1999 and 2000. For the 1999 tax year, respondent issued a Notice of Proposed
Assessment (NPA) on July 8, 2004, which increased appellant's California taxable income by the
amount reported on the 1999 Form 1099-R, \$1,299,194, for a revised taxable income of \$8,181,411.

Appeal of Matt Ward

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review. It does not represent the Board's decision or opinion.

1 Because the 1999 Form 1099-R indicated that this amount was an early distribution from an IRA with
2 no known exception, respondent assessed the early distribution tax of \$32,480, for a total proposed
3 additional California tax of \$153,305.

4 For the 2000 tax year, respondent issued an NPA on July 8, 2004, which increased
5 appellant's California taxable income by the amount reported on the 2000 Form 1099-R, \$969,904,² for
6 a revised taxable income of \$2,427,376. Because the 2000 Form 1099-R indicated this was an early
7 distribution from an IRA with no known exception, respondent assessed the early distribution tax of
8 \$24,248, for a total proposed additional California tax of \$114,449.

9 In response to the audit, appellant contacted Bear Stearns, requesting the records for his
10 IRA, but Bear Stearns allegedly failed to respond to appellant's requests for documents.³ Accordingly,
11 appellant requested and received two letters⁴ from Albert Keyack, the former Vice-President and
12 General Counsel of DirectWeb, Inc. (DirectWeb). In the letter dated April 30, 2004, Mr. Keyack states:

13 It is my recollection and understanding that all funds forwarded by the Matt Ward IRA
14 resulted in shares being issued to the Trustee of the IRA. I recall a number of investors
15 investing in DirectWeb through retirement accounts, and thereafter verifying transactions
16 with various custodians, confirming wire transfers of monies, etc. The Matt Ward IRA
made investments in DirectWeb preferred stock, and upon receipt of funds it was
DirectWeb's standard business practice that shares were issued accordingly.

17 Respondent considered Mr. Keyack's recollections insufficient to substantiate that the distributions were
18 transferred in nontaxable transactions to the Matt Ward IRA, and therefore, respondent issued Notices of
19 Action (NOAs) on November 2, 2007, affirming the proposed assessments in the NPAs. Appellant then
20 filed this timely appeal.

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24 ² The amount on the NPA was rounded up from the amount reported on the Form 1099-R, \$969,903.96.

25 ³ Appellant explains that Bear Stearns did not respond to appellant's requests for information because "National Securities
26 Corporation (Appellant's employer) utilized Bear Stearns as its clearinghouse for securities transactions and recordkeeping in
27 prior years (including 1999 and 2000). National Securities Corporation, however, terminated its relationship with Bear
Stearns several years ago (in or about 2001). As a result of this termination, all requests by Appellant to Bear Stearns for
records and other information in its possession have been ignored by Bear Stearns." (App. Reply Br. p.3.)

28 ⁴ Both letters are provided as Exhibit C in Appellant's Opening Brief.

1 Contentions

2 Appellant contends that neither the 1999 distribution nor the 2000 distribution is taxable
3 because both distributions were timely rolled over from his IRA at Bear Stearns to his self-directed IRA.
4 Appellant alleges these contributions to his self-directed IRA were then invested in DirectWeb's stock,
5 resulting in his self-directed IRA holding the stock of DirectWeb.

6 In addition, appellant argues that because the distributions from his IRA at Bear Stearns
7 were timely rolled over to his self-directed IRA, the additional 2.5 percent tax on early distributions,
8 imposed pursuant to Revenue and Taxation Code (R&TC) section 17085, is not applicable.

9 Appellant also argues that if this Board determines that he should be taxed on the
10 distributions in 1999 and 2000, then he should be entitled to claim a deduction for worthless stock in the
11 tax year 2000, the year when DirectWeb's stock allegedly became worthless.

12 Respondent contends that appellant has not provided sufficient documentation to
13 demonstrate that the distributions in 1999 and 2000 were timely rolled over from his IRA at Bear
14 Stearns to his self-directed IRA. For example, respondent states that the type of information or
15 documents reasonably expected to be available to appellant would include, but is not limited to: the
16 dates for both transfers from the IRA at Bear Stearns to the self-directed IRA in order to determine if the
17 transfers were made within the 60-day transfer/rollover period described in Internal Revenue Code
18 (IRC) section 402(c)(3)(A); documents memorializing the distributions from the IRA at Bear Stearns
19 and the transfer of the amounts to his self-directed IRA; if appropriate, corrected Forms 1099-R showing
20 the original amounts were reported in error; and/or documents confirming that the amounts rolled over
21 from the IRA at Bear Stearns to the self-directed IRA were then used to purchase shares of DirectWeb,
22 which remained property of the self-directed IRA.

23 Respondent also states that Mr. Keyack's recollection of the facts is insufficient to
24 establish that the alleged transfers from the IRA at Bear Stearns to the self-directed IRA are non-taxable
25 transfers or that the self-directed IRA utilized the transferred amounts to purchase shares in DirectWeb.

26 Next, respondent asserts that the additional 2.5 percent tax on early distributions from an
27 IRA, imposed pursuant to R&TC section 17085, applies in this case because (1) appellant has not
28 proven that the distributions from his IRA at Bear Stearns were timely rolled over to his self-directed

1 IRA, (2) appellant has not argued (or proven) that he was 59½ years old (or older) at the time he
2 received either of the distributions, and (3) no known exceptions to the additional 2.5 percent tax apply
3 in this case and appellant has not alleged that any such exceptions apply.

4 Finally, respondent argues that appellant's ability to claim a deduction in the 2000 tax
5 year for the alleged worthlessness of the DirectWeb stock is subject to the strict requirements set forth in
6 IRS Notices 89-25 and 87-16, which appellant allegedly has not met. Specifically, respondent claims
7 that in order to claim a loss for stock held in his self-directed IRA, appellant must demonstrate that in
8 2000 he distributed all amounts in all of his "traditional" IRAs, and that the amounts distributed were
9 less than his unrecovered basis in all of his "traditional" IRAs; however, respondent asserts that
10 appellant has not provided any evidence to support such facts.

11 In reply, appellant asserts that "if Respondent is correct and Appellant is required to
12 include the IRA proceeds in income these proceeds will (sic) then belong to Appellant (individually).
13 As a result, any loss incurred as a result of the worthlessness of the Directweb stock purchased with
14 these proceeds may be claimed by Appellant (individually)."

15 In rebuttal, respondent contends that a loss in an IRA may be recognized only if: (1) the
16 amounts in all of the taxpayer's traditional IRA accounts have been distributed, and (2) the amounts
17 distributed are less than the taxpayer's unrecovered basis. Respondent contends that appellant has not
18 shown that the loss can be recognized.

19 Applicable Law

20 R&TC section 17041 provides for the taxation of the entire taxable income of every
21 resident of California. R&TC section 17501 incorporates by reference IRC section 408(d), which
22 provides that any amount paid or distributed out of an IRA is included in the gross income of the
23 taxpayer when received, in accordance with IRC section 72.

24 R&TC section 17085 incorporates by reference IRC section 72 and assesses an additional
25 tax of 2.5 percent on an early distribution from an IRA, when the distribution does not meet one of the
26 available exceptions provided for in IRC section 72.

27 In general, a tax-free rollover from an IRA to another tax favored account must be made

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1 within 60 days of the distribution. (Int.Rev. Code § 402(c)(3)(A).)⁵

2 Recognizing a loss in an IRA is subject to strict requirements. A loss in an IRA may be
3 recognized only if: (1) the amounts in all of the taxpayer's traditional IRA accounts have been
4 distributed, and (2) the amounts distributed are less than the taxpayer's unrecovered basis. (See IRS
5 Notice 89-25, IRS Notice 87-16.)

6 Respondent's determination of tax is presumed to be correct, and a taxpayer has the
7 burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
8 2001-SBE-001, May 31, 2001.)⁶ Unsupported assertions are not sufficient to satisfy appellant's burden
9 of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of
10 uncontradicted, credible, competent, and relevant evidence showing error in respondent's
11 determinations, they must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18,
12 1980.) An appellant's failure to produce evidence that is within his control gives rise to a presumption
13 that such evidence is unfavorable to his case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

14 It is well settled that income tax deductions are a matter of legislative grace, and a
15 taxpayer who claims a deduction has the burden of proving by competent evidence that the taxpayer is
16 entitled to that deduction. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of*
17 *Michael E. Myers, supra.*)

18 STAFF COMMENTS

19 In relation to the first issue (i.e., whether the distributions from the Bear Stearns IRA are
20 includable in appellant's taxable income for 1999 and 2000, respectively), the parties should be prepared
21 to discuss whether appellant has presented sufficient evidence to show that the distributions from his
22 IRA at Bear Stearns were rolled over in a timely manner to his self-directed IRA, such that the
23 distributions should not be included in his taxable income. Staff notes that the parties both rely on the
24 1099-R forms, which contain conflicting information. The parties should be prepared to discuss the
25 significance of the payee being set forth as "Matt Ward IRA R/O," while the entire amount is set forth as
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27 ⁵ The relevant portions of IRC section 402 have been incorporated into California law at R&TC section 17501 and 17504.

28 ⁶ Board of Equalization cases are generally available for viewing on our website (www.boe.ca.gov).

1 taxable in box 2 and the distribution code is set forth a “1” for early distribution, no known exception.

2 Appellant should be prepared to explain why he did not obtain corrected 1099-Rs
3 showing that “Matt Ward IRA R/O” did not receive taxable distributions in 1999 and 2000.

4 Appellant should further be prepared to discuss the timing of the roll-over, i.e., whether
5 the transfer was made within the 60-day period, and any evidence he has to support that the transfer was
6 timely.

7 In relation to the second issue (i.e., whether the distributions are subject to the additional
8 2.5 percent tax on early distributions), we note that appellant does not allege that he meets any of the
9 exceptions to the imposition of the additional 2.5 percent tax that are set forth in IRC section 72. Rather,
10 appellant simply argues that the distributions from his IRA at Bear Stearns were rolled over in a timely
11 manner to his self-directed IRA, and therefore, the additional 2.5 percent tax is not applicable. Thus,
12 resolution of the first issue above will resolve this second issue.

13 With respect to the third issue, staff notes that it appears that respondent concedes the
14 existence of appellant’s self-directed IRA (see FTB’s opening brief, page 4, line 10) while finding that
15 appellant has not shown that the transfer of funds from his IRA at Bear Stearns to his self-directed IRA
16 were non-taxable transactions. Thus, appellant contends the loss suffered by “Matt Ward IRA R/O”
17 must meet the requirements for recognizing a loss in an IRA.⁷ The parties should be prepared to discuss
18 any applicable authority supporting that an IRA is not subject to the IRA loss requirements set forth in
19 IRC section 408(o) where a transfer of funds into the IRA constitutes a taxable transaction. The parties
20 should further be prepared to discuss whether appellant meets those requirements. Appellant should
21 also clarify whether he is alternatively contending that no self directed IRA existed in 1999 and 2000.

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28 ⁷ Appellant should correct staff’s interpretation at the oral hearing if this is not correct.