

STATE BOARD OF EQUALIZATION



Appeal Name: Leo R. Boese

Case ID: 547667 ITEM #. B3

Date: February 2, 2012 Exhibit No: 2.4

TP

FTB DEPT PUBLIC COMMENT

CONTENTS

- TAB 1** California Revenue and Taxation Code 18152.5
- TAB 2** Incorporation documents, Lebo Automotive
Lebo Automotive Stock Certificate
California Certificate of Qualification
- TAB 3** Lebo Automotive 2000 Corporate Tax Return
Balance Sheet showing \$1.7 M Capital Stock + \$3.5 M Preferred
Stock
- TAB 4** Automotive 2007 Amended Federal 1040X & California 540X
- TAB 5** KB Parrish letter dated October 28, 2009
KB Parrish Response Letter to Denial of Amended Claim, dated
May 17, 2010
- TAB 6** Kruse Mennillo letter of appeal, dated August 25, 2010
Kruse Mennillo letter of appeal, dated January 4, 2011
- TAB 7** FTB Examination Letter, dated October 21, 2009
FTB Opening Brief, dated December 2, 2010
FTB Reply Brief, dated March 10, 2011

18152.5. (a) For purposes of this part, **gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years.**

(b) (1) If the taxpayer has eligible gain for the taxable year from one or more dispositions of stock issued by any corporation, the aggregate amount of the gain from dispositions of stock issued by the corporation which may be taken into account under subdivision (a) for the taxable year shall not exceed the greater of either of the following:

(A) Ten million dollars (\$10,000,000) reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subdivision (a) for prior taxable years and attributable to dispositions of stock issued by the corporation.

(B) Ten times the aggregate adjusted bases of qualified small business stock issued by the corporation and disposed of by the taxpayer during the taxable year. For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which the stock was originally issued.

(2) For purposes of this subdivision, **the term "eligible gain" means any gain from the sale or exchange of qualified small business stock held for more than five years.**

(3) (A) In the case of a married individual filing a separate return, subparagraph (A) of paragraph (1) shall be applied by substituting five million dollars (\$5,000,000) for ten million dollars (\$10,000,000).

(B) In the case of a married taxpayer filing a joint return, the amount of gain taken into account under subdivision (a) shall be allocated equally between the spouses for purposes of applying this subdivision to subsequent taxable years.

(C) For purposes of this subdivision, marital status shall be determined under Section 7703 of the Internal Revenue Code.

(c) For purposes of this section:

(1) **Except as otherwise provided in this section, the term "qualified small business stock" means any stock in a C corporation which is originally issued after August 10, 1993, if both of the following apply:**

(A) **As of the date of issuance, the corporation is a qualified small business.**

(B) **Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at its original issue (directly or through an underwriter) in either of the following manners:**

(i) **In exchange for money or other property (not including stock).**

(ii) **As compensation for services provided to the corporation (other than services performed as an underwriter of the stock).**

(2) (A) **Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for the stock, the corporation meets the active business requirements of subdivision (e) and the corporation is a C corporation.**

(B) (i) **Notwithstanding subdivision (e), a corporation shall be treated as meeting the active business requirements of subdivision (e) for any period during which the corporation qualifies as a specialized small business investment company.**

(B) For purposes of subparagraph (A), the term "parent-subsidary controlled group" means any controlled group of corporations as defined in Section 1563(a)(1) of the Internal Revenue Code, except that both of the following shall apply:

(i) "More than 50 percent" shall be substituted for "at least 80 percent" each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(ii) Section 1563(a)(4) of the Internal Revenue Code shall not apply.

(e) (1) For purposes of paragraph (2) of subdivision (c), the requirements of this subdivision are met by a corporation for any period if during that period both of the following apply:

(A) At least 80 percent (by value) of the assets of the corporation are used by the corporation in the active conduct of one or more qualified trades or businesses in California.

(B) The corporation is an eligible corporation.

(2) For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in:

(A) Startup activities described in Section 195(c)(1)(A) of the Internal Revenue Code,

(B) Activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under Section 174 of the Internal Revenue Code, or

(C) Activities with respect to in-house research expenses described in Section 41(b)(4) of the Internal Revenue Code, then assets used in those activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from those activities at the time of the determination.

(3) For purposes of this subdivision, the term "qualified trade or business" means any trade or business other than any of the following:

(A) Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees.

(B) Any banking, insurance, financing, leasing, investing, or similar business.

(C) Any farming business (including the business of raising or harvesting trees).

(D) Any business involving the production or extraction of products of a character with respect to which a deduction is allowable under Section 613 or 613A of the Internal Revenue Code.

(E) Any business of operating a hotel, motel, restaurant, or similar business.

(4) For purposes of this subdivision, the term "eligible corporation" means any domestic corporation, except that the term shall not include any of the following:

(A) A DISC or former DISC.

(B) A corporation with respect to which an election under Section 936 of the Internal Revenue Code is in effect or which has a direct or indirect subsidiary with respect to which the election is in effect.

(C) A regulated investment company, real estate investment trust

(REIT), or real estate mortgage investment conduit (REMIC).

(D) A cooperative.

(5) (A) For purposes of this subdivision, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

(B) A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of the corporation (other than assets described in paragraph (6)).

(C) For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of the corporation.

(6) For purposes of subparagraph (A) of paragraph (1), the following assets shall be treated as used in the active conduct of a qualified trade or business:

(A) Assets that are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation.

(B) Assets that are held for investment and are reasonably expected to be used within two years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business. For periods after the corporation has been in existence for at least two years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

(7) A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property that is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of, real property shall not be treated as the active conduct of a qualified trade or business.

(8) For purposes of paragraph (1), rights to computer software that produces active business computer software royalties (within the meaning of Section 543(d)(1) of the Internal Revenue Code) shall be treated as an asset used in the active conduct of a trade or business.

(9) A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 20 percent of the corporation's total payroll expense is attributable to employment located outside of California.

(f) If any stock in a corporation is acquired solely through the conversion of other stock in the corporation that is qualified small business stock in the hands of the taxpayer, both of the following shall apply:

(1) The stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer.

(2) The stock so acquired shall be treated as having been held during the period during which the converted stock was held.

(g) (1) If any amount included in gross income by reason of

holding an interest in a pass-through entity meets the requirements of paragraph (2), then both of the following shall apply:

(A) The amount shall be treated as gain described in subdivision (a).

(B) For purposes of applying subdivision (b), the amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-through entity and the taxpayer's proportionate share of the adjusted basis of the pass-through entity in the stock shall be taken into account.

(2) An amount meets the requirements of this paragraph if both of the following apply:

(A) The amount is attributable to gain on the sale or exchange by the pass-through entity of stock that is qualified small business stock in the hands of the entity (determined by treating the entity as an individual) and that was held by that entity for more than five years.

(B) The amount is includable in the gross income of the taxpayer by reason of the holding of an interest in the entity that was held by the taxpayer on the date on which the pass-through entity acquired the stock and at all times thereafter before the disposition of the stock by the pass-through entity.

(3) Paragraph (1) shall not apply to any amount to the extent the amount exceeds the amount to which paragraph (1) would have applied if the amount was determined by reference to the interest the taxpayer held in the pass-through entity on the date the qualified small business stock was acquired.

(4) For purposes of this subdivision, the term "pass-through entity" means any of the following:

- (A) Any partnership.
- (B) Any S corporation.
- (C) Any regulated investment company.
- (D) Any common trust fund.

(h) For purposes of this section:

(1) In the case of a transfer described in paragraph (2), the transferee shall be treated as meeting both of the following:

(A) Having acquired the stock in the same manner as the transferor.

(B) Having held the stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subdivision) by the transferor.

(2) A transfer is described in this subdivision if the transfer is any of the following:

- (A) By gift.
- (B) At death.

(C) From a partnership to a partner of stock with respect to which requirements similar to the requirements of subdivision (g) are met at the time of the transfer (without regard to the five-year holding period requirement).

(3) Rules similar to the rules of Section 1244(d)(2) of the Internal Revenue Code shall apply for purposes of this section.

(4) (A) In the case of a transaction described in Section 351 of the Internal Revenue Code or a reorganization described in Section 368 of the Internal Revenue Code, if qualified small business stock is exchanged for other stock that would not qualify as qualified small business stock but for this subparagraph, the other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

(B) This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain that would have been recognized at the time of the transfer described in subparagraph (A) if Section 351 or 368 of the Internal Revenue Code had not applied at that time. The preceding sentence shall not apply if the stock that is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation that (as of the time of the transfer described in subparagraph (A)) is a qualified small business.

(C) For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which the limitation applied (determined after the application of the second sentence of subparagraph (B)).

(D) In the case of a transaction described in Section 351 of the Internal Revenue Code, this paragraph shall apply only if immediately after the transaction the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of Section 368(c) of the Internal Revenue Code) of the corporation whose stock was exchanged.

(i) For purposes of this section:

(1) In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in the corporation, both of the following shall apply:

(A) The stock shall be treated as having been acquired by the taxpayer on the date of the exchange.

(B) The basis of the stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

(2) If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which the stock was originally issued, in determining the amount of the adjustment by reason of the contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

(j) (1) If the taxpayer has an offsetting short position with respect to any qualified small business stock, subdivision (a) shall not apply to any gain from the sale or exchange of the stock unless both of the following apply:

(A) The stock was held by the taxpayer for more than five years as of the first day on which there was such a short position.

(B) The taxpayer elects to recognize gain as if the stock was sold on that first day for its fair market value.

(2) For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if any of the following apply:

(A) The taxpayer has made a short sale of substantially identical property.

(B) The taxpayer has acquired an option to sell substantially identical property at a fixed price.

(C) To the extent provided in regulations, the taxpayer has entered into any other transaction that substantially reduces the risk of loss from holding the qualified small business stock. For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is

related (within the meaning of Section 267(b) or 707(b) of the Internal Revenue Code) to the taxpayer.

(k) The Franchise Tax Board may prescribe those regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, or otherwise.

(l) It is the intent of the Legislature that, in construing this section, any regulations that may be promulgated by the Secretary of the Treasury under Section 1202(k) of the Internal Revenue Code shall apply to the extent that those regulations do not conflict with this section or with any regulations that may be promulgated by the Franchise Tax Board.

State of Delaware
Office of the Secretary of State PAGE 1

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF INCORPORATION OF "LEBO AUTOMOTIVE, INC.", FILED IN THIS OFFICE ON THE TWENTIETH DAY OF JUNE, A.D. 2000, AT 9 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.



Edward J. Freel

Edward J. Freel, Secretary of State

3234948 8100

001313746

AUTHENTICATION: 0510304

DATE: 06-21-00

Item 2b

CERTIFICATE OF INCORPORATION

of

LEBO AUTOMOTIVE, INC.

FIRST: The name of this Corporation is LEBO Automotive, Inc.

SECOND: The address, including street, number, city, and county, of the registered office of the Corporation in the State of Delaware is 1013 Centre Road, City of Wilmington 19805, County of New Castle; and the name of the registered agent of the Corporation in the State of Delaware at such address is Corporation Service Company.

THIRD: The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware.

FOURTH: The total amount of the authorized capital stock of the Corporation is Fifty-two Thousand Eighty (52,080) shares of the par value of One Hundred Dollars (\$100) each, of which: (a) Thirty-five Thousand Eighty (35,080) shares shall be Cumulative Preferred Stock (the "Preferred Shares" or the "Preferred Stock"); and (b) Seventeen Thousand (17,000) shares shall be Common Stock (the "Common Shares" or the "Common Stock"). The rights, preferences, privileges and restrictions granted or imposed upon the two classes of shares are set forth in succeeding subdivisions of this Certificate.

Leo
Boese

FIFTH: The preferences, voting powers, rights, privileges, restrictions and qualifications of the Preferred Stock and Common Stock are as follows:

- (a) The holders of the Preferred Shares shall be entitled to receive cash dividends for each fiscal year of the Corporation, or fractional part thereof, equal to the sum of (i) the portion of the Corporation's "Profits" (as that term is defined in that certain Investment Agreement effective as of June 20, 2000 (the "Agreement")) specified for that purpose in the Agreement; and (ii) the amount of any Additional Dividends, as defined in the Agreement. Such dividends shall be payable, when and as declared by the Corporation's Board of Directors. Such dividends upon the Preferred Shares shall be cumulative, and all amounts thereof that are unpaid and in arrears shall be fully paid or set apart for payment before any disbursement may be paid to the holders of Common Stock.
- (b) When there are no outstanding Preferred Shares, the Board of Directors may, in its discretion, at such times as it deems advisable, declare and pay dividends from the surplus or net profits of the Corporation which shall be equal amounts per share on the outstanding

Common Shares. No dividends shall be declared or paid on the Common Shares as long as any Preferred Shares are outstanding.

- (c) Each holder of Common Shares and Preferred Shares shall be entitled to one vote for each share thereof held on all matters for which such shares are entitled to vote. Except as otherwise provided by law or this Certificate, the Common Shares have exclusive voting rights on all matters requiring a vote of shareholders, and the Preferred Shares have no voting rights. The voting rights of either the Preferred or Common Stock may be limited by mutual written consent of all of the Preferred and Common Stockholders.
- (i) Except as provided in Section (c)(ii), the holders of a majority of the Preferred Shares, voting as a separate class, shall be entitled to elect one (1) of the three (3) directors of the Corporation, which director need not be a shareholder of the Corporation. Except as provided in Section (c)(ii), the holders of a majority of the Common Shares voting as a separate class, shall be entitled to elect two (2) of the three (3) directors of the Corporation. If there is only one holder of Common Stock, at least one of the directors elected by the Common Stock shall be a holder of the Common Stock. If there are two or more holders of Common Stock, both of the directors elected by the Common Stock shall be holders of Common Stock.
- (ii) Upon the occurrence of a Triggering Default (as defined below), the holders of the Preferred Stock, as a class, shall, immediately upon the giving of written notice to the Corporation by any holder of Preferred Stock, be entitled to elect the smallest number of directors which shall constitute a majority of the authorized number of directors of the Corporation, and the holders of Common Stock, as a class, shall be entitled to elect the remaining members of the Board. Whenever the holders of Preferred Stock shall be entitled to elect directors as provided in this subsection (ii), the holders of the Preferred Stock may call a special meeting of shareholders and shall have access to the stock books and records of the Corporation for such purpose. At any such meeting, or at any other meeting held while the holders of Preferred Stock have the voting power described in this subsection (ii), the holders of a majority of the Preferred Stock, present in person or by proxy, shall be sufficient to constitute a quorum for the election of directors as herein provided. At such meeting or, if no such special meeting shall have been called, then at the next annual meeting of the shareholders, the holders of the Preferred Stock, as a class, shall be entitled to elect a majority of the directors of the Corporation, and the holders of Common Stock, as a class, shall be entitled to elect the remaining members of the Board. Upon the election by the holders of Preferred Stock of a majority of the directors, the terms of office of all persons who are then directors of the Corporation shall terminate immediately, whether or not the holders of the Common Stock shall then have elected the remaining directors of the Corporation.

- (iii) If all Triggering Defaults shall have been cured in full in the reasonable determination of the holders of a majority of the Preferred Stock (or if all uncured Triggering Defaults have been waived by the holders of a majority of the Preferred Stock), then the holders of Preferred Stock shall notify the Corporation in writing and, after delivery of such notice, the holders of the Preferred Stock shall be divested of the voting rights specified in subsection (c)(ii). These voting rights shall again accrue to the holders of Preferred Stock as and when provided in subsection (c)(ii). Upon the termination of any such voting rights as hereinabove provided, the Board of Directors shall call a special meeting of the shareholders at which all directors will be elected as provided in subsection (c)(i), and the terms of office of all persons who are then directors of the Corporation shall terminate immediately upon the election of their successors.
- (iv) In the case of any vacancy in the office of a director occurring among the directors elected by the holders of the Preferred Stock pursuant to subsections (c)(i) or (c)(ii), the remaining director or directors so elected by the holders of the Preferred Stock, if any, may, by affirmative vote of a majority thereof (or the remaining director so elected if there is only one such director), elect the successor or successors to hold the office for the unexpired term of the director or directors whose place or places shall be vacant. If there are no remaining directors elected by the holders of the Preferred Stock, the vacancy shall be filled by the affirmative vote of the holders of a majority of the Preferred Stock. In the case of any vacancy in the office of a director occurring among the directors elected by the holders of the Common Stock pursuant to subsections (c)(i) or (c)(ii), the remaining director or directors so elected by the holders of the Common Stock, if any, may, by affirmative vote of the majority thereof (or the remaining director so elected if there is only one such director) elect the successor or successors to hold the office for the unexpired term of the director or directors whose place or places shall be vacant. If there are no remaining directors elected by the holders of the Common Stock, the vacancy shall be filled by the affirmative vote of the holders of a majority of the Common Stock. Except as specifically provided in subsections (c)(ii) and (c)(iii), any director who shall have been elected by the holders of either class of Stock, or any director so elected as provided in this subsection (c)(iv), shall be removed during the aforesaid term of office, whether with or without cause, only by the affirmative vote of the holders of a majority of the class by which such director was elected.
- (v) For purposes of this Certificate of Incorporation, a "Triggering Default" shall mean any of the following:
- (1) The dividends on the Preferred Stock provided for in the first sentence of subsection (a) shall be in arrears, whether or not funds are legally available therefor and whether or not such dividends have been declared by the Board of Directors;

- (2) The Corporation shall fail to redeem the Preferred Stock as provided in subsection (d)(ii), whether or not funds are legally available therefor and whether or not the redemption is allowed under applicable law;
- (3) There shall occur a default under this Certificate of Incorporation or the Corporation's Bylaws or a default by the Corporation or by the Operator (as that term is defined in the Agreement) under Sections 13 or 14 of the Agreement or Sections 2, 3 or 5 of that certain Management Agreement, as defined in the Agreement (the "Management Agreement"), which default is not cured within 10 days after written notice by a holder of the Preferred Stock to the defaulting party;
- (4) The Agreement and/or the Management Agreement shall be terminated;
- (5) The Corporation shall file a petition commencing a voluntary case under the Bankruptcy Code or shall be adjudicated a bankrupt or insolvent or shall file any petition or answer seeking or acquiescing in any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief for itself under any present or future federal, state or other statute, law or regulation relating to bankruptcy, insolvency or other relief for debtors; or the Corporation shall seek or consent to or acquiesce in the appointment of any trustee, receiver or liquidator; or shall make any general assignment for the benefit of creditors, or shall admit in writing its inability to pay its debts generally as they become due; or a court of competent jurisdiction shall enter an order for relief, order, judgment or decree approving a petition filed against the Corporation commencing an involuntary case under any chapter of the Bankruptcy Code, or seeking any reorganization, dissolution or similar relief under any present or future federal, state or other statute, law or regulation relating to bankruptcy, insolvency or other relief for debtors, and such order for relief, order, judgment or decree shall remain unvacated and unstayed for an aggregate of 30 days from the first date of entry thereof; or any trustee, receiver or liquidator of the Corporation shall be appointed without the consent or acquiescence of the Corporation, and such appointment shall remain unvacated and unstayed for an aggregate of 30 days;
- (6) A lien, writ of execution or attachment or any similar process shall be issued or levied against the Corporation, or any judgment involving monetary damages shall be entered against the Corporation, and the Corporation shall not discharge the same or provide for its discharge in accordance with its terms or procure a stay of execution thereof within 30 days after the date of entry thereof and within said period of 30 days appeal therefrom and cause the execution to be stayed during such appeal;

- (7) The transfer of any Common Stock shall occur in violation of the terms of the Agreement;
 - (8) The Corporation shall fail to operate, or shall lose the right to operate, as an authorized Toyota dealer;
 - (9) The Operator shall fail to serve as a director and as the president and general manager of the Corporation;
 - (10) Any legal action, suit, arbitration or other administrative or governmental investigation or proceeding shall be instituted against the Corporation which (A) could materially and adversely affect its condition (financial or otherwise), prospects, assets, business or results of operation and (B) shall have a reasonable probability of success;
 - (11) A default by the Corporation shall occur under any loan document or agreement in connection with any debt incurred by or on behalf of the Corporation, which default shall not be cured or waived within 10 days;
 - (12) The death of the Operator;
 - (13) The Operator becomes physically or mentally incapacitated, in the sole determination of the holders of the Preferred Stock;
 - (14) Any other event shall occur which could materially and adversely affect the condition (financial or otherwise), prospects, assets, business or results of operation of the Corporation.
- (vi) Whenever this Certificate of Incorporation requires or permits a vote of stockholders to be taken at a meeting (annual, special or otherwise), the meeting and vote may be dispensed with if the holders of the requisite number of shares shall consent in writing, to the extent and in the manner, provided in the Corporation's Bylaws.
- (d) (i) Elective Redemption. Except as provided in subsection (d)(iii) below, to the extent allowed by applicable law and the provisions of the Agreement, the Corporation may, at any time and from time to time, at the option of the Board of Directors, redeem the whole or any number of the outstanding Preferred Shares, without notice, by paying for said Shares an amount equal to (i) the redemption price specified in the Agreement or (ii) if no redemption price is specified, at their par value, plus the amount of any Accumulated and Accrued Dividends (as those terms are defined in the Agreement) on such Shares calculated to the date of redemption.

- (ii) Mandatory Redemption. Except as provided in subsection (d)(iii) below, to the extent allowed under applicable law, (A) the Corporation shall redeem pro rata, no later than March 15 of each year there are Preferred Shares outstanding, that number of outstanding Preferred Shares that can be purchased with an amount equal to that portion of the Corporation's "Profits" (as that term is defined in the Agreement) specified for that purpose in the Agreement; and (B) the Corporation shall redeem pro rata that number of outstanding Preferred Shares that can be purchased with an amount equal to the amount of Required or Optional Operator Contributions (as such terms are defined in the Agreement). The Corporation, however, is not required to redeem fractional interests in the Preferred Shares. The redemption price for the mandatorily redeemed Preferred Shares shall be their par value plus the amount of any Accumulated and Accrued Dividends on such shares calculated to the date of redemption.
- (iii) Long-Term Note. So long as any "Long-Term Note" (as that term is defined in the Agreement) of the Corporation and any other obligation owed by the Operator or the Corporation to the holders of the Preferred Stock or their affiliates (as provided in the Agreement) remains outstanding or is not repaid, the Corporation shall be prohibited from redeeming the last remaining share of Preferred Stock except with the consent of the holders of the Preferred Stock.
- (iv) General Terms. If less than all of the outstanding Preferred Shares are to be redeemed, the Preferred Shares to be redeemed shall be selected pro rata from the number of Shares held by each Preferred Stockholder or by lot or in such other manner as the Preferred Stockholders shall determine. The holders of Preferred Shares called for redemption shall, from and after the date fixed for the redemption of such Shares, continue to possess or exercise by reason of their holding such Shares, all rights as Preferred Stockholders of the Corporation until such holders receive from the Corporation the redemption price of such Shares.
- (e) The Preferred Stock shall be preferred over the Common Stock as to both earnings and assets as provided in this Certificate. In the event of the liquidation, dissolution or winding up of the affairs of the Corporation, whether voluntary or involuntary, the total net earnings and assets remaining after the payment of all debts and obligations of the Corporation shall be distributed to the Stockholders as follows:
 - (i) The holders of the Preferred Shares shall first receive the par value of their Preferred Shares plus an amount equal to all the Accumulated and Accrued Dividends thereon (as those terms are defined in the Agreement) up to the date on which the Corporation ceased to transact business; and
 - (ii) Any remaining assets shall be distributed equally per Share to the Common Stock without any preference whatsoever.

If upon any liquidation, dissolution, or winding up of the Corporation, whether voluntary or involuntary, the net earnings and assets to be distributed to the holders of the Preferred Shares shall be insufficient to permit the payment to such shareholders of the full preferential amount provided for in subsection (c)(i), then all of the net earnings and assets of the Corporation to be distributed shall be distributed ratably to the holders of the Preferred Shares on the basis of the number of Preferred Shares held.

- (f) Except as and only to the extent specifically required otherwise by law or in the Agreement, no holder of shares of this Corporation of any class shall be entitled as of right to subscribe for, purchase or receive any part of any new or additional issue of stock, whether now or hereafter authorized.
- (g) Upon the retirement of all of the Preferred Stock of the Corporation, the entire voting power shall vest exclusively in the holders of Common Stock and such Common Stockholders shall have such rights as to dividends, assets and earnings upon liquidation or dissolution of the Corporation, and otherwise, as are customary with respect to holders of common stock of a corporation which has no other class of stock.
- (h) So long as any shares of Preferred Stock are outstanding, this Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of a majority of the then outstanding shares of Preferred Stock, voting separately as a class:
 - (i) (a) sell, lease, exchange, convey or otherwise dispose of or encumber (other than in the ordinary course of business) all or substantially all of its property or business, or (b) merge into or consolidate with any other corporation, or effect any reclassification or other change of any stock, or any recapitalization, or any dissolution, liquidation or winding up of the Corporation, or (c) enter into any agreement, or become obligated to do any of the actions specified in clauses (a) or (b) of this subsection (h)(i); or
 - (ii) alter or change the rights, preferences, privileges or limitations of the shares of Preferred or Common Stock; or
 - (iii) increase the authorized number of shares of Preferred or Common Stock; or
 - (iv) authorize or create shares of any class of stock or any stocks, bonds, debentures, notes or other obligations or securities convertible into, or exchangeable for, or having optional rights to purchase, any shares of the Corporation; or
 - (v) declare or pay any dividends on, or make any distributions with respect to, any shares of any equity security of any kind of the Corporation, other than dividends pursuant to subsection (a) of Article FIFTH hereof and stock dividends of Preferred Stock to the holders of Preferred Stock in accordance with the terms of the Agreement; or

- (vi) repurchase any shares of any equity security of any kind of the Corporation, other than redemptions pursuant to subsections (d)(i) and (d)(ii) of Article FIFTH; or
- (vii) amend any provision of its Certificate of Incorporation or its Bylaws in any manner; or
- (viii) issue any capital stock of the Corporation other than stock dividends of Preferred Stock to the extent specifically provided for in the Agreement; or
- (ix) engage in any business other than operating as an authorized Toyota dealer; or
- (x) file a petition commencing a voluntary case under the Bankruptcy Code or any petition or answer seeking or acquiescing in any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief for itself under any present or future federal, state or other statute, law or regulation relating to bankruptcy, insolvency or other relief for debtors; or seek or consent to or acquiesce in the appointment of any trustee, receiver or liquidator for the Corporation, or make any general assignment for the benefit of creditors, or admit in writing its inability to pay its debts generally as they become due; or
- (xi) indemnify any officer, director, employee or agent of the Corporation against any cost, expense or liability in connection with any action, suit or proceeding.

SIXTH: So long as any Preferred Stock of the Corporation shall be issued and outstanding, the "Profits" (as that term is defined in the Agreement) of the Corporation for each fiscal year shall be applied in the stated order of priority, and in the manner, specified in the Agreement.

SEVENTH: The name and place of residence of the Incorporator is as follows:

<u>Name</u>	<u>Address</u>
Richard Green	[REDACTED]

EIGHTH: The authorized number of directors is three.

NINTH: The private property of the Stockholders shall not be subject to the payment of corporate debts to any extent whatever.

TENTH: To the fullest extent that the General Corporation Law of the State of Delaware or any other law of the State of Delaware as it exists on the date hereof or as it may hereafter be amended permits the limitation or elimination of the liability of directors, a director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director except for liability: (i) for any breach of the director's duty of loyalty to

the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived any improper personal benefit. No amendment to, or modification or repeal of, this Article TENTH shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to acts or omissions of such director occurring prior to such amendment, modification or repeal.

ELEVENTH: In furtherance and not in limitation of the powers conferred upon it by law, the Board of Directors is expressly authorized to adopt, repeal, alter or amend the Bylaws of the Corporation by the vote of a majority of the entire Board of Directors then in office, subject to the right of the shareholders entitled to vote with respect thereto to adopt, alter, amend and repeal Bylaws made by the Board of Directors; and provided that any adoption, amendment, alteration or repeal of Bylaws (whether such action is taken by the Board of Directors or the shareholders) shall be subject to obtaining the approval of the holders of a majority of the then outstanding shares of Preferred Stock.

TWELFTH: Subject to any requirements of law and any other provisions of this Certificate of Incorporation, the Corporation reserves the right to amend, alter, change or repeal any provisions contained in this Certificate of Incorporation in the manner now or hereafter prescribed by law and all rights and powers conferred herein on stockholders, directors, and officers are subject to this reserved power; provided, however, if the holders of all of the outstanding Preferred Stock and Common Stock have agreed to limit the voting rights of either category of stock by mutual written consent, then the vote shall be in accordance with such agreement.

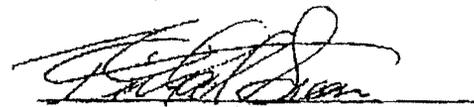
I, THE UNDERSIGNED, for the purpose of forming a corporation under the laws of the State of Delaware, do make, file and record this Certificate, and do certify that the facts herein stated are true; and I have accordingly hereunto set my hand.

Dated at Torrance, California on June 20, 2000.

Signed and Delivered in the
Presence of:



Witness



Incorporator

Richard Green

COMMON

CERTIFICATE

No. **17,000** Shares

LEO BOESE

Started
FROM WHOM TRANSFERRED

ORIGINAL ISSUE

<i>Started</i>	No. ORIGINAL CERTIFICATE	No. ORIGINAL SHARES	No. OF SHARES TRANSFERRED
----------------	--------------------------	---------------------	---------------------------

Numbered Certificate No. **17,000**

drawn

INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE
2000

COMMON STOCK
17,000 SHARES
PAR VALUE \$100.00 EACH

DUPLICATE REGISTERED STOCK
25,000 SHARES
PAR VALUE \$100.00 EACH

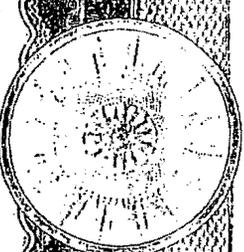
LEO BOESE

This Certifies that _____ is the record holder of SEVENTEEN THOUSAND (17,000) Shares of the Common Stock of LEO BOESE AUTOMOTIVE, INC.

transferrable on the books of the Corporation by the holder hereof or person or by attorney upon surrender of this Certificate properly endorsed, or assigned.

THE CORPORATION WILL FURNISH WITHOUT CHARGE TO EACH STOCKHOLDER WHO SO REQUESTS THE POWERS, DENOTATIONS, PREFERENCES AND RELATIONS, LIMITATIONS OR OTHER SPECIAL RIGHTS AND PRIVILEGES OF THE SHARES THEREOF OF THE CORPORATION, AND THE QUALIFICATIONS, LIMITATIONS OR RESTRICTIONS OF SUCH PREFERENCES AND/OR RIGHTS, SUCH REQUEST MAY BE MADE TO THE CORPORATION AT ITS PRINCIPAL EXECUTIVE OFFICE.

In Witness Whereof the said Corporation has caused this Certificate to be signed by its duly authorized officers and its Corporate Seal to be hereunto affixed this _____ day of _____ 1928.



Item 2c

219653



SECRETARY OF STATE

I, *BILL JONES*, Secretary of State of the State of California, hereby certify:

That the attached transcript of 1 page(s) has been compared with the record on file in this office, of which it purports to be a copy, and that it is full, true and correct.

IN WITNESS WHEREOF, I execute this certificate and affix the Great Seal of the State of California this day of



JUL 19 2000

Bill Jones

Secretary of State

State of California

SECRETARY OF STATE

CERTIFICATE OF QUALIFICATION

I, BILL JONES, Secretary of State of the State of California, hereby certify:

That on the 13TH day of JULY, 2000, LEBO AUTOMOTIVE, INC., a corporation organized and existing under the laws of DELAWARE, complied with the requirements of California law in effect on that date for the purpose of qualifying to transact intrastate business in the State of California, and that as of said date, said corporation became and now is qualified and authorized to transact intrastate business in the State of California, subject however, to any licensing requirements otherwise imposed by the laws of this State.

IN WITNESS WHEREOF, I execute this certificate and affix the Great Seal of the State of California this day of July 18, 2000.



Bill Jones
BILL JONES
Secretary of State

2190503

STATEMENT AND DESIGNATION
BY FOREIGN CORPORATION

ENDORSED-FILED
In the Office of the Secretary of State
of the State of California

JUL 13 2001

LEBO Automotive, Inc.
(Name of Corporation)

Bill Jones
BILL JONES, Secretary of State

_____, a corporation organized and existing under the laws of Delaware, makes the following statements and designation:
(State or Place of Incorporation)

- 1. The address of its principal executive office is 1510 North Sepulveda Blvd.
Los Angeles, California, 90266
- 2. The address of its principal office in the State of California is _____
Blvd., Los Angeles, California 90266

DESIGNATION OF AGENT FOR SERVICE OF PROCESS IN THE STATE OF CALIFORNIA
(Complete Either Item 3 or Item 4)

3. (Use this paragraph if the process agent is a natural person.)

Leo Boese, a natural person residing in the State of California, whose complete address is 1510 North Sepulveda Blvd.,
Los Angeles, California 90266, is designated as agent upon whom process directed to this corporation may be served within the State of California, in the manner provided by law

4. (Use this paragraph if the process agent is a corporation.)

_____, a corporation organized and existing under the laws of _____, is designated as agent upon whom process directed to this corporation may be served within the State of California, in the manner provided by law.

NOTE: Corporate agents must have complied with Section 1505, California Corporations Code, prior to designation.

5. It irrevocably consents to service of process directed to it upon the agent designated above, and to service of process on the Secretary of State of the State of California if the agent so designated or the agent's successor is no longer authorized to act or cannot be found at the address given.

Leo Boese

(Signature of Corporate Officer)

Leo Boese, President

(Typed Name and Title of Officer Signing)



U.S. Corporation Income Tax Return
For calendar year 2000 or tax year
beginning JULY 17, 2000 and ending DECEMBER 31, 2000

OMB No. 1545-0123

2000

- A Check if a:**
 1 Consolidated return (attach Form 951)
 2 Personal holding co. (attach Sch. P1)
 3 Personal service corp. (as defined in Temp. Regs. sec. 1.441-4T)

Use IRS label. Otherwise, print or type.

Name **LEBO AUTOMOTIVE, INC.
DBA MANHATTAN BEACH TOYOTA**
 Number, street, and room or suite no. (if a P.O. box, see page 7 of instructions.)
1500 NORTH SEPULVEDA
 City or town, state, and ZIP code
MANHATTAN BEACH, CA 90266

Employer identification number
 [REDACTED]
 Date prepared
06/21/2000
 Total assets (see page 8 of instructions)

E Check applicable boxes: (1) Initial return (2) Final return (3) Change of address \$ **14,915,005.**

Income	1a	Gross receipts or sales	17,781,160.	b	Less returns and allowances		c	Bal	1c	17,781,160.
	2	Cost of goods sold (Schedule A, line 8)							2	15,503,445.
	3	Gross profit. Subtract line 2 from line 1c							3	2,277,715.
	4	Dividends (Schedule C, line 19)							4	
	5	Interest							5	
	6	Gross rents							6	
	7	Gross royalties							7	
	8	Capital gain net income (attach Schedule D (Form 1120))							8	
	9	Net gain or (loss) from Form 4797, Part II, line 18 (attach Form 4797)							9	
	10	Other income (attach schedule)							10	SEE STATEMENT 2
	11	Total income. Add lines 3 through 10							11	2,310,128.

Deductions	12	Compensation of officers (Schedule E, line 4)							12	149,336.
	13	Salaries and wages (less employment credits)							13	1,174,075.
	14	Repairs and maintenance							14	10,277.
	15	Bad debts							15	
	16	Rents							16	362,530.
	17	Taxes and licenses							17	120,299.
	18	Interest							18	272,734.
	19	Charitable contributions	SEE STATEMENT 4 AND SEE STATEMENT 5						19	0.
	20	Depreciation (attach Form 4562)			20	101,767.				
	21	Less depreciation claimed on Schedule A and elsewhere on return			21a				21b	101,767.

Tax and Payments	22	Depletion							22	
	23	Advertising							23	312,548.
	24	Pension, profit-sharing, etc., plans							24	
	25	Employee benefit programs							25	33,005.
	26	Other deductions (attach schedule)							26	SEE STATEMENT 6
	27	Total deductions. Add lines 12 through 26							27	3,037,126.
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11							28	<726,998.>
	29	Less: a Net operating loss (NOL) deduction			29a				29c	
		b Special deductions (Schedule C, line 20)			29b					
	30	Taxable income. Subtract line 29c from line 28							30	<726,998.>

31 Total tax (Schedule J, line 11) **0.**
 32 Payments: a 1999 overpayment credited to 2000 **32a**
 b 2000 estimated tax payments **32b**
 Less 2000 refund applied for on Form 4466 **32c** () d Bal **32d**
 e Tax deposited with Form 7004 **32e**
 f Credit for tax paid on undistributed capital gains (attach Form 2439) **32f**
 g Credit for Federal tax on fuels (attach Form 4136) **32g** **32h**
 33 Estimated tax penalty. Check if Form 2220 is attached **33**
 34 Tax due. If line 32h is smaller than the total of lines 31 and 33, enter amount owed **0.**
 35 Overpayment. If line 32h is larger than the total of lines 31 and 33, enter amount overpaid
 36 Enter amount of line 35 you want: Credited to 2001 estimated tax Refunded **36**

Sign Here
 Signature of officer: _____ Date: _____ Title: **PRESIDENT**
 Preparer's signature: _____ Date: **09/05/01** Check if self-employed Preparer's SSN or PTIN: **P00179246**
 Firm's name (or yours if self-employed), address, and ZIP code: **KRUSE MENNILLO & CO.
17906 CRUSADER AVE, STE 100
CERRITOS, CA 90703-2631**
 EIN: [REDACTED] Phone no.: **(562) 403-2560**

Item 2a

Schedule A Cost of Goods Sold (See page 14 of instructions.)

1	Inventory at beginning of year	1	
2	Purchases	2	20,652,066.
3	Cost of labor	3	217,262.
4	Additional section 263A costs (attach schedule)	4	SEE STATEMENT 7 <57,550.>
5	Other costs (attach schedule)	5	
6	Total. Add lines 1 through 5	6	20,811,778.
7	Inventory at end of year	7	5,308,333.
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on line 2, page 1	8	15,503,445.

9a Check all methods used for valuing closing inventory:

- (i) Cost as described in Regulations section 1.471-3
- (ii) Lower of cost or market as described in Regulations section 1.471-4
- (iii) Other (Specify method used and attach explanation.) ► SEE STATEMENT 1

b Check if there was a writedown of subnormal goods as described in Regulations section 1.471-2(c)

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970)

d If the LIFO inventory method was used for this tax year, enter percentage (or amounts) of closing inventory computed under LIFO 9d

e If property is produced or acquired for resale, do the rules of section 263A apply to the corporation? Yes No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? Yes No
If "Yes," attach explanation

Schedule C Dividends and Special Deductions		(a) Dividends received	(b) %	(c) Special deductions (a) x (b)
1	Dividends from less-than-20%-owned domestic corporations that are subject to the 70% deduction (other than debt-financed stock)		70	
2	Dividends from 20%-or-more-owned domestic corporations that are subject to the 80% deduction (other than debt-financed stock)		80	
3	Dividends on debt-financed stock of domestic and foreign corporations (section 246A)		see instructions	
4	Dividends on certain preferred stock of less-than-20%-owned public utilities		42	
5	Dividends on certain preferred stock of 20%-or-more-owned public utilities		48	
6	Dividends from less-than-20%-owned foreign corporations and certain FSCs that are subject to the 70% deduction		70	
7	Dividends from 20%-or-more-owned foreign corporations and certain FSCs that are subject to the 80% deduction		80	
8	Dividends from wholly owned foreign subsidiaries subject to the 100% deduction (section 245(b))		100	
9	Total. Add lines 1 through 8			
10	Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11	Dividends from certain FSCs that are subject to the 100% deduction (section 245(c)(1))		100	
12	Dividends from affiliated group members subject to the 100% deduction (sec. 243(e)(3))		100	
13	Other dividends from foreign corporations not included on lines 3, 6, 7, 8, or 11			
14	Income from controlled foreign corporations under subpart F (attach Form(s) 5471)			
15	Foreign dividend gross-up (section 78)			
16	IC-DISC and former DISC dividends not included on lines 1, 2, or 3 (section 246(d))			
17	Other dividends			
18	Deduction for dividends paid on certain preferred stock of public utilities			
19	Total dividends. Add lines 1 through 17. Enter here and on line 4, page 1			
20	Total special deductions. Add lines 9, 10, 11, 12, and 18. Enter here and on line 29b, page 1			

Schedule E Compensation of Officers (See instructions for line 12, page 1.)
Note: Complete Schedule E only if total receipts (line 1a plus lines 4 through 10 on page 1, Form 1120) are \$500,000 or more.

(a) Name of officer	(b) Social security number	(c) Percent of line devoted to business	Percent of corporation stock owned		(f) Amount of compensation
			(d) Common	(e) Preferred	
1 LEO R. BOESE III	204-38-7532	100%	100.00%		149,336.
2 Total compensation of officers					149,336.
3 Compensation of officers claimed on Schedule A and elsewhere on return					
4 Subtract line 3 from line 2. Enter the result here and on line 12, page 1					149,336.

Schedule J Tax Computation (See page 17 of instructions.)

1 Check if the corporation is a member of a controlled group (see sections 1561 and 1563)
 Important: Members of a controlled group, see instructions on page 17.

2a If the box on line 1 is checked, enter the corporation's share of the \$50,000, \$25,000, and \$9,925,000 taxable income brackets (in that order):
 (1) \$ _____ (2) \$ _____ (3) \$ _____

b Enter the corporation's share of:
 (1) Additional 5% tax (not more than \$11,750) \$ _____
 (2) Additional 3% tax (not more than \$100,000) \$ _____

3 Income tax. Check if a qualified personal service corporation under section 448(d)(2) (see page 17) **3** 0.

4 Alternative minimum tax (attach Form 4626) **4**

5 Add lines 3 and 4 **5** 0.

6a Foreign tax credit (attach Form 1118) **6a**

b Possessions tax credit (attach Form 5735) **6b**

c Check: Nonconventional source fuel credit QEV credit (attach Form 8834) **6c**

d General business credit. Enter here and check which forms are attached: 3800 **6d**
 3468 5884 6478 8765 8586 8830 8826
 8835 8844 8845 8846 8820 8847 8861

e Credit for prior year minimum tax (attach Form 8827) **6e**

f Qualified zone academy bond credit (attach Form 8860) **6f**

7 Total credits. Add lines 6a through 6f **7**

8 Subtract line 7 from line 5 **8** 0.

9 Personal holding company tax (attach Schedule PH (Form 1120)) **9**

10 Recapture taxes. Check if from: Form 4255 Form 8611 **10**

11 Total tax. Add lines 8 through 10. Enter here and on line 31, page 1 **11** 0.

Schedule K Other Information (See page 19 of instructions.)

1 Check method of accounting: a Cash b Accrual **Yes No**
 c Other (specify) _____

2 See page 21 of the instructions and enter the:
 a Business activity code no. **441110**
 b Business activity **AUTOMOBILE DEALERSHI**
 c Product or service **SALES AND SERVICE**

3 At the end of the tax year, did the corporation own, directly or indirectly, 50% or more of the voting stock of a domestic corporation? (For rules of attribution, see section 267(c).) **X**

If "Yes," attach a schedule showing: (a) name and employer identification number (EIN), (b) percentage owned, and (c) taxable income or (loss) before NOL and special deductions of such corporation for the tax year ending with or within your tax year.

4 Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? **X**
 If "Yes," enter name and EIN of the parent corporation _____

5 At the end of the tax year, did any individual, partnership, corporation, estate, or trust own, directly or indirectly, 50% or more of the corporation's voting stock? (For rules of attribution, see section 267(c).) **X**
 If "Yes," attach a schedule showing name and identifying number. (Do not include any information already entered in 4 above.) Enter percentage owned _____

6 During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) **X**

7 At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of stock of the corporation entitled to vote or (b) the total value of all classes of stock of the corporation? **X**
 If "Yes,"
 a Enter percentage owned _____
 b Enter owner's country _____
 c The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter number of Forms 5472 attached _____

8 Check this box if the corporation issued publicly offered debt instruments with original issue discount
 If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.

9 Enter the amount of tax-exempt interest received or accrued during the tax year **\$** _____

10 Enter the number of shareholders at the end of the tax year (if 75 or fewer) **2**

11 If the corporation has an NOL for the tax year and is electing to forgo the carryback period, check here

12 Enter the available NOL carryover from prior tax years (Do not reduce it by any deduction on line 29a.) **\$** _____

Note: If the corporation, at any time during the tax year, had assets or operated a business in a foreign country or U.S. possession, it may be required to attach Schedule N (Form 1120), Foreign Operations of U.S. Corporations, to this return. See Schedule N for details.

Schedule L Balance Sheets per Books	Beginning of tax year		End of tax year	
	(a)	(b)	(c)	(d)
Assets				
1 Cash				2,011,174.
2a Trade notes and accounts receivable			274,024.	
b Less allowance for bad debts	()		(35,051.)	238,973.
3 Inventories				5,308,333.
4 U.S. government obligations				
5 Tax-exempt securities				
6 Other current assets STMT 8				325,429.
7 Loans to shareholders				
8 Mortgage and real estate loans				
9 Other investments				
10a Buildings and other depreciable assets			1,482,972.	
b Less accumulated depreciation	()		(71,585.)	1,411,387.
11a Depletable assets				
b Less accumulated depletion	()		()	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)			5,269,716.	
b Less accumulated amortization	()		(109,786.)	5,159,930.
14 Other assets STMT 9				459,779.
15 Total assets		0.		14,915,005.
Liabilities and Shareholders' Equity				
16 Accounts payable				794,153.
17 Mortgages, notes, bonds payable in less than 1 year				5,307,052.
18 Other current liabilities STMT 10				436,759.
19 Loans from shareholders				
20 Mortgages, notes, bonds payable in 1 year or more				3,508,036.
21 Other liabilities STMT 11				124,871.
22 Capital stock: a Preferred stock			3,508,000.	
b Common stock			1,700,000.	5,208,000.
23 Additional paid-in capital				
24 Retained earnings - Appropriated (attach schedule)				
25 Retained earnings - Unappropriated				<463,866.>
26 Adjustments to shareholders' equity				
27 Less cost of treasury stock		()		()
28 Total liabilities and shareholders' equity		0.		14,915,005.

Note: The corporation is not required to complete Schedules M-1 and M-2 if the total assets on line 15, column (d) of Schedule L are less than \$25,000.

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return		
1 Net income (loss) per books	<463,866.>	7 Income recorded on books this year not included on this return (itemize):
2 Federal income tax		Tax-exempt interest \$
3 Excess of capital losses over capital gains		STMT 14 291,475.
4 Income subject to tax not recorded on books this year (itemize):		<i>Declared fit</i> 291,475.
SEE STATEMENT 12	57,550.	8 Deductions on this return not charged against book income this year (itemize):
5 Expenses recorded on books this year not deducted on this return (itemize):		a Depreciation \$ 30,182.
a Depreciation		b Contributions carryover \$
b Contributions carryover \$ 500.		STMT 15 (AMORT) 86,595.
c Travel and entertainment \$ 997.		<i>of goodwill</i> 66,777.
STMT 13 36,073.	37,570.	9 Add lines 7 and 8
6 Add lines 1 through 5	<368,746.>	10 Income (line 28, page 1) - line 6 less line 9
		<726,998.>

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)		
1 Balance at beginning of year		5 Distributions: a Cash
2 Net income (loss) per books	<463,866.>	b Stock
3 Other increases (itemize):		c Property
		6 Other decreases (itemize):
		7 Add lines 5 and 6
4 Add lines 1, 2, and 3	<463,866.>	8 Balance at end of year (line 4 less line 7)
		<463,866.>

Amended U.S. Individual Income Tax Return

(Rev. November 2007)

See separate instructions.

This return is for calendar year 2007, or fiscal year ended

Personal information section including names (LEO R. BOESE, BARBARA A. BOESE), address, and apartment number.

- A If the address shown above is different from that shown on your last return filed with the IRS, would you like us to change it in our records?
B Filing status. Be sure to complete this line. Note. You cannot change from joint to separate returns after the due date.

Table with 4 columns: Description, A. Original amount or as previously adjusted (see page 3), B. Net change - amount of increase or (decrease) - explain in Part II, C. Correct amount. Rows include Income and Deductions, Tax Liability, Payments, and Refund or Amount You Owe.

Sign Here section containing signature lines for the taxpayer and preparer, along with preparer information for K. B. PARRISH & CO. LLP.

Part I Exemptions. See Form 1040 or 1040A instructions.

Complete this part only if you are:
 • Increasing or decreasing the number of exemptions claimed on line 6d of the return you are amending, or
 • Increasing or decreasing the exemption amount for housing individuals displaced by Hurricane Katrina.

A. Original number of exemptions reported or as previously adjusted

B. Net change

number of exemptions

25	Yourself and spouse Caution. If someone can claim you as a dependent, you cannot claim an exemption for yourself.	25																
26	Your dependent children who lived with you	26																
27	Your dependent children who did not live with you due to divorce or separation	27																
28	Other dependents	28																
29	Total number of exemptions. Add lines 25 through 28	29																
30	Multiply the number of exemptions claimed on line 29 by the amount listed below for the tax year you are amending. Enter the result here.	30																
	<table border="1"> <thead> <tr> <th>Tax year</th> <th>Exemption amount</th> <th>But see the instructions for line 4 on page 4 if the amount on line 1 is over:</th> </tr> </thead> <tbody> <tr> <td>2007</td> <td>\$3,400</td> <td>\$117,300</td> </tr> <tr> <td>2006</td> <td>3,300</td> <td>112,875</td> </tr> <tr> <td>2005</td> <td>3,200</td> <td>109,475</td> </tr> <tr> <td>2004</td> <td>3,100</td> <td>107,025</td> </tr> </tbody> </table>	Tax year	Exemption amount	But see the instructions for line 4 on page 4 if the amount on line 1 is over:	2007	\$3,400	\$117,300	2006	3,300	112,875	2005	3,200	109,475	2004	3,100	107,025		
Tax year	Exemption amount	But see the instructions for line 4 on page 4 if the amount on line 1 is over:																
2007	\$3,400	\$117,300																
2006	3,300	112,875																
2005	3,200	109,475																
2004	3,100	107,025																
31	If you are claiming an exemption amount for housing individuals displaced by Hurricane Katrina, enter the amount from Form 8914, line 2 for 2005 or line 6 for 2006 (see instructions for line 4). Otherwise enter -0-	31																
32	Add lines 30 and 31. Enter the result here and on line 4	32																

33 Dependents (children and other) not claimed on original (or adjusted) return:

(a) First name	Last name	(b) Dependent's social security number	(c) Dependent's relationship to you	(d) Check if qualifying child for child tax credit	No. of children on 33 who:
				<input type="checkbox"/>	<input type="checkbox"/> lived with you <input type="checkbox"/> did not live with you due to divorce or separation Dependents on 33 not entered above ...
				<input type="checkbox"/>	
				<input type="checkbox"/>	
				<input type="checkbox"/>	
				<input type="checkbox"/>	

Part II Explanation of Changes

Enter the line number from page 1 for each item you are changing and give the reason for each change. Attach only the supporting forms and schedules for the items changed. If you do not attach the required information, your Form 1040X may be returned. Be sure to include your name and social security number on any attachments.

If the change relates to a net operating loss carryback or a general business credit carryback, attach the schedule or form that shows the year in which the loss or credit occurred. See page 2 of the instructions. Also, check here

TAXPAYER IS AMENDING THE 2007 RETURN TO REFLECT THE FOLLOWING:

- CARRY OVER A NOL FROM 2006 (CAUSED BY A CARRYBACK OF A NOL FROM THE 2008 RETURN)
- CORRECTLY REPORT THE EXCLUSION OF CAPITAL GAIN ON SALE OF COMMON STOCK AS QUALIFIED SMALL BUSINESS STOCK UNDER SECTION 1202(A).

Part III Presidential Election Campaign Fund. Checking below will not increase your tax or reduce your refund.

If you did not previously want \$3 to go to the fund but now want to, check here
 If a joint return and your spouse did not previously want \$3 to go to the fund but now wants to, check here

LEO R. & BARBARA A. BOESE
ANALYSIS OF CHANGES TO 2006 FEDERAL INCOME TAX RETURN

	<u>AS ORIGINALLY REPORTED</u>	<u>ADJUSTMENT</u>	<u>AS ADJUSTED</u>
<u>ADJUSTED GROSS INCOME</u>	5,658,638		5,658,638
NET OPERATING LOSS CARRIED OVER FROM 2006		(678,108)	(678,108)
SECTION 1202(a) EXCLUSION OF CAPITAL GAIN FROM THE SALE OF QUALIFIED SMALL BUSINESS STOCK		(2,658,342)	(2,658,342)
ADJUSTED GROSS INCOME		<u>(3,336,450)</u>	<u>2,322,188</u>
 <u>ITEMIZED DEDUCTIONS</u>	 61,836		 61,836
CONTRIBUTIONS CARRIED OVER FROM THE 2006 RETURN WHEN 2008 NOL WAS CARRIED BACK TO 2006		30,075	30,075
CHANGE IN ITEMIZED DEDUCTIONS (LINE 11 OF THE WORKSHEET)			
LIMITATION AS FILED		70,670	70,670
AS AMENDED		(43,316)	(43,316)
ITEMIZED DEDUCTIONS		<u>57,429</u>	<u>119,265</u>

TAXABLE YEAR

CALIFORNIA FORM

2007

Amended Individual Income Tax Return

540X

Fiscal year filers only: Enter month of year end: _____ year _____

BE SURE TO COMPLETE AND SIGN SIDE 2



SCANNED

P
A
A
R
RP

LONG BEACH CA 90807

- a Have you been advised that your original federal return has been, is being, or will be audited? Yes No
- b Filing status claimed.
 On original return Single Married filing jointly Married filing separately Head of household Qualifying widow(er)
 On this return Single Married filing jointly Married filing separately Head of household Qualifying widow(er)
- c If for the year you are amending, you (or your spouse) can be claimed as a dependent on someone else's tax return, check the box
- d If claiming head of household, enter name and relationship of qualifying person on: Original return _____ Amended return _____

Note: If you are amending Form 540NR, see General Information D before continuing. If you are amending Forms 540 2EZ or 540TEL, see the instructions for lines 1 through 6.		A. As originally reported/ adjusted by FTB. See instructions	B. Net change: Explain on Side 2	C. Correct amount
1 a	State wages. See instructions	181,787.	0.	181,787.
1 b	Federal AGI. See instructions	5,658,638.	3,336,450.	2,322,188.
2	CA adjustments. See specific instructions on Form 540A or Sch. CA (540 or 540NR).			
2 a	California nontaxable interest income			
2 b	State income tax refund			
2 c	Unemployment compensation			
2 d	Social Security benefits			
2 e	Other (list) FEDERAL NOL		678,108.	678,108.
3	Total California adjustments. Combine line 2a through line 2e. See instructions		678,108	678,108
4	California adjusted gross income. Combine line 1b and line 3. See instructions	5,658,638	2,658,342	3,000,296
5	California itemized deductions or California standard deduction. See instructions	22,309.		22,309.
6	Taxable income. Subtract line 5 from line 4. If less than zero, enter -0-	5,636,329	2,658,342	2,977,987
7 a	Tax method used for Column C. See instructions			
7 b	Tax. See instructions	519,789.	247,225.	272,564.
8	Exemption credits. See instructions			
9	Subtract line 8 from line 7b. If less than zero, enter -0-	519,789	247,225	272,564
10	Tax from Schedule G-1 and form FTB 5870A. See instructions			
11	Add line 9 and line 10.	519,789.	247,225.	272,564.
12	Special credits and nonrefundable renter's credit. See instructions			
13	Subtract line 12 from line 11	519,789.	247,225.	272,564.
14	Other taxes (alternative minimum tax, credit recapture, etc.). See instructions		23,602.	23,602.
15	Mental Health Services Tax, see instructions	46,363.	26,583.	19,780.
16	Total tax. Add line 13, line 14, and line 15. If amending Form 540NR, see instructions	566,152	250,206	315,946
17	California income tax withheld. See instructions	13,484.		13,484.
18	California real estate or nonresident withholding. See instructions			
19	Excess California SDI (or VPD) withheld. See instructions			
20	Estimated tax payments and other payments. See instructions	14,000.		14,000.
21	Child and Dependent Care Expenses or Other Refundable Credits. See inst.			

• 22 _____ • 23 _____ ■ 24 \$ _____

25 Tax paid with original return plus additional tax paid after it was filed. Complete Side 2, Part I before entering amount here ■ 25 538,668.

26 Total payments. Add lines 17, 18, 19, 20, 21, and 25 of column C. ■ 26 566,152

Your name: LEO BOESE and BARBARA BOESE

Your SSN or ITIN: [REDACTED]

- 27 Overpaid tax, if any, as shown on original return or as previously adjusted by FTB. See instructions
- 28 Subtract line 27 from line 26. If line 27 is more than line 26, see instructions. 28 566,152
- 29 Use tax payments as shown on original return. See instructions • 29 _____
- 30 Voluntary contributions as shown on original return. See instructions • 30 _____
- 31 Subtract line 29 and line 30 from line 28 31 566,152.
- 32 AMOUNT YOU OWE. If line 16, column C is more than line 31, enter the difference and see instructions ■ 32 _____
- 33 Penalties/Interest. See instructions: Penalties 33a _____ Interest 33b _____ ■ 33c _____
- 34 REFUND. If line 16, column C is less than line 31, enter the difference. See instructions ■ 34 250,206.

Part I Payments Complete this part before completing Side 1, line 25.

- 1 a Amount paid with the original return. Do not include payments of interest or penalties 1a 538,668
- b Enter the serial number stamped on the face of your canceled check(s) by the Franchise Tax Board (if available). 1b []
- 2 Additional payments made after the original return was filed:
Enter in the spaces below the date of the payment(s), the serial number stamped on the face of your canceled check(s) by the Franchise Tax Board, and the amount(s) of additional payment(s). If you did not receive a canceled check or you made payment(s) on line or by credit card, enter the payment amount(s) below and attach a copy of the statement from your financial institution showing the:
 - Check number (if applicable);
 - Amount of the check or charge; and
 - Date the check or charge posted to your account.

Payment date	Serial number	Amount of payment
		\$
		\$
		\$
- Total of additional payments listed above 2 _____
- 3 Total payments. Add line 1a and line 2. Enter here and on Side 1, line 25 3 538,668.

Part II Explanation of Changes

- 1 Enter name(s) and address as shown on original return below (if same as shown on this return, write "Same"). If changing from separate returns to a joint return, enter names and addresses from original returns SAME
- 2 a If you checked the box for "Yes," on Side 1, question a, are you filing this Form 540X to report a final federal determination? Yes No
- b If the answer to question 2a above is "Yes," are you filing this Form 540X to report additional tax due within six months of the final federal determination? Yes No
- c If the answer to question 2a above is "Yes," what is the date and tax change amount of the final federal determination?
Date _____ Tax change amount _____
- 3 Have you been advised that your original California return has been, is being, or will be audited? Yes No
- 4 Did you file an amended return with the Internal Revenue Service on a similar basis? See General Information E Yes No
- 5 Explain your changes to income, deductions, and credits in the space provided below. If additional space is needed, attach a separate sheet of paper. Enter the line number from Side 1 for each item you are changing. Attach all supporting forms and schedules for items changed. Include federal schedules if you made a change to your federal return. Be sure to include your name and social security or individual taxpayer identification number on each attachment. Refer to the tax booklet for the year you are amending.

SEE ATTACHED FEDERAL RETURN PAGES 1 AND 2 AND FORM 1040X.

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return including accompanying schedules and statements and to the best of my knowledge and belief, this amended return is true, correct, and complete.

Your signature _____ Spouse's signature (if filing jointly, both must sign) _____ Daytime phone number (optional) _____

Sign Here

It is unlawful to forge a spouse's signature. X _____ X _____ Date _____
Paid preparer's signature (declaration of preparer is based on all information of which preparer has any knowledge)

Firm's name (or yours if self-employed) _____ Firm's address _____
K. B. PARRISH & CO. LLP 6840 EAGLE HIGHLANDS WAY, INDEPLS, IN 462

Paid preparer's SSN/PTIN
• P00005439
FEIN

Where to File Form 540X: Do not file a duplicate amended return unless one is requested. This may cause a delay in processing your amend if you are due a refund or have no amount due, mail your return to: FRANCHISE TAX BOARD, PO BOX 9428 If you owe, mail your return and check or money order to: FRANCHISE TAX BOARD, PO BOX 9428

October 28, 2009

Franchise Tax Board
Attn: 343:SM:F381
P.O. Box 1673
Sacramento, California 95812-1673

Re: Leo R. & Barbara A. Boese
Account #: [REDACTED]

To Whom It May Concern:

This letter is in regards to the enclosed letter dated October 21, 2009. The letter has requested additional information be provided to substantiate the exclusion of gain from the sale of qualified small business stock on the taxpayer's 2007 amended California return. The requested information is provided below.

- 1) Corporation name: Lebo Automotive, Inc.
d/b/a Manhattan Beach Toyota
Corporation number: 2194503
- 2) Documentation that the corporation met the requirements of CR&TC § 18152.5(c)
 - a) Corporation is a C Corporation - see attached item 2a, 2000 Form 1120
 - b) Date of original stock issuance was June 20, 2000, the date of incorporation. See attached item 2b, Certificate of Incorporation.
 - c) The taxpayer purchased 17,000 shares of stock at its original issuance, referenced in the Certificate of Incorporation. See attached item 2c, taxpayer's stock certificate.
 - d) The corporation met the necessary requirements to qualify as a small business at the date of issuance. See attached item 2a, 2000 Form 1120 and item 2d California Form 100 to confirm the following:
 - i) Total gross assets were less than \$50 million
 - ii) The corporation was doing business exclusively in California
 - iii) All payroll was attributable to California
 - e) All assets owned by the corporation were located in California at all times. The entity only had one location which was in Manhattan Beach California. This is substantiated by the fact that there was no apportionment of assets, payroll, or sales to any state other than California.
 - f) All payroll was attributable to California. This is substantiated by the same facts listed in 2e above.

- 3) Documentation that the corporation is a qualified small business.
 - a) Gross assets of the corporation have never been greater than \$50 million. See attached item 2a referenced above.
 - b) Immediately after the issuance of stock the gross assets did not exceed \$50 million. The stock was issued at the inception of the corporation; please reference the initial tax return for the entity, labeled item 2a.
 - c) All payroll was attributable to California. See explanation in 2(f) above.

It is our intentions that this letter and the documentation enclosed will provide sufficient information so the taxpayer's amended return can continue to be processed as filed. If you have any further questions regarding this matter, please feel free to contact me. Thank you for your assistance.

Very truly yours,

K. B. PARRISH & CO. LLP

Christine S. Keith, CPA

CK:jt

Enclosures

cc: Mr. & Mrs. Leo Boese

REC MAY 19 2010 SAC

**KB Parrish
Co. LLP**

CERTIFIED PUBLIC ACCOUNTANTS
6840 Eagle Highlands Way
Indianapolis, IN 46254-2693
(317) 347-5200
FAX (317) 347-5211

May 17, 2010

Ms. Soni Mangat
Franchise Tax Board
P. O. Box 1673
Sacramento, California 95812-1673

Re: Case 18570389976875116
343:SM:F381
Taxpayer: Boese, Leo R.

Dear Ms. Mangat:

I am in receipt of your letter dated May 11, 2010, in regards to your examination of an amended 2007 California Form 540, in which the taxpayer claimed an exclusion under Section 1202 of the Internal Revenue Code and Section 18152.5 of the California Revenue and Taxation Code.

As stated in your letter, you have denied the taxpayer's claim for refund based on your analysis of the facts and the applicable federal and California revenue code sections stated above. I believe that your analysis is incorrect and I wish to formally protest your proposed denial of the taxpayer's refund claim. I believe that you based your decision on incomplete and inaccurate facts that lead to an incorrect application California R&TC §18152.5.

Following is a complete statement of the facts and my analysis of the applicable law.

FACTS:

On April 14, 2000, Mr. Leo Boese (buyer) and AutoNation, Inc. (seller) entered into a stock purchase agreement for the acquisition of all the outstanding common stock of Auto Nation Enterprises (wholly owned subsidiary of AutoNation, Inc., d/b/a Manhattan Beach Toyota) for a price of \$5,814,000. See the AMENDED AND RESTATED STOCK PURCHASE AGREEMENT, Article 1 Section 1.3 on Page 2. EXHIBIT 1.

The buyer and seller agreed to treat the stock purchase of Manhattan Toyota as an asset purchase under §338(h) (10) of the Internal Revenue Code. See page 18 at section 5.9 (d) of the AMENDED AND RESTATED STOCK PURCHASE AGREEMENT. Also see Statement 1 to the year 2000 federal income tax return, EXHIBIT 2, as well as Statement 2 to the year 2000 California income tax return, Form 100. EXHIBIT 3. Consequently, the purchase price of the Manhattan Toyota stock was allocated to the underlying assets based on the fair market value at time of purchase.

EXHIBIT: 1
PAGE 1 OF 3

0007 1117

Lebo Automotive, Inc. was incorporated in the State of Delaware on June 20, 2000. On July 17, 2000, Manhattan Beach Toyota was merged into Lebo Automotive, Inc. under the Delaware merger statute and §368(a) of the Internal Revenue Code. Mr. Boese was issued 17,000 shares, with the par value determined based on the fair market value of assets and cash contributed in the merger. The total value of Mr. Boese's stock was \$1,700,000.

Mr. Boese held his stock in Lebo Automotive, Inc. until March 16, 2007 and continued to operate a Toyota Franchise until that time. On the 2007 tax return, Mr. Boese reported a capital gain from the sale of Lebo Automotive, Inc. stock for the full amount of the gain. The 2007 return was subsequently amended due to the omission of the IRC §1202 and California R&TC §18152.5 exclusion for qualifying small business stock.

REBUTTAL TO CALIFORNIA FRANCHISE BOARD APPLICATION OF IRC §1202 AND R&TC §18152.5

You are proposing to disallow the §1202 gain exclusion based on the following arguments:

1. Lebo Automotive, Inc. is not qualified small business stock because it is not original issue stock. (18152.5(c)(1)(B))
2. Lebo Automotive, Inc. was not actively involved in a qualified trade or business for substantially all of the taxpayer's holding period. (18152.5(c)(2)(A))
3. Lebo Automotive, Inc. does not qualify as an active trade or business because it is engaged in investment activities. (18152.5(e)(3))

You have based your decision to deny the refund claim because Lebo Automotive, Inc. acquired the stock of another corporation doing business as Manhattan Beach Toyota. The stock of Manhattan Beach Toyota was purchased stock, not original issue stock; therefore, it is disqualified. You also argue that Lebo Automotive, Inc. had no business activity before acquiring the Manhattan Beach Toyota stock and that its primary activity is that of investing because the trade or business activity lies with the Manhattan Beach Toyota stock.

I agree that you have stated the requirements of the statutes correctly. I disagree that you have applied the facts to the statute correctly.

The stock that was sold in 2007 that produced the gain is the stock of Lebo Automotive, Inc. Mr. Boese was the original owner of this stock. Lebo Automotive, Inc. stock was original issue stock issued in exchange for the assets of Manhattan Beach Toyota. Mr. Boese was the purchaser of the Manhattan Beach Toyota stock as evidenced by the purchase agreement in Exhibit 1. The Manhattan Beach Toyota stock was ultimately merged into Lebo Automotive, Inc. in exchange for its stock. I do not disagree with your argument that Lebo Automotive, Inc. was formed to acquire an existing Toyota Franchise. However, the statute requires that the taxpayer acquire original issue stock in exchange for cash or property. The taxpayer has met this requirement. The Lebo Automotive stock did not exist until Mr. Boese exchanged the Manhattan Beach Stock for it. The taxpayer did not claim a §18152.5 exclusion on the Manhattan Toyota stock, he claimed the exclusion on the Lebo Automotive, Inc. stock acquired in 2002.

EXHIBIT: F
PAGE 2 OF 3

2007-11148

You also argue that Lebo Automotive, Inc. was not engaged in an active trade or business when its stock was issued to the taxpayer. I agree with your assertion. However, the law does not require that the issuer of the stock be engaged in an active trade or business at the time of the original stock issuance. The law requires that the issuer be engaged in an active trade or business for "substantially all" of the taxpayer's holding period. Lebo Automotive, Inc. was engaged in an active business from July 19, 2000 until March 16, 2007. Mr. Boese held his stock in Lebo Automotive, Inc. from June 20, 2000 to March 16, 2007. Lebo Automotive, Inc. was actively involved in a trade or business for substantially all of the taxpayer's holding period.

Lastly, you argue that by virtue of purchase of the Manhattan Toyota stock, Lebo Automotive, Inc. was engaged in an investment activity, not a trade or business. This argument overlooks the fact that the Manhattan Beach Toyota stock was cancelled when the assets were merged in Lebo Automotive, Inc. It also does not take into consideration the §338(h)(10) election made by AutoNation and Mr. Boese to treat the stock purchase of Manhattan Beach Toyota as an asset purchase for income tax purposes. You have also not factored in IRC §1202(e)(5)(A) and R&TC§18152.5(e)(5)(A) which states "For purposes of this subdivision, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiaries' assets, and to conduct its ratable share of the subsidiaries' activities. This provision requires you to ignore the Manhattan Beach stock purchase and look only to the stock and business activity of Lebo Automotive, Inc. Even if Lebo Automotive, Inc.'s only asset was Manhattan Beach Toyota stock, which is not factually true, the statute requires you to ignore that and look to the underlying business activity. Therefore, Lebo Automotive, Inc. did not engage in the activity of investing. It operated a Toyota franchise. It is obvious by looking at page one of the annual income tax returns of Lebo Automotive, Inc. from years 2000 through 2006 that the business was the sales and service of automobiles. See EXHIBIT 4 for several of the years.

I believe that the above facts and application of the relevant statutes require you to reconsider your position and allow the claim for refund to be approved. If you need any additional information, please do not hesitate to contact me.

Very truly yours,

K. B. PARRISH & CO. LLP



Daniel J. Sullivan, CPA

DJS:ath

Enclosures

cc: Mr. Leo R. Boese

(letter only)

EXHIBIT: F
PAGE 3 OF 3



KRUSE MENNILLO LLP
ACCOUNTANTS AND MANAGEMENT CONSULTANTS

17777 CENTER COURT DRIVE, SUITE 550
CERRITOS, CA 90703
TEL 562 403 2560
FAX 562 403 2559
WWW.KRUSEMENNILLO.COM

VIA FACSIMILE (916.324.3984) AND UNITED STATES POSTAL SERVICE (CERTIFIED MAIL)

August 23, 2010

Board Proceedings Division, MIC:81
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0081
Attn: Mr. Anil Bali

**RE: Letter of Appeal from FTB Denial of Claim for Refund
Leo R. Boese (SS [REDACTED])
Taxable year 2007**

Dear Mr. Bali,

This formal letter of appeal is hereby filed on behalf of the above-named Taxpayer, Leo R. Boese ("Taxpayer"), appealing the denial of his claim for refund issued by the California Franchise Tax Board ("FTB") on or about May 24 2010. A copy of said denial letter is attached herein as **Exhibit A**. The Taxpayer respectfully requests that the Board of Equalization ("BOE") reconsider the FTB's denial of his refund claim for the reasons contained herein. In addition, the Taxpayer also respectfully requests a hearing before the BOE to discuss the points of difference between the FTB's position and the Taxpayer's position.

To reiterate, the Taxpayer named above DOES NOT agree with the denial of his refund claim issued by the FTB dated on or about May 24, 2010. The Taxpayer wishes to preserve whatever rights granted to them for administrative review of the FTB's denial of his refund claim beyond the specific requests of this letter. No statement in this letter should be interpreted as a waiver of any rights for administrative review for the above-named Taxpayer. Additionally, Taxpayer respectfully requests an oral hearing before the Board related to the instant appeal.

TAXPAYER NAME/ADDRESS/I.D.

Leo R. Boese
[REDACTED]

YEARS/AMOUNT OF REFUND CLAIM

<u>Year</u>	<u>Amount at issue</u>
2007	\$2,658,342 (capital gains to be excluded)

GROUND FOR APPEAL

Initially, the Taxpayer wishes to provide a brief summary of the FTB's position for the limited purposes of ensuring that the FTB's position is communicated clearly and providing a structure to the Taxpayer's response. Based on her review of Taxpayer's refund claim, the FTB agent Soni Mangat concluded that the gain from Taxpayer's sale of stock in Lebo Automotive should not be excluded from capital gain under IRC §1202(a) and R&TC §18152.5 because "Lebo Automotive, Inc., stock does not qualify as 'qualified small business stock' as required by R&TC §18152.5." Specifically, Ms. Mangat stated that "the taxpayer purchased the stock from an existing business and did not acquire the stock at its original issue" as required by R&TC §18152.5(c)(1)(B). Secondly, she found that "at the time of incorporation, Lebo Automotive, Inc. was not involved in an active business as the corporation lacked books, records and an inventory." Furthermore, she believed that "Lebo Automotive, Inc. was incorporated as an investing company" in direct contravention of R&TC §18152.5(e)(3). Based on those three grounds, Ms. Mangat denied Taxpayer's claim for refund pursuant to R&TC §18152.5.

Contrary to the FTB agent's findings, Taxpayer asserts that the \$2,658,342 gain from the sale of his stock in Lebo Automotive, Inc. should be excluded from capital gains because: 1) the stock was indeed original issue stock, issued in exchange for the assets of Manhattan Beach Toyota; 2) Lebo Automotive, Inc. was actively engaged in a trade or business for "substantially all" of Taxpayer's holding period; and 3) Lebo Automotive, Inc. was not engaged in the activity of investing but rather acquired Manhattan Beach Toyota as an asset purchase for income tax purposes pursuant to its IRC §338(h)(10) election. Accordingly, the sale of Taxpayer's share in Lebo Automotive, Inc. stock clearly meets the requirements of R&TC §18152.5 and should be excluded from capital gains.

FACTS

On April 14, 2000, Taxpayer Leo Boese ("Taxpayer") and AutoNation, Inc. ("AutoNation") entered into a stock purchase agreement wherein Taxpayer acquired from AutoNation all the outstanding common stock of Auto Nation Enterprises (wholly owned subsidiary of AutoNation, Inc. dba Manhattan Beach Toyota) ("Manhattan Beach Toyota") for \$5,814,000. See Amended and Restated Stock Purchase Agreement, Art. 1, Sec. 1.3 on p. 2, herein attached as **Exhibit B**. Both Taxpayer and AutoNation agreed to treat the stock purchase of Manhattan Beach Toyota as an asset purchase under IRC §338(h)(10). See **Exhibit B**, p. 18, sec. 5.9(d) of Amended and Restated Stock Purchase Agreement; see also 2000 IRS Form 1120, Statement 1, herein attached as **Exhibit C**. Consequently, the purchase price of the Manhattan

Beach Toyota stock was allocated to the underlying assets based on the fair market value at time of purchase.

On June 20, 2000, Lebo Automotive, Inc. was incorporated in the state of Delaware. See incorporating documents, herein attached as **Exhibit D**. On July 17, 2000, Manhattan Beach Toyota was merged into Lebo Automotive, Inc. under the Delaware merger statute and IRC §368(a). Taxpayer was issued 17,000 shares of Lebo Automotive, Inc., with the par value determined based on the fair market value of assets and cash contributed in the merger. The total value of Taxpayer's stock was \$17,000,000.

Taxpayer held his stock in Lebo Automotive, Inc. until March 16, 2007 and continued to actively operate a Toyota dealership franchise until then. On his 2007 income tax return, Taxpayer reported a gain from the sale of Lebo Automotive, Inc. stock for the full amount of the gain, \$2,658,342. Subsequent to the filing of the original 2007 return, Taxpayer amended his return to properly reflect the exclusion from capital gain based on the sale of Lebo Automotive, Inc. stock, pursuant to IRC §1202 and California R&TC §18152.5 exclusion for qualifying small business stock. See amended 2007 540X, herein attached as **Exhibit E**.

On or about October 21, 2009, the FTB informed Taxpayer that his amended 2007 income tax return was being reviewed, namely, the refund claim based on the exclusion of the gain from the sale of qualified small business stock. After collecting additional information and much correspondence with Taxpayer's representative, KB Parrish Co., LLP, on May 24, 2010, Ms. Mangat issued a formal denial of Taxpayer's claim for refund as stated in his amended 2007 tax return. See two FTB letters dated May 24, 2010, herein attached as **Exhibit F**.

TAXPAYER'S POSITION

A. Lebo Automotive, Inc. stock was original stock issued in exchange for the assets of Manhattan Beach Toyota.

Law

California Revenue & Taxation Code §18152.5 provides, in relevant part,

- (a) For purposes of this part, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years.
- (b) [...]
 - (2) For purposes of this subdivision, the term "eligible gain" means any gain from the sale or exchange of qualified small business stock held for more than five years.
 - [...]
- (c) (1) Except as otherwise provided in this section, the term "qualified small business stock" means any stock in a C corporation which is originally issued after August 10, 1993, if both of the following apply:
 - (A) As of the date of issuance, the corporation is a qualified small business.

(B) Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at its original issue (directly or through an underwriter) in either of the following manners:

- (i) **In exchange for money or other property** (not including stock).
- (ii) As compensation for services provided to the corporation (other than services performed as an underwriter of the stock).

[emphasis added]

Analysis

The subject stock that was sold and produced the gain that should be excluded from capital gains is that of Lebo Automotive, Inc., originally acquired by Taxpayer in 2000. It is apparent from her letters dated May 24, 2010 that Ms. Mangat erred in finding that the gain Taxpayer is seeking to exclude is that of Manhattan Beach Toyota stock; on the contrary, the stock at issue is the sale of Lebo Automotive, Inc. stock that was issued in 2000 and sold in 2007. As previously stated in Taxpayer's former representative's correspondence with Ms. Mangat, Lebo Automotive stock was indeed original issue stock, as Mr. Boese paid monetary consideration to purchase the assets of Manhattan Beach Toyota, which then merged into a new dealership under Lebo Automotive, Inc. The stock that was subsequently issued was that of Lebo Automotive, Inc., not Manhattan Beach Toyota, which no longer existed. See Lebo Automotive, Inc. stock certificate issued to Mr. Boese, attached herein as **Exhibit G**; see also Stock Purchase Agreement, **Exhibit B**.

Ms. Mangat additionally contends that based on the substance over form doctrine, the Lebo Automotive, Inc. stock is not original issue stock because the corporation was formed "as a conduit to acquire stock of an existing business," as opposed to a brand new business. According to Ms. Mangat, §18152.5 requires that the qualified stock to be that of a brand new corporation, not the result of a valid corporate merger. Ms. Mangat's interpretation of the statute is misplaced. No portion of the relevant statutes mandates the qualifying stock to be that of a "brand new corporation." The only relevant requirement of §18152.5(c)(1)(B) is that the original issue stock be acquired either "in exchange for money or other property" or "as compensation for services provided to the corporation." There is no mention that the stock must be that of a brand new business. Taxpayer here has satisfied that requirement by paying monetary consideration for the assets of Manhattan Beach Toyota, which merged into Lebo Automotive, Inc., the new corporation that issued the stock at issue. In other words, the stock that was sold and Taxpayer is seeking to exclude from capital gains is not Manhattan Beach Toyota stock but a new original issue stock that belonged to a corporation for which Taxpayer paid good consideration.

Therefore, it is unequivocal that the subject stock that was sold and should be excluded from capital gains (i.e., Lebo Automotive, Inc.) satisfies the original issue stock requirement of §18152.5(c)(1)(B).

B. Lebo Automotive, Inc. was engaged in an active trade or business for substantially all of Taxpayer's holding period.

Law

Section 18152.5(c)(2)(A) of CR&T Code provides,

Stock in a corporation shall not be treated as qualified small business stock unless, during **substantially all of the taxpayer's holding period** for the stock, the corporation meets the active business requirements of subdivision (e) and the corporation is a C corporation [emphasis added].

Analysis

Ms. Mangat apparently found that Taxpayer failed to satisfy the above-reference provision, namely, that Lebo Automotive, Inc. did not engage in active business during the holding period of the subject stock. Specifically, she states, "Since Lebo Automotive, Inc. was *not* involved in an active business prior to the purchase of Manhattan Beach Toyota, the Lebo Automotive, Inc. stock does not qualify as 'small business stock, as required by R&TC §18152.5(c)(2)(A)" [emphasis original]. See FTB letter dated May 11, 2010, p. 4, herein attached as **Exhibit H**.

While Ms. Mangat's statement regarding the fact that Lebo Automotive, Inc. was not engaged in active business prior to purchasing Manhattan Beach Toyota is accurate, her interpretation of the statutory provision is again misplaced. The language of the statute clearly states that the corporation whose stock qualifies as small business stock must be engaged in active business for "substantially all of the taxpayer's holding period," not the entire holding period. The word "substantially" is significant, as the Legislature could have easily chosen to require that the corporation be in active business mode for 100% of the holding period; but the Legislature did not. The logical conclusion is that the Legislature contemplated a scenario such as this, wherein for a short period of time (during formation or otherwise), a corporation is temporarily inactive in anticipation of acquiring another business.

Here, Taxpayer held Lebo Automotive, Inc. stock from June 20, 2000 (its date of incorporation) to March 16, 2007; Lebo Automotive, Inc. was engaged in an active automobile dealership from July 19, 2000 to March 16, 2007. It should be pointed out that rarely does a regular C-corporation have all the necessary assets, inventory, staff, books and records to operate on the day of incorporation. That is, the date of incorporation is generally the date on which the legal entity comes into formation and is granted status by the Secretary of State. In other words, a typical C-corporation the size of a renowned automobile franchise requires more time than a few hours to fund and capitalize its business, acquire assets and inventory, and hire sufficient staff to actively start operating. In the instant case, there was only one month out of nearly seven years that Lebo Automotive, Inc. was not actively engaged in a trade or business, which amounts to roughly 1% of the holding period. Therefore, a reasonable mind would surely agree that 99% qualifies as "substantially" all of the holding period.

Therefore, the FTB's position that Taxpayer did not satisfy the requirement of engaging in active business for "substantially" all of the holding period is without merit.

C. Lebo Automotive, Inc. did not merely engage in investment activities but actively conducted and operated an automobile dealership after the purchase of assets pursuant to its IRC §338(h)(10) election.

Law

CR&T §18152.5(e)(3) provides,

For purposes of this subdivision, the term "qualified trade or business" means any trade or business other than any of the following:

- (A) Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees.
- (B) Any banking, insurance, financing, leasing, investing, or similar business.
- (C) Any farming business (including the business of raising or harvesting trees).
- (D) Any business involving the production or extraction of products of a character with respect to which a deduction is allowable under Section 613 or 613A of the Internal Revenue Code.
- (E) Any business of operating a hotel, motel, restaurant, or similar business.

Analysis

Ms. Mangat further contends that Taxpayer did not engage in a qualified trade or business because according to her, "Lebo Automotive, Inc. was incorporated to acquire the outstanding capital stock of Manhattan Beach Toyota... The transaction clearly reflects that Lebo Automotive, Inc. was incorporated as an investing company which shortly after its incorporation acquired the outstanding stock of Manhattan Beach Toyota and started active participation in a qualified business of an auto dealership." See **Exhibit H**, p. 4. On this ground, the FTB concluded that Taxpayer did not satisfy the "qualified trade or business" requirement to exclude the gain from the sale of the corporate stock.

Here, Ms. Mangat again ignores the substance over form doctrine in her analysis of the facts. In a true investment scenario, the holding company would purchase only shares of the stock, not assets, of the company in which it is investing. In addition, a true investment company would hardly be actively engaged in the daily operation, sales, and financing of an automobile dealership. Nor would the investment company merge its business into that of the company whose shares are being held for investment purposes. In the instant situation, Mr. Boese formed Lebo Automotive, Inc. intentionally and factually to fully engage and participate in the running of an automobile dealership, as manifested in Lebo's purchase of Manhattan Beach Toyota's assets, including inventory,

fixtures, furniture, staff, and books and records. His intentions and actions clearly reflect the opposite of Ms. Mangat's contentions. Indeed, but for the one month in its corporate formation, Lebo Automotive, Inc. actually took over and operated the automobile franchise that was once owned by Manhattan Beach Toyota. It is also critical to note that the transaction resulted in the cancellation of Manhattan Beach Toyota stock, a fact that would not be present in a true investment scenario.

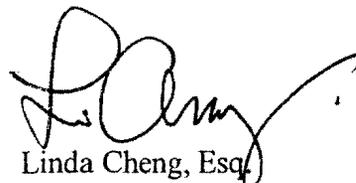
Also important to the analysis is the fact that Taxpayer (and AutoNation) elected to treat the stock purchase of Manhattan Beach Toyota as an asset purchase for income tax purposes, pursuant to IRC §338(h)(10). See **Exhibit C**. As correctly pointed out by K.B. Parrish & Co., LLP, IRC §1202(e)(5)(A) provides, in relevant part, "stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiaries' assets, and to conduct its ratable share of the subsidiaries' activities." Even more clear is the case here, wherein Lebo Automotive, Inc. purchases all the outstanding shares and assets of Manhattan Beach Toyota, effectuated a merger, and took over the entire operation of the Toyota franchise. In adhering to the substance over form doctrine, Lebo Automotive, Inc. was engaged in the qualified business of an automobile dealership, despite the fact it initially purchased the outstanding stock of another company.

CONCLUSION

Based on the foregoing facts and the analysis, the FTB's denial of Taxpayer's refund claim must be reversed, as the gain from Taxpayer's sale of qualified small business stock is excludable from capital gain pursuant to CR&T Code §18152.5.

Thank you in advance for your consideration of the instant appeal setting forth the Taxpayer's position. We look forward to receiving notice regarding the oral hearing shortly. Should you wish to discuss the issues in-depth or have further questions, please feel free to contact me at the above-listed telephone number or mailing address.

Sincerely,



Linda Cheng, Esq.
Senior Tax Consultant
Kruse Mennillo, LLP

Encl.

Cc: Client
K.B. Parrish



KRUSE MENNILLO LLP
ACCOUNTANTS AND MANAGEMENT CONSULTANTS

17777 CENTER COURT DRIVE, SUITE 550
CERRITOS, CA 90703
TEL 562 403 2560
FAX 562 403 2559
WWW.KRUSEMENNILLO.COM

VIA FACSIMILE (916.324.3984) AND UNITED STATES POSTAL SERVICE (CERTIFIED MAIL)

January 4, 2011

Board Proceedings Division, MIC:81
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0081
Attn: Mr. Anil Bali

RE: Response to Franchise Tax Board (Respondent's) Opening Brief dated December 8, 2010

Case ID No. [REDACTED]

Taxable year 2007

Dear Sir or Madam:

This formal response brief is hereby filed on behalf of the above-named Taxpayer, Leo R. Boese ("Taxpayer"), in response to the California Franchise Tax Board ("FTB") filed opening brief which was filed on or about December 8, 2010. A copy of said brief is attached as **Exhibit A**. The Taxpayer respectfully requests that the Board of Equalization ("BOE") reconsider the FTB's denial of his refund claim for the reasons contained herein. In addition, the Taxpayer also respectfully requests a hearing before the BOE to discuss the points of difference between the FTB's position and the Taxpayer's position.

To reiterate, the Taxpayer named above DOES NOT agree with the denial of his refund claim issued by the FTB dated on or about May 24, 2010. The Taxpayer wishes to preserve whatever rights granted to them for administrative review of the FTB's denial of his refund claim beyond the specific requests of this letter. No statement in this letter should be interpreted as a waiver of any rights for administrative review for the above-named Taxpayer. Additionally, Taxpayer respectfully requests an oral hearing before the Board related to the instant appeal.

TAXPAYER NAME/ADDRESS/I.D.

[REDACTED]

YEARS/AMOUNT OF REFUND CLAIM

<u>Year</u>	<u>Amount at issue</u>
2007	\$2,658,342 (capital gains to be excluded)

GROUND FOR APPEAL

Initially, the Taxpayer wishes to provide a brief summary of the FTB's position for the limited purposes of ensuring that the FTB's position is communicated clearly and providing a structure to the Taxpayer's response. Based on her review of Taxpayer's refund claim, the FTB agent Soni Mangat concluded that the gain from Taxpayer's sale of stock in Lebo Automotive should not be excluded from capital gain under IRC §1202(a) and R&TC §18152.5 because "Lebo Automotive, Inc., stock does not qualify as 'qualified small business stock' as required by R&TC §18152.5." Specifically, Ms. Mangat stated that "the taxpayer purchased the stock from an existing business and did not acquire the stock at its original issue" as required by R&TC §18152.5(c)(1)(B). Secondly, she found that "at the time of incorporation, Lebo Automotive, Inc. was not involved in an active business as the corporation lacked books, records and an inventory." Furthermore, she believed that "Lebo Automotive, Inc. was incorporated as an investing company" in direct contravention of R&TC §18152.5(e)(3). Based on those three grounds, Ms. Mangat denied Taxpayer's claim for refund pursuant to R&TC §18152.5.

Contrary to the FTB agent's findings, Taxpayer asserts that the \$2,658,342 gain from the sale of his stock in Lebo Automotive, Inc. should be excluded from capital gains because: 1) the stock was indeed original issue stock, issued in exchange for the assets of Manhattan Beach Toyota; 2) Lebo Automotive, Inc. was actively engaged in a trade or business for "substantially all" of Taxpayer's holding period; and 3) Lebo Automotive, Inc. was not engaged in the activity of investing but rather acquired Manhattan Beach Toyota as an asset purchase for income tax purposes pursuant to its IRC §338(h)(10) election. Accordingly, the sale of Taxpayer's share in Lebo Automotive, Inc. stock clearly meets the requirements of R&TC §18152.5 and should be excluded from capital gains.

The Franchise Tax Board (Respondent's Opening Brief) dated December 3, 2010 further narrows the focus of the appeal to one issue. The issue that is argued focuses on the issuance of new business stock. The Respondent cites the facts as he understands them and relies on previous assertions made by the taxpayer's representative. The focus of this response is to outline the facts as they truly happened and not as they may have been assumed or thought to have happened.

FACTS

The taxpayer, rather than rehash the same arguments that have been made previously in the "Letter of Appeal from FTB Denial of Claim for Refund" dated August 23, 2010, wishes to

clarify certain "Facts" as stated in the "Respondent's Opening Brief" dated on or about December 3, 2010.

First, the facts as outlined by the respondent under fact 3. page 4 attributes to the representative for Lebo Automotive as stating "[Old] Manhattan Beach Toyota" was merged into Lebo Automotive, Inc [New Manhattan Beach Toyota] under the Delaware merger statute and Sec. 368(a) of the Internal Revenue Code. This statement is factually incorrect as both Lebo Automotive and AutoNation both knew that this purchase was to be accounted for as an asset purchase under Sec 338(h)(10) of the Internal Revenue Code. Whether stated by the appellant's representative or not, the statement asserted above is factually incorrect. For evidence of this I refer to:

1. The Stock purchase agreement, page 18 Sec. 5.9(d) provided for the making of a Sec. 338(h)(10) election treating the entire transaction as an asset purchase.
2. The tax year 2000 tax return for Lebo Automotive, Inc. shows a beginning date of July 17, 2000 through December 31, 2000 as its taxable year. This is consistent with a split of the tax year between the old Manhattan Beach Toyota (with AutoNation picking up the January 1 through July 16, 2000 income on its consolidated tax return) and the Lebo Automotive, Inc..
3. The Lebo Automotive, Inc. tax year 2000 tax return statement 1 shows that the Sec. 338(h)(10) election was properly made on the timely filed tax return.
4. No merger documents were filed with the Lebo Automotive, Inc. 2000 tax return nor with the Delaware Secretary of State office.

The respondent brief further attributes to appellant's representative that ****The Lebo Automotive [New Manhattan Beach Toyota] stock did not exist until Mr. Boese exchanged the [Old] Manhattan Beach [Toyota] stock for it.**** Again this statement is simply factually incorrect on its face. You simply can't exchange what yet hasn't been created. Stock was issued by the newly formed Lebo Automotive, Inc (Delaware Corporation) to Mr. Boese on or about June 20, 2000. The issuance was for 17,000 shares on share certificate No. 1 as original issue. This stock certificate was never cancelled. Respondent agrees that 17,000 shares of stock were issued by Lebo Automotive in exchange for \$1,700,000 from Mr. Boese. This was the initial capitalization of Lebo Automotive, Inc.

TAXPAYER'S POSITION

Lebo Automotive, Inc. stock was original stock issued in exchange for the assets of Manhattan Beach Toyota.

Law

California Revenue & Taxation Code §18152.5 provides, in relevant part,

- (a) For purposes of this part, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years.
- (b) [...]

(2) For purposes of this subdivision, the term “eligible gain” means any gain from the sale or exchange of qualified small business stock held for more than five years.

[...]

(c) (1) Except as otherwise provided in this section, the term “qualified small business stock” means any stock in a C corporation which is originally issued after August 10, 1993, if both of the following apply:

(A) As of the date of issuance, the corporation is a qualified small business.

(B) Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at its original issue (directly or through an underwriter) in either of the following manners:

(i) **In exchange for money or other property** (not including stock).

(ii) As compensation for services provided to the corporation (other than services performed as an underwriter of the stock).

[emphasis added]

Analysis

The subject stock that was sold and produced the gain that should be excluded from capital gains is that of Lebo Automotive, Inc., originally acquired by Taxpayer in 2000. It is apparent from Respondent’s brief dated December 3, 2010, that the only argument Respondent has against the finding of Lebo Automotive qualifying as small business stock is that Mr. Boese obtained his stock in Lebo Automotive (New Manhattan Beach Toyota) in exchange for other stock. As can be seen from the facts and the exhibits that were presented, the newly formed Lebo Automotive, Inc originally issued 17,000 shares of stock (in fact the only corporate issued shares of common stock throughout the corporation’s history) to Mr. Boese for \$1,700,000 of consideration.

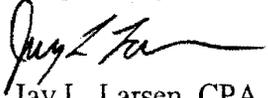
The respondent spends considerable time addressing the “supposed merger” of the “Old Manhattan Beach Toyota” with the Lebo Automotive, Inc. “New Manhattan Beach Toyota”. No where does the respondent show that the two corporations actually merged. Respondent at best cites the “Amended and Restated Stock Purchase Agreement” as though because it says “Amended and Restated Stock Purchase Agreement” so it must be so. Yet Respondent does not respect that the substance of the transaction was that of an asset purchase as both parties contemplated in the “Amended and Restated Stock Purchase Agreement” with the ability of both parties to treat the transaction as a Sec. 338(h)(10) transaction. (See page 18 of the Amended and Restated Stock Purchase Agreement)

Respondent fails to grasp the true nature of the whole transaction. Mr. Boese entered into this transaction to essentially acquire one asset only. That one asset was the franchise rights to sell Toyota vehicles. Without this franchise right, Mr. Boese could not sell Toyota vehicles or conduct business as an automotive franchise. Once Lebo Automotive acquired the franchise rights to sell Toyota’s, Lebo Automotive then acquired rights, subject to Toyota’s approval, to expand the store, move the store or subsequently sell those rights.

On page 2 of the “Amended and Restated Stock Purchase Agreement” Mr. Boese was to pay a purchase price of \$5,814,000 for [Old] Manhattan Beach Toyota. This purchase price was then subsequently placed on the books of Lebo Automotive \$5,269,716 as an intangible asset for the Toyota franchise rights. (See Schedule L Balance Sheet of the 2000 Lebo Automotive tax return

intangible assets). The approximate difference of \$544,000 was attributed to the purchase of fixed assets.

Respectfully submitted,



Jay L. Larsen., CPA, JD

Encl.

Cc: Client
K.B. Parrish



State of California
Franchise Tax Board

P.O. Box 1673
Sacramento CA 95812-1673
ftb.ca.gov

10-21-09

BOESE, LEO R.
[REDACTED]

Date: 10.21.09
Case: 18570389976875116
Case Unit: 18570389976875166
In reply refer to: 343:SM:F381

Regarding: California Income Tax Examination
Account Number: [REDACTED]
Taxpayer's Name: BOESE, LEO R.
Taxable Year: 2007

I am reviewing your amended California personal income tax return for the year listed above.

The amended 2007 California return reports an IRC § 1202 exclusion of \$2,658,342. California did not conform to IRC § 1202. California docs, however, have similar provisions for the exclusion of the gain from the sale of qualified small business stock (CR&TC § 18152.5).

Please provide the following information and/or documents:

1. The name and corporate number of the corporation claimed as a qualifying small business.
2. Documentation that the corporation met the requirements of CR&TC § 18152.5(c):
 - a. The corporation is a c corporation (c)(1),
 - b. Date of the original issuance of the stock. It must be issued after August 10, 1993 (c)(1),
 - c. Your purchase of the stock was at its original issuance (c)(1),
 - d. The corporation was a qualified small business at the date of issuance (c)(1)(A),
 - e. At substantially all times during your stock holding period, 80% (by value) of corporate assets are in California (e)(1)(A), referenced by (c)(2)(A),
 - f. At substantially all times during your stock holding period, 80% of the corporation's payroll expense is attributed to California (e)(9), referenced by (c)(2)(A).
3. Documentation that the corporation is a qualified small business as defined in CR&TC § 18152.5 (d).

10.21.09

Account Number

: [REDACTED]
: 18570389976875166

Case Unit

Page 2

- a. Aggregate gross assets at all times on or after July 1, 1993 and before the stock issuance did not exceed \$50,000,000 (d)(1)(A),
 - b. Immediately after the issuance the gross assets did not exceed \$50,000,000 (d)(1)(B),
 - c. At least 80% of the corporation's payroll, as measured by total dollar value, is attributable to employment in California (d)(1)(C).
4. The company may meet the requirements of subdivisions and/or paragraphs of CR&TC § 18152.5 other than those cited above. If so, please provide documentation.

Please provide the requested information by 11/21/2009. To ensure proper handling, attach a copy of this letter to your response and send to:

Franchise Tax Board
Attn: 343:SM:F381
P.O. Box 1673
Sacramento CA 95812-1673

If we need additional information to close this case, we would like permission to call you or your representative during weekdays between 8:00 am and 4:00 pm. Please indicate the best time to call.

Person to Contact: _____ Time: _____

Telephone Number: _____ Extension: _____

Taxpayer's Signature: _____ Date: _____

Spouse's Signature: _____ Date: _____

If the Internal Revenue Service has notified you of an audit or if they have completed an audit of your personal income tax returns for any tax year(s) in question, please provide a copy of their initial contact letter and/or a copy of the completed audit report, if applicable.

10.21.09
Account Number : [REDACTED]
Case Unit : 18570389976875166
Page 3

Thank you for your cooperation. Please call me at the telephone number listed below if you have questions regarding this matter.

Soni Mangat
Soni Mangat
Telephone: (916) 845-5376
Fax: (916) 843-1020

Enclosure: FTB 1015B Frequently Asked Questions About Your Tax Audit

If you have any questions or concerns regarding the audit process and are unable to resolve them with the auditor, you may contact either¹:

¹ Sandy Gemmingen, Audit Supervisor.....(916) 845-3361
Kelly Heckman, Personal Income Tax Manager.....(916) 845-4515

1 STATE OF CALIFORNIA
2 FRANCHISE TAX BOARD
3 Legal Division
4 Ann H. Hodges, Tax Counsel IV
5 PO Box 1720
6 Rancho Cordova CA 95741-1720
7 (916) 845-3088

8 Respondent's Representative

9 BEFORE THE STATE BOARD OF EQUALIZATION
10 OF THE STATE OF CALIFORNIA

11 In the Matter of the Appeal of:) Appeal Case ID No. 547667
12)
13)
14)
15)
16)
17)
18)
19)
20)
21)
22)
23)
24)
25)
26)
27)
28)
29)
30)
31)
32)
33)
34)
35)
36)
37)
38)
39)
40)
41)
42)
43)
44)
45)
46)
47)
48)
49)
50)
51)
52)
53)
54)
55)
56)
57)
58)
59)
60)
61)
62)
63)
64)
65)
66)
67)
68)
69)
70)
71)
72)
73)
74)
75)
76)
77)
78)
79)
80)
81)
82)
83)
84)
85)
86)
87)
88)
89)
90)
91)
92)
93)
94)
95)
96)
97)
98)
99)
100)
101)
102)
103)
104)
105)
106)
107)
108)
109)
110)
111)
112)
113)
114)
115)
116)
117)
118)
119)
120)
121)
122)
123)
124)
125)
126)
127)
128)
129)
130)
131)
132)
133)
134)
135)
136)
137)
138)
139)
140)
141)
142)
143)
144)
145)
146)
147)
148)
149)
150)
151)
152)
153)
154)
155)
156)
157)
158)
159)
160)
161)
162)
163)
164)
165)
166)
167)
168)
169)
170)
171)
172)
173)
174)
175)
176)
177)
178)
179)
180)
181)
182)
183)
184)
185)
186)
187)
188)
189)
190)
191)
192)
193)
194)
195)
196)
197)
198)
199)
200)
201)
202)
203)
204)
205)
206)
207)
208)
209)
210)
211)
212)
213)
214)
215)
216)
217)
218)
219)
220)
221)
222)
223)
224)
225)
226)
227)
228)
229)
230)
231)
232)
233)
234)
235)
236)
237)
238)
239)
240)
241)
242)
243)
244)
245)
246)
247)
248)
249)
250)
251)
252)
253)
254)
255)
256)
257)
258)
259)
260)
261)
262)
263)
264)
265)
266)
267)
268)
269)
270)
271)
272)
273)
274)
275)
276)
277)
278)
279)
280)
281)
282)
283)
284)
285)
286)
287)
288)
289)
290)
291)
292)
293)
294)
295)
296)
297)
298)
299)
300)
301)
302)
303)
304)
305)
306)
307)
308)
309)
310)
311)
312)
313)
314)
315)
316)
317)
318)
319)
320)
321)
322)
323)
324)
325)
326)
327)
328)
329)
330)
331)
332)
333)
334)
335)
336)
337)
338)
339)
340)
341)
342)
343)
344)
345)
346)
347)
348)
349)
350)
351)
352)
353)
354)
355)
356)
357)
358)
359)
360)
361)
362)
363)
364)
365)
366)
367)
368)
369)
370)
371)
372)
373)
374)
375)
376)
377)
378)
379)
380)
381)
382)
383)
384)
385)
386)
387)
388)
389)
390)
391)
392)
393)
394)
395)
396)
397)
398)
399)
400)
401)
402)
403)
404)
405)
406)
407)
408)
409)
410)
411)
412)
413)
414)
415)
416)
417)
418)
419)
420)
421)
422)
423)
424)
425)
426)
427)
428)
429)
430)
431)
432)
433)
434)
435)
436)
437)
438)
439)
440)
441)
442)
443)
444)
445)
446)
447)
448)
449)
450)
451)
452)
453)
454)
455)
456)
457)
458)
459)
460)
461)
462)
463)
464)
465)
466)
467)
468)
469)
470)
471)
472)
473)
474)
475)
476)
477)
478)
479)
480)
481)
482)
483)
484)
485)
486)
487)
488)
489)
490)
491)
492)
493)
494)
495)
496)
497)
498)
499)
500)
501)
502)
503)
504)
505)
506)
507)
508)
509)
510)
511)
512)
513)
514)
515)
516)
517)
518)
519)
520)
521)
522)
523)
524)
525)
526)
527)
528)
529)
530)
531)
532)
533)
534)
535)
536)
537)
538)
539)
540)
541)
542)
543)
544)
545)
546)
547)
548)
549)
550)
551)
552)
553)
554)
555)
556)
557)
558)
559)
560)
561)
562)
563)
564)
565)
566)
567)
568)
569)
570)
571)
572)
573)
574)
575)
576)
577)
578)
579)
580)
581)
582)
583)
584)
585)
586)
587)
588)
589)
590)
591)
592)
593)
594)
595)
596)
597)
598)
599)
600)
601)
602)
603)
604)
605)
606)
607)
608)
609)
610)
611)
612)
613)
614)
615)
616)
617)
618)
619)
620)
621)
622)
623)
624)
625)
626)
627)
628)
629)
630)
631)
632)
633)
634)
635)
636)
637)
638)
639)
640)
641)
642)
643)
644)
645)
646)
647)
648)
649)
650)
651)
652)
653)
654)
655)
656)
657)
658)
659)
660)
661)
662)
663)
664)
665)
666)
667)
668)
669)
670)
671)
672)
673)
674)
675)
676)
677)
678)
679)
680)
681)
682)
683)
684)
685)
686)
687)
688)
689)
690)
691)
692)
693)
694)
695)
696)
697)
698)
699)
700)
701)
702)
703)
704)
705)
706)
707)
708)
709)
710)
711)
712)
713)
714)
715)
716)
717)
718)
719)
720)
721)
722)
723)
724)
725)
726)
727)
728)
729)
730)
731)
732)
733)
734)
735)
736)
737)
738)
739)
740)
741)
742)
743)
744)
745)
746)
747)
748)
749)
750)
751)
752)
753)
754)
755)
756)
757)
758)
759)
760)
761)
762)
763)
764)
765)
766)
767)
768)
769)
770)
771)
772)
773)
774)
775)
776)
777)
778)
779)
780)
781)
782)
783)
784)
785)
786)
787)
788)
789)
790)
791)
792)
793)
794)
795)
796)
797)
798)
799)
800)
801)
802)
803)
804)
805)
806)
807)
808)
809)
810)
811)
812)
813)
814)
815)
816)
817)
818)
819)
820)
821)
822)
823)
824)
825)
826)
827)
828)
829)
830)
831)
832)
833)
834)
835)
836)
837)
838)
839)
840)
841)
842)
843)
844)
845)
846)
847)
848)
849)
850)
851)
852)
853)
854)
855)
856)
857)
858)
859)
860)
861)
862)
863)
864)
865)
866)
867)
868)
869)
870)
871)
872)
873)
874)
875)
876)
877)
878)
879)
880)
881)
882)
883)
884)
885)
886)
887)
888)
889)
890)
891)
892)
893)
894)
895)
896)
897)
898)
899)
900)
901)
902)
903)
904)
905)
906)
907)
908)
909)
910)
911)
912)
913)
914)
915)
916)
917)
918)
919)
920)
921)
922)
923)
924)
925)
926)
927)
928)
929)
930)
931)
932)
933)
934)
935)
936)
937)
938)
939)
940)
941)
942)
943)
944)
945)
946)
947)
948)
949)
950)
951)
952)
953)
954)
955)
956)
957)
958)
959)
960)
961)
962)
963)
964)
965)
966)
967)
968)
969)
970)
971)
972)
973)
974)
975)
976)
977)
978)
979)
980)
981)
982)
983)
984)
985)
986)
987)
988)
989)
990)
991)
992)
993)
994)
995)
996)
997)
998)
999)
1000)

Refund	Year	Amount
	2007	\$2,658,342 ¹

RESPONDENT'S OPENING BRIEF

RECEIVED
DEC 8 - 2010
Board Proceedings

¹ Respondent notes that this represents the amount of the exclusion of gain from the sale of stock reported by appellant on his amended return and not the amount of refund of tax paid of \$250,206 claimed by appellant.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

INTRODUCTION

Appellant, Leo Boese, appeals from the action of respondent in denying his claim for refund in the amount of \$250,206 for tax year 2007.

ISSUE

Whether appellant's purchase of an auto dealership meets the requirements of the qualified small business stock provisions designed to encourage taxpayers to make investments in new businesses or a new investment in an existing business?

BACKGROUND

The issue in this appeal concerns appellant's exclusion of gain from his sale of stock which he contends is qualified small business stock. The qualified small business stock statutes provide for two tax incentives, one of which is relevant to this appeal: a taxpayer may exclude 50 percent of the gain from the sale of qualified small business stock.² (See Rev. and Tax. Code section 18152.5.) The California qualified small business stock statutory scheme was intended to mirror the federal qualified small business stock statutory scheme with the exception of limiting the incentives to investments in California businesses.

In 1993, Congress enacted legislation permitting taxpayers to exclude from taxable income 50 percent of the gain derived from the sale of qualified small business stock as part of the Omnibus Budget Reconciliation Act of 1993. (See P.L. 103-66, Sec. 13113(a).) Similarly, in 1993, the California Legislature enacted similar exclusion from gain statutes dealing with the sale of qualified small business stock. (Stats. 1993, Ch. 881, SB 671.) The legislature stated its intent with respect to the small business stock statutes as follows:

This bill conforms to the recently enacted federal tax provisions relating to small business investment, but only for an investment in small California businesses. [Emphasis added.]

(See Exhibit A, SB 671 Bill Analysis, Senate Committee on Revenue and Taxation, as amended 9/9/93, page 7.)

The purpose of the qualified small business stock statutes was to encourage new investments in qualified small businesses. Furthermore, the intent was that the primary purpose

² The incentive not relevant to this appeal is that a taxpayer may defer gain from the sale of qualified small business stock if the taxpayer invests in other qualified small business stock within sixty days from the date of the sale. (See Rev. and Tax. Code section 18038.5.)

1 was to encourage investment in new businesses. This intent is reflected in comments made by
2 Congressman Kleczka upon the enactment of the qualified small business stock legislation in
3 which he discusses the qualified small business stock provisions as incentives to encourage
4 investments in new businesses and other legislation designed to assist existing businesses:

5 Lastly, with this package we addressed the concerns of small businesses, the engine driving
6 job growth today. The bill provides a 50-percent cut in the capital gains tax to investors who
7 hold onto stock in a small business for 5 years, giving investors an incentive to contribute to
8 the creation of *new businesses*. For *existing companies*, this budget plan expands the
expensing provision for purchases of equipment by 75 percent, from \$10,000 a year now up
to \$17,500. *** [emphasis added.]

9 (Exhibit B, The House's Passage of the 1993 Budget Reconciliation Act, Hon. Gerald D. Kleczka,
Extension of Remarks - August 6, 1993.)

10 Furthermore, the qualified small business stock statutory scheme reflects the fact
11 that these statutes were enacted to generate new investments. First, the statute prohibits a
12 taxpayer from acquiring small business stock from an existing shareholder. It specifically requires
13 that the stock be acquired in an original issuance³ in exchange for money or other property (not
14 including stock):

15 (1) Except as otherwise provided in this section, the term "qualified small business stock"
16 means any stock in a C corporation which is **originally issued** after August 10, 1993, if both
of the following apply:

17 (A) As of the date of issuance, the corporation is a qualified small business.

18 (B) Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at
its original issue (directly or through an underwriter) in either of the following manners:

19 (i) In exchange for money or other property (not including stock).

20 (ii) As compensation for services provided to the corporation (other than services
performed as an underwriter of the stock). [emphasis added.]

21 (Rev. and Tax. Code section 18152.5, subdv. (c)(1).)

22 ³ An issuance is defined as:

23 The issuance of shares of a corporation historically has been held to refer to the act or
24 contract of the corporation by which shares become owned by a person as a member or
25 shareholder of the corporation. The particular time when a share originally comes into
26 existence and is deemed "issued" traditionally has been viewed as being affected by the
intent of the parties. Their contract may be examined to ascertain what arrangements they
made concerning such issuance.

27 (4 Ballantine & Sterling, Cal. Corporation Laws (Rev. 4th ed. 2005) § 123.03[2], (rel. 91-9/05).)

28 Furthermore, an original issuance is "[t]he first issue of securities of a particular type
or series." (Exhibit C, Black's Law Dict. (8th ed. 1999), p. 849, col. 2.)

1 Second, in order to prevent further evasion of the requirement that the stock
2 issuance generate a new investment for the issuing corporation, the exclusion does not apply to
3 stock that was previously redeemed by the corporation in certain circumstances. (See Rev. and
4 Tax. Code section 18152.5(c)(3).)

5 FACTS

6 Appellant operated car dealership(s) in the Manhattan Beach, California metropolitan
7 area. In April of 2000, appellant entered into a stock purchase agreement to obtain an existing
8 Manhattan Beach Toyota dealership ("Old Manhattan Beach Toyota") owned and operated by a
9 subsidiary of Auto Nation, Inc. (Auto Nation). (See Appeal Letter, Exhibit B, Amended and Restated
10 Stock Purchase Agreement dated April 14, 2000.) According to Auto Nation's SEC filings, as of the
11 end of 2000:

12 AutoNation, Inc. is the largest automotive retailer in the United States. As of December 31,
13 2000, we owned and operated approximately 400 new vehicle franchises from dealership
14 locations in major metropolitan markets in 18 states, predominantly in the Sunbelt. ***4

15 During 2000, we also completed the sale of various non-core franchised new vehicle
16 dealerships for an aggregate sale price of approximately \$89.7 million. ***

17 Total revenue was \$20.61 billion*** for the year[.] ended December 31, 2000***

18 (Exhibit D, Auto Nation's 2000 Form 10K, pages 2 to 4.)

19 Appellant's purchase of the Old Manhattan Beach Toyota stock was the first of
20 several steps which culminated in appellant's exchange of Old Manhattan Beach Toyota stock for
21 New Manhattan Beach Toyota stock. The New Manhattan Beach Toyota stock is the stock
22 appellant's contends is qualified small business stock and for which he is entitled to exclude 50
23 percent of the gain from its subsequent sale. These steps occurred over a total time period of three
24 months as follows:

25 1. Step One, Appellant Purchases Old Manhattan Beach Toyota Stock (April 14, 2000):

26 On April 14, 2000, appellant (as an individual) entered into an amended and
27 restated stock purchase agreement with AutoNation, Inc. (See Appeal Letter, Exhibit B, page 1.)

28 ⁴ Furthermore, in the stock purchase agreement, appellant acknowledged that "Auto Nation
(together with its affiliates) is the largest automotive retailer in the world...." (See Appeal Letter,
Exhibit B, Article 5, ADDITIONAL AGREEMENTS, ¶ 5.3.)

1 Appellant (as an individual) agreed to purchase all of the outstanding stock of "Manhattan Beach
2 Motors, Inc. dba Manhattan Toyota" or Old Manhattan Beach Toyota. (*Id.* at Article 1, ¶ 1.2 The
3 Purchase.) The agreement specifically provided that Auto Nation would sell, assign, transfer and
4 convey all of the stock of Old Manhattan Beach Toyota to appellant on the closing date. (*Id.*)
5 Furthermore, on the closing date, appellant would pay \$5,814,000 for the stock. (*Id.* at ¶1.3
6 Purchase Price.) The closing date was either the date certain conditions were met or waived or by
7 mutual agreement. (*Id.* at ¶ 1.1 The Closing.) Appellant has not established the exact closing date
8 but it appears to be sometime prior to July 13, 2000.

9 **2. Step 2, Lebo Automotive, dba Manhattan Beach Toyota Incorporates ("New Manhattan
10 Beach Toyota") (June 20, 2000 and July 13, 2000):**

11 On June 20, 2000, Lebo Automotive, Inc. dba Manhattan Beach Toyota (New
12 Manhattan Beach Toyota) incorporated in Delaware. (Appeal Letter, Exhibit D, Delaware Certificate
13 of Incorporation for Lebo Automotive dated June 20, 2000.) On July 13, 2000, Lebo Automotive
14 (New Manhattan Beach Toyota) qualified to do business in California. (Exhibit E.)

15 **3. Step 3, Old Manhattan Beach Toyota Merges Into New Manhattan Beach Toyota and
16 Appellant Exchanges His Stock in Old Manhattan Beach Toyota Stock for New Manhattan
17 Beach Toyota Stock (July 17, 2000.)**

18 Appellant acquired his Lebo Automotive (New Manhattan Beach Toyota) stock in
19 exchange for the Old Manhattan Beach Toyota stock as follows. According to appellant's
20 representative during the audit:

21 On April 14, 2000, Mr. Leo Boese (buyer) and AutoNation, Inc. (seller) entered into a stock
22 purchase agreement for the acquisition of all the outstanding common stock of [Old
23 Manhattan Beach Toyota].***

24 Lebo Automotive, Inc. [New Manhattan Beach Toyota] was incorporated in the State of
25 Delaware on June 20, 2000. On July 17, 2000, [Old] Manhattan Beach Toyota] was merged
26 into Lebo Automotive, Inc. [New Manhattan Beach Toyota] under the Delaware merger
27 statute and §368(a) of the Internal Revenue Code. Mr. Boese was issued 17,000 shares,
28 with the par value determined based on the fair market value of assets and cash
contributed in the merger. The total value of Mr. Boese's stock was \$1,700,000. ***

***The Lebo Automotive [New Manhattan Beach Toyota] stock did not exist until Mr. Boese
exchanged the [Old] Manhattan Beach [Toyota] Stock for it.***

(Exhibit F, Correspondence from Appellant's Representative to Respondent's Auditor dated May 17,
2010, page 1 et seq.)

1 As a result, appellant received his stock in New Manhattan Beach Toyota in exchange
2 for the stock of Old Manhattan Beach Toyota. (See also, Appeal Letter, page 2.)

3 Subsequently, on March 16, 2007, appellant sold his New Manhattan Beach Toyota
4 stock. (See Appeal Letter, Exhibit E, Appellant's 2007 Forms 1040X and 540X.) Appellant
5 reported gain from the sale in the amount of \$5,316,683 on his original return. (*Id.*) On an
6 amended 2007 Form 540, appellant reported he was entitled to exclude 50 percent of that gain or
7 \$2,658,342. (*Id.*) Respondent denied appellant's claim and this timely appeal followed. (Appeal
8 Letter, Exhibit A.)

9 ARGUMENT

10 THE LEBO AUTOMOTIVE (NEW MANHATTAN BEACH TOYOTA) STOCK CANNOT BE
11 CONSIDERED QUALIFIED SMALL BUSINESS STOCK BECAUSE APPELLANT OBTAINED HIS
12 STOCK IN LEBO AUTOMOTIVE (NEW MANHATTAN BEACH TOYOTA) IN EXCHANGE FOR OTHER
13 STOCK.

14 Appellant contends he is entitled to exclude 50 percent of the gain from his sale of
15 Lebo Automotive (New Manhattan Beach Toyota) stock because it was qualified small business
16 stock. As set forth above, appellant obtained his stock in Lebo Automotive (New Manhattan Beach
17 Toyota) in exchange for the stock of Old Manhattan Beach Toyota pursuant to a statutory merger,
18 i.e. Internal Revenue Code section 368(a). (Rev. and Tax. Code section 18152.5.)

19 An Internal Revenue Section 368(a) transaction is a statutory merger or
20 consolidation. The actual steps of a statutory merger or consolidation are as follows:

21 Under § 368(a)(1)(A), *** one corporation absorbs the corporate enterprise of another
22 corporation, with the result that the acquiring company steps into the shoes of the
23 disappearing corporation as to its assets and liabilities. ***

24 Example

25 While an applicable state law plan of merger of X into Y typically provides that the articles of
26 merger will be filed and thereafter the X shareholders will deliver their X shares to Y's agent
27 from which they will receive Y shares in exchange, for tax purposes the transaction is treated
28 as though X has transferred its property to Y for Y stock and then has dissolved, distributing
the Y stock to its shareholders in exchange for their X stock. ***

(Bittker and Eustice, Federal Income Taxation of Corporations and Their Shareholders, ¶ 12.22
Statutory Mergers and Consolidations (Type A Reorganization), ¶ 12.22[1] In General.)

///

1 The relevant Revenue and Taxation code provision prohibits a taxpayer from
2 acquiring qualified small business stock in exchange or other stock as follows:

3 (c) For purposes of this section:

4 (1) Except as otherwise provided in this section, the term "qualified small business stock"
5 means any stock in a C corporation which is originally issued after August 10, 1993, if
6 both of the following apply:

7 (A) As of the date of issuance, the corporation is a qualified small business.

8 (B) Except as provided in subdivisions (f) and (h), the stock is acquired by the taxpayer at
9 its original issue (directly or through an underwriter) in either of the following manners:

10 (i) In exchange for money or other property (*not including stock*).

11 (ii) As compensation for services provided to the corporation (other than services
12 performed as an underwriter of the stock). [emphasis added.]

13 Therefore, because appellant acquired the Lebo Automotive (New Manhattan Beach
14 Toyota) stock in exchange for "other stock", i.e. the Old Manhattan Beach Toyota stock, the Lebo
15 Automotive stock cannot be considered qualified small business stock and appellant is not entitled
16 to exclude gain from the sale of such stock.

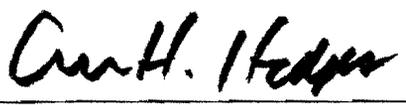
17 As a policy matter, this result is appropriate because appellant did not make a "new
18 investment" in Manhattan Beach Toyota. Appellant presumably paid only the fair market value for a
19 pre-existing business which represented the return of the investment of the previous owner. As set
20 forth above, the purpose of the qualified small business stock statutes was to encourage new
21 investments in qualified small businesses.

22 CONCLUSION

23 For the reasons stated above, respondent requests that its action be sustained.

24 Respectfully submitted,

25 FRANCHISE TAX BOARD

26 By 
27 Ann H. Hodges
28 Tax Counsel IV

Date:

9/09/93

BILL ANALYSIS
SB 671 - Alquist
(amended 9/9/93)

SUBJECT: Personal Income Tax, Bank & Corporation Tax, Sales Taxes: Unitary method of apportionment, 6% manufacturing credit, reduction in Sub S rate, Exemption for start-up manufacturers and space launches from Vandenburg, conforms with business meal deductions and small business incentives, changes research & development base and removes sunset on credit

AS PASSED BY THE SENATE SB 671:

- deleted the requirement that firms making the water's-edge election file a domestic disclosure spreadsheet
- removed the FTB's authority to disregard a water's edge election
- repealed the election fee for a water's-edge election
- reduced the business meals deduction for corporate taxpayers from 80% of cost to 62% of cost

AS PASSED BY THE ASSEMBLY SB 671 contains the following provisions:

1. Unitary method of income apportionment. The bill deletes § the requirement to file the domestic disclosure spreadsheet for § firms making the water's-edge election and replaces this § requirement with a minimal reporting requirement for firms with § over \$200 million in assets.

It eliminates FTB's authority to "disregard" a water's-edge § election. In place of this authority, the bill requires § taxpayers to provide specified audit information. Taxpayers § failing to provide that information would be subject to a § substantial penalty.

SB 671 repeals the election fee for taxpayers filing their § return on a water's edge-basis. The repeal is effective for § income years beginning on or after January 1, 1994.

2. Credit for manufacturing equipment. SB 671 establishes a § tax credit equal to 6% of qualified manufacturing equipment § placed in service after January 1, 1994. The credit could be § claimed beginning with the 1995 tax year.

The credit would be available for property used primarily in § manufacturing, research and development, or the repair and § maintenance of qualified equipment. Qualified equipment is § depreciable property as defined in Section 1245 of the Internal § Revenue Code. However, the credit could be claimed for special § purpose buildings and foundations that do not meet the Section § 1245 criteria if they are used by biotech firms and manufacturers § of office, computing, and accounting machines as well as § manufacturers of electronic components and accessories.

The credit could be claimed against both the regular tax and § the alternative minimum tax. Unused credits could be carried § forward to offset future tax liabilities for up to 8 years (10 § years for "small" firms.)

The credit would sunset January 1, 2001, if manufacturing § employment -- other than aerospace employment -- does not § increase by 100,000 jobs during the period between January 1, § 1994 and January 1, 2001.

Instead of this credit, a start-up firm has the option of a § 6% sales tax exemption on manufacturing equipment during its § first three years of operation.

3. Small business stock capital gains. This bill exempts § from taxation 50% of the capital gain realized from the sale of § qualified small business stock held for 5 or more years. For a § stock to be eligible for this income exclusion, it must meet the § following criteria:

-- The stock must be originally issued after August 10, 1993 and before December 31, 1998 by a company doing business in California which has less than \$50 million in gross assets. At least 80% of the qualifying company's payroll must be attributable to employment located in California.

-- The issuing company cannot be engaged primarily in the performance of specified services including: health, law, engineering, accounting, performing arts, or consulting. Banking, insurance, farming, oil and gas extraction, hotel, and restaurant business are also ineligible.

4. Business Meals. SB 671 reduces from 80% to 50% the § percentage of business meals and entertainment which may be § deducted as a business expense. This change is consistent with § recent federal tax law changes.

5. Subchapter S. This bill reduces from 2.5% to 1.5% the § tax rate applied to Subchapter S corporations.

6. Space Flight Material. Space flight material used in a § launch at Vandenberg Air Force Base would be exempt from state § and local taxes. This exemption sunsets January 1, 2004.

7. Research and Development Credit. This bill makes the § credit permanent by deleting the January 1, 1998 sunset date. In § addition, it replaces the state's "three-year rolling average" § method of calculating the credit with the federal "fixed base" § method.

FISCAL EFFECT: (Franchise Tax Board)

	93-94	94-95	95-96	96-97	97-98	98-99	99-00
Unitary	\$ - 15	- 60	- 75	- 80	- 80	- 80	- 80
Investment Credit		-125	-406	-373	-375	-375	-375
Business Meals	+ 40	+140	+160	+160	+160	+160	+160
Sub S Reduction	- 30	- 70	- 78	- 80	- 80	- 80	- 80

Sm. Bus. Investment					- 15	- 26
Research & Devt	- 22	- 45	- 50	- 60	-60	-200
Space Launches		- 7	- 15	- 15	-15	- 15
	\$ - 27	-167	-474	-448	-450	-605
					-605	-616

1. Unitary Method of Income Apportionment

EXISTING LAW (Bank and Corporation Franchise Tax Law) imposes a tax on corporations doing business in California. The tax is technically a "franchise tax" on the privilege of doing business as a corporation in California; and is "measured by" the amount of income derived from California activities; the tax is imposed at a rate of 9.3%, with a minimum tax of \$800.

If a corporation is engaged in a business which is conducted both within and without California, that business is considered "unitary business," and the amount of income subject to tax in California is determined by a formula based on the average percentage of payroll, property and sales in California as compared with total payroll, property and sales for the entire business, nationwide or worldwide. This is known as "formulary apportionment."

For example, if the corporation's California payroll, property and sales are 20%, 25% and 30%, respectively, of the payroll, property and sales for the entire business, worldwide, then 25% (the average of 20, 25 and 30) of the net income of the business would be subject to California's 9.3% tax rate.

If a commonly owned or controlled group of corporations conducts a unitary business both within and without California, then the group must file a "combined report" with FTB which includes the California payroll, property and sales factors for all of the corporations combined. The share of the unitary group's income which is subject to California's 9.3% tax rate is based on each taxpayer's California payroll, property and sales as a percentage of the group's nationwide or worldwide payroll, property and sales as shown on the group's combined report. When foreign operations are included in a combined report, it is called "worldwide combination."

Since 1988, an alternative method has been available for determining California's share of a worldwide unitary business--the so-called "water's edge" method. Under water's edge (enacted by SB 85 (Alquist - 1986)), a worldwide group of commonly owned or controlled corporations conducting a unitary business may elect to have formulary apportionment apply only with respect to those operations which are within the "water's edge." In other words, only those corporate affiliates which are defined to be within the United States water's edge must be included in the combined report; foreign affiliates are not included in the report.

In order to compute tax on a water's edge basis, the members of the unitary group must agree to pay an election fee equal to 0.03% (three hundredths of one percent) of the sum of their 1986 payroll, 1986 property, and current-year sales in California,

§ reduced by increases in investment and payroll since 1986. The
 § election period is a minimum of five years.

In addition, corporate groups electing water's edge must
 § agree to provide FTB, every three years, with a "domestic
 § disclosure spreadsheet" showing the income and tax liability
 § reported to each state, the method of apportioning income to each
 § other state, a list of affiliated corporations, and other
 § information as required by FTB regulation.

Finally, if a taxpayer electing water's edge willfully
 § refuses to file the spreadsheet or other necessary audit
 § information, or if FTB determines that evasion of taxes cannot be
 § prevented with the audit tools available, then the FTB may
 § "disregard" (or revoke) the water's edge election, thus throwing
 § the taxpayer back under the worldwide combination method.

Note that the election fee, the domestic disclosure
 § spreadsheet, and FTB's ability to disregard the election have
 § been the subject of much dispute since passage of SB 85 in 1986.
 § Many taxpayers, most notably British corporations, have
 § strenuously objected to these features of our water's edge
 § method, arguing that water's edge, and the accompanying "direct
 § accounting" method, conform with international standards of
 § taxation, and that California's divergence from these standards
 § is offensive to them. (Note, however, that a number of
 § corporations continue to prefer filing under the old worldwide
 § combination method, since their tax liability is lower under that
 § method.)

THIS BILL would repeal the current election fee for those
 § desiring to use the water's edge method, and would extend the
 § current five-year contract period to seven years.

The bill would also repeal the present domestic disclosure
 § spreadsheet requirement for companies electing water's edge, and
 § would substitute an information return containing a list of the
 § corporation's affiliates. Whereas the current spreadsheet is
 § required of all large corporations which elect water's edge, the
 § proposed list-of-affiliates requirement would apply to all large
 § corporations.

FTB believes that the list of affiliates is the most useful
 § of the information currently required as part of the spreadsheet;
 § they also believe that this information is readily available,
 § unlike much of the presently required spreadsheet information.
 § The information return would be due in the year of first election
 § to water's edge, and would subsequently be due every three years.

□
 And the bill would remove FTB's ability to disregard the
 § water's edge election. In place of the disregard power the bill
 § would require electing taxpayers to maintain and provide on
 § request information necessary to (1) determine the amount of
 § income attributable to the state, (2) classify income as business
 § or nonbusiness income, (3) determine unitary apportionment
 § factors for use within the water's edge, and (4) make audits of
 § attribution of income to the U.S. and foreign countries under
 § certain federal provisions. Failure to comply would result in a
 § substantial penalty (in lieu of the current disregard power):
 § \$10,000 for each taxable year for which information is not made

§ available, and another \$10,000 for each 30 days (after an initial
 § 90 days) if the taxpayer continues to refuse to provide
 § information. (This penalty is adopted from a similar federal
 § information requirement. It would be limited to a maximum of
 § \$50,000 until detailed regulations are adopted by the FTB.) The
 § bill further provides that if information is not provided to FTB,
 § then the income apportioned to California, the classification of
 § business vs. nonbusiness income, the apportionment factors, and
 § certain other information will be determined for the taxpayer by
 § FTB. FTB indicates that the required information is necessary in
 § order to properly audit the complex relationship between the
 § water's edge group and affiliated corporations beyond the water's
 § edge.

The bill is intended to accomplish two objectives. First, it
 § is intended to respond to the British Government's threat of
 § retaliation against states which require multinationals to use
 § the worldwide unitary method by revoking a tax credit previously
 § granted to companies which do business both in Britain and in
 § California. In 1985, the British Parliament added a clause to
 § the Finance Bill which would allow the Government to retaliate
 § unless by an unspecified date the worldwide unitary method had
 § been repealed by the states then using it. This May, in response
 § to the new Clinton Administration's apparent reversal of federal
 § position on the Barclays case (see below), Chancellor of the
 § Exchequer Lamont announced that "the Government will have to take
 § retaliatory measures in relation to United States based companies
 § if there is not a satisfactory resolution of the unitary tax
 § problem by the end of the year." Although direct communications
 § with British Government representatives have been few, the best
 § information now available is that a three-part bill (elimination
 § of the election fee, reform of the spreadsheet requirements and
 § repeal of FTB's disregard power) would be sufficient to avoid
 § retaliation. (It should be noted that the total amount
 § associated with retaliation is well over \$1 billion in cost to
 § U.S.-based corporations.)

Second, it is intended that, by removing the threat of
 § British retaliation, the bill would make it possible for the
 § Clinton Administration to file a neutral brief with the Supreme
 § Court with respect to whether the Court should take up the
 § Barclays case. Although the Supreme Court has blessed the
 § worldwide unitary method in the past, most notably in the 1983
 § Container Corp. v. Franchise Tax Board, the Court has remained
 § silent on commerce clause questions relating to whether a state
 § could require a foreign-based multinational to file on a
 § worldwide combined basis. The prior Administration had filed a
 § brief with the Supreme Court on behalf of Barclays. But as a
 § presidential candidate, Clinton assured California officials that
 § he would side with the states on the issue.

The threat of retaliation, however, naturally caused a
 § seriously awkward situation for the new Administration, and
 § Treasury representatives have requested that California's law be
 § modified to remove the threat. California officials have been
 § assured that if our law is changed in a manner which will remove
 § the threat, then a neutral brief (to the effect that the
 § Administration does not advise the Court to take up the Barclays
 § case) would be filed. The deadline for the Solicitor General to
 § act is apparently September 10.

If the Supreme Court takes up the Barclays case and decides § in favor of Barclays, the direct result will be that California § would owe some \$500 million in refunds to taxpayers, and we would § NOT collect some \$350 million in pending assessments, for a total § of about \$900 million in real costs and opportunity cost. It is § likely that if we are unable to require worldwide combination for § foreign-based multinationals, we would be unable to so tax § domestic-based multinationals as well. We would then lose an § additional \$1.2 billion in refund claims and another \$1.9 billion § in cancellation of pending assessments, for a grand total of \$4 § billion. (This casts the \$60 million annual cost of repealing § the election fee in a new perspective.)

2. Credit for Manufacturing Equipment

This bill provides a credit equal to 6% of the cost of § eligible manufacturing equipment used by manufacturers. Eligible § equipment is depreciable property as defined in Section 1245 of § the Internal Revenue Code. Eligible equipment also includes § special purpose buildings and foundations used by biotech firms, § manufacturers of computers, office and accounting machines, § electronic components and accessories.

The credit may be used to reduce regular tax liability or § alternative minimum tax liability. Unused credits may be carried § forward for 8 years. "Small firms" may carry forward these § credits 10 years. "Small firms" are defined as firms which meet § one of the following criteria:

- has gross receipts of less than \$50 million
- has net assets of less than \$50 million
- has a total credit of less than \$1 million. This is equal to about \$16.7 million in purchases.

This credit is effective for purchases made on or after January 1, 1994 and may be claimed beginning with the 1995 tax year. This means that taxpayers may claim a credit for purchases made both in 1994 and 1995 on their 1995 returns.

This exemption sunsets January 1, 2001 if manufacturing jobs § -- other than aerospace jobs -- do not increase by at least § 100,000 during the period between January 1, 1994 and January 1, § 2000.

Exemption for New Manufacturers

In lieu of the credit for manufacturing equipment, new § manufacturers may claim an exemption from the 6% state portion of § the sales tax. New manufacturers are defined as manufacturers in § the 2000-3999 SIC Codes in the first 3 years of operation who § first commence business on or after January 1, 1994.

Property eligible for the exemption is broader than property § eligible for the credit and "includes, but is not limited to"

- machinery & equipment
- computers or other devices used to regulate machinery

EXHIBIT: A

PAGE 6 OF 10

- replacement parts with a useful life of 1 year or more
- property used in pollution control
- special purpose buildings used in manufacturing
- fuels used in manufacturing

The following kinds of property are not eligible for the exemption: furniture, inventory, equipment used to store finished products (e.g., shelving), buildings used as warehouses or property with a useful life of less than one year.

Manufacturers must file an exemption with the retailer at the time of purchase. Manufacturers would be required to pay the sales tax on equipment for which they had claimed an exemption if they remove the property from California within one year or if they use the property for a non-exempt purpose -- e.g., purchasing a computer and claiming that it will be used for manufacturing then later using it for payroll and accounting.

This exemption sunsets January 1, 2001 if manufacturing jobs other than aerospace jobs -- do not increase by at least 100,000 during the period between January 1, 1994 and January 1, 2000.

3. Small Business Stock Capital

Gains

This bill conforms to the recently enacted federal tax provisions relating to small business investment, but only for investment in small California businesses.

Exclusion from gain. It excludes from income subject to tax 50% of the gain on the sale of certain small business stock if the stock is held for five or more years.

The total amount of gain which can be excluded is equal to the greater of:

- 10 times the taxpayer's basis in the stock.
(Purchase price is generally the basis).

or

- \$10 million in gain. The \$10 million limitation is applied on a shareholder by shareholder basis.

One half of any excluded gain is treated as an item of preference for purposes of calculating the alternative minimum tax.

Eligible stock. Stock in qualified small businesses, issued on or after August 10, 1993 and prior to December 31, 1998 at the original issuance of the stock in exchange for money, property other than stock, or compensation for services is eligible for the exclusion. (Note: August 10, 1993 is the date the federal tax bill went into effect.)

Qualified small business. To be eligible for the exclusion, the taxpayer must purchase eligible stock in a business which:

- is a C corporation

- has gross assets of \$50 million or less
- uses 80% or more of its gross assets in the active conduct of a trade or business in California
- employs at least 80% of its payroll in California
- holds 10% or less of its assets in real property or stock

Investment in the following kinds of businesses would not qualify for the exclusion:

- Domestic international sales corporations (DISC), regulated investment companies (RIC), real estate investment trust (REIT), real estate mortgage investment conduit (REMIC), possessions corporations (Section 936)
- Performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the trade or business is the skill or reputation of one or more of its employees
- Banking, insurance, leasing, financing, investing, farming, extraction, operation of a hotel, motel, restaurant, or similar business.

Partnerships and other restrictions. Gain from the sale of § qualified small business stock that is purchased by a § partnership, S corporation, or RIC qualifies for the exclusion if § the stock is held by the entity for the minimum 5 years and the § partner or shareholder of the entity was a partner or shareholder § from the time the stock was acquired until its sale. A partner's § or shareholder's ability to exclude gain is limited by the § partner's or shareholder's interest in the entity at the time the § stock was purchased.

A partnership may distribute qualified small business stock § to its partners provided a partner was a member of the § partnership when the stock was acquired.

If qualified small business stock is transferred to a § partnership and the partnership sells the stock, the gain on the § sale will not qualify for the exclusion provided by AB 44.

When qualified small business stock is transferred by gift or § death, the recipient is treated as owning the stock in the same § manner as the donor.

Stock acquired through the exercise of options, warrants or § conversions of convertible debt is treated as acquired at § original issue.

A taxpayer is not permitted to exclude gain from the sale of § qualified small business stock if the taxpayer held a share

EXHIBIT

PAGE

A
8 of 10

§ position in that stock during the 5-year holding period.

This bill requires that the Legislative Analyst's Office
§ study the effectiveness of the capital gains exclusion and report
§ to the Legislature by December 31, 1996. The study will include:

- the effect on investor decisions and amount of additional investment and jobs which occur
- a listing by industry of investments made
- estimated state and local fiscal impact

4. Business Meals

SB 671 conforms to 1993 federal tax changes by reducing the amount businesses can deduct for business meals and entertainment from 80% of cost to 50% of cost.

5. Subchapter S

Current law conforms with federal provisions allowing certain
§ "small business corporations" (defined as corporations with 35 or
§ fewer shareholders, all of whom must be human beings, and only
§ one class of stock) to be treated as partnerships for tax
§ purposes. Our law diverges from federal law in that there is no
§ federal tax at the corporate level for S corporations, whereas
§ California charges a 2.5% tax on net income of S corporations
§ (compared with the 9.3% tax on ordinary corporations).

The bill would reduce the 2.5% tax on S corporations to 1.5%.

6. Space Flight Material

□ This bill would exempt property from both the state and local
§ share of the sales tax if it is used in a space flight
§ originating at Vandenberg Air Force Base from January 1, 1994
§ through December 31, 2003.

Eligible property includes, but is not limited to:

- orbital space facilities
- space propulsion systems
- space vehicles
- satellites
- space stations
- any component parts

"Material that is not intended to be launched into space" is
§ not exempt.

This exemption would be granted even if the launch is
§ cancelled, postponed or fails.

7. Research and Development Credit

EXISTING LAW provides a tax credit for qualified research and
§ development (R&D) expenses incurred by businesses. The credit is
§ generally 8 percent of the increase in research and development
§ expenses above the average of the prior three years' R&D

EXHIBIT A
PAGE 9 OF 10

§ expenditures. The minimum base is 50% of the total research and
§ development expense for the current taxable year. In the case of
§ "basic research" the credit is 12 percent. For start-up
§ companies with fewer than three taxable years, a fixed-base
§ method is used--research expenditures qualify for the credit to
§ the extent that they exceed 3% of a firm's California gross
§ receipts. The credit is currently scheduled to sunset at the end
§ of 1997.

Except for start-ups, California does not conform to the
§ federal base period computation. Federal law provides that
§ research expenditures in excess of a fixed base amount qualify
§ for the credit. The base amount is determined by (1) calculating
§ the ratio of research expenditures to gross receipts for a firm's
§ 1984 through 1988 income years (the "fixed base percentage"); and
§ (2) multiplying that ratio by the firm's average gross receipts
§ during the past four years.

THIS BILL deletes the current 1997 sunset for the research
§ and development credit, and substitutes the federal fixed base
§ period for the present "rolling" three-year average base period.
§ The bill also conforms with the new federal definition of
§ start-up companies as.

This provision is part of the Assembly Democratic Economic
§ Prosperity Team (Adept) package of business incentives. It is
§ intended to be part of a coordinated attempt to stimulate more
§ California economic development and make it possible for
§ California to compete more effectively with other states in
§ retaining and attracting business. This part of the package is
§ "aimed at making capital more available for California's economic
§ development.

Consultants: Martin Helmke & Anne Maitland
Revised 9-17-93

THE HOUSE'S PASSAGE OF THE 1993 BUDGET RECONCILIATION ACT -- HON. GERALD D. KLECZKA (Extension of Remarks - August 06, 1993)

[Page: E2054]

HON. GERALD D. KLECZKA**in the House of Representatives***FRIDAY, AUGUST 6, 1993*

- Mr. KLECZKA. Mr. Speaker, the passage of the budget bill last night puts us on the verge of restoring America's confidence that we can and will take bold, decisive action to improve our economic future.
- The American people demanded that we bring down the budget deficit, and the plan we passed last night delivers: It cuts the deficit \$496 billion over the next 5 years. This is not an empty promise--the President has issued an Executive order that will ensure that savings will be locked into paying off our debt.
- We heard the calls for more spending cuts, and we responded with an agreement that improves the ratio of cuts to tax increases to better than 1:1. The plan we forward today to the Senate calls for \$255 billion in cuts, compared to \$241 billion in new taxes.
- On top of that, the House has voted in the last few months to cut billions more from the budget as part of its appropriations process. Gone are the \$11 billion superconducting super collider, the wasteful European Development Bank Program, and \$940 million in foreign aid. More cuts are sure to come.
- Equally important, we delivered on our commitment to sharing the tax burden equitably. If the Senate passes this bill, working Wisconsin families making less than \$180,000 a year will not pay a dime more in income taxes. In fact, middle class families will be asked to make a very small contribution--we calculate that the average Wisconsin driver will have to pay only 55 cents more a week because of the gasoline tax increase.
- Similarly, the most vulnerable Americans, senior citizens, will not be overburdened--Social Security recipients will not pay additional taxes on their benefits unless they have an income of more than \$34,000 for individuals and \$44,000 for couples. And the \$56 billion reduction in Medicare spending will come out of reduced reimbursement to health care providers.
- Lastly, with this package we addressed the concerns of small businesses, the engine driving job growth today. The bill provides a 50-percent cut in the capital gains tax to investors who hold onto stock in a small business for 5 years, giving investors an incentive to contribute to the creation of new businesses. For existing companies, this budget plan expands the expensing provision for purchases of equipment by 75 percent, from \$10,000 a year ^B now up to \$17,500. For the self-

EXHIBIT: PAGE 1 OF 2

employed, the plan allows for a deduction of 25 percent for health care premiums. And to encourage more research and development, the plan contains a significant tax credit for research and development.

- The alternative to this plan is more of the status quo: more inaction, more distractions, and no deficit reduction. The choice is clear: action versus more neglect, serious deficit reduction versus more bickering, economic growth versus more stagnation. I support this agreement because I believe we must rise above partisan differences and continued gridlock to do what's best for America, and this bill is a giant step in that direction.

END

Stay Connected with the Library [All ways to connect »](#)

Find us on



Subscribe & Comment

[RSS & E-Mail](#) [Blogs](#)

Download & Play

[Podcasts](#) [Webcasts](#) [iTunes U](#)

[About](#) | [Press](#) | [Site Map](#) | [Contact](#) | [Accessibility](#) | [Legal](#) | [External Link Disclaimer](#) | [USA.gov](#)

[Speech Enabled](#) ↗

EXHIBIT: 2 ^B
PAGE 2 OF 2

IRV. See *instant-runoff voting* under VOTING.

ISCGS. *abbr.* INTERNATIONAL SCHEDULE OF CLASSES OF GOODS AND SERVICES.

ish. *Scots law*. 1. An exit. • This appears in the phrase "ish and entry," often used in a lease, license, etc., to give someone right to use necessary ways and passages to pass through another's property, esp. to reach a church or marketplace. 2. The expiration of a lease, license, etc.; the end of a period of time.

island. A tract of land surrounded by water but smaller than a continent; esp., land that is continually surrounded by water and not submerged except during abnormal circumstances.

ISO. *abbr.* 1. Incentive stock option. See STOCK OPTION (2). 2. INSURANCE SERVICES OFFICE.

isolated sale. See SALE.

isolating, *n.* *Family law*. A parent's or caregiver's pattern of cutting a child off from normal social experiences, preventing the child from forming friendships, or making the child believe that he or she is alone in the world. Cf. IGNORING; REJECTING.

ISP. *abbr.* INTERNET SERVICE PROVIDER.

is qui cognoscit (is kwī cog-nos-it). [Latin "he who recognizes"] The cognizor in a fine. See COGNIZOR; FINE (1).

is qui cognoscitur (is kwī cog-nos-a-tar). [Latin "he who is recognized"] A cognizee in a fine. See COGNIZEE; FINE (1).

is qui omnino desipit (is kwī om-ni-noh dee-sip-it). [Latin] *Hist.* One who is completely void of reason. • The phrase appeared in reference to an insane person, not an idiot.

issuable, *adj.* 1. Capable of being issued <an issuable writ>. 2. Open to dispute or contention <an issuable argument>. 3. Possible as an outcome <an award as high as \$5 million is issuable in this case>.

issuable defense. See DEFENSE (1).

issuable plea. See PLEA (3).

issue, *n.* 1. A point in dispute between two or more parties.

"In federal civil procedure, an issue is a single, certain, and material point arising out of the allegations and contentions of the parties; it is matter affirmed on one side and denied on the other, and when a fact is alleged in the complaint and denied in the answer, the matter is then put in issue between the parties." 35A C.J.S. *Federal Civil Procedure* § 357, at 541 (1960).

collateral issue. A question or issue not directly connected with the matter in dispute. [Cases: Evidence § 99; Witnesses § 405. C.J.S. *Evidence* §§ 2-5, 197-199, 204, 206; *Witnesses* § 770.]

deep issue. The fundamental issue to be decided by a court in ruling on a point of law. • A deep issue is usu. briefly phrased in separate sentences, with facts interwoven (in chronological order) to show precisely what problem is to be addressed. Cf. *surface issue*.

"Essentially, a deep issue is the ultimate, concrete question that a court needs to answer to decide a point your way. Deep refers to the deep structure of the case — not to deep thinking. The deep issue is the final question you pose when you can no longer usefully ask the follow-up question,

"And what does that turn on?" Bryan A. Garner, *The Winning Brief* 58 (2d ed. 2004).

fact issue. See *issue of fact*.

general issue. 1. A plea (often a general denial) by which a party denies the truth of every material allegation in an opposing party's pleading. 2. The issue arising from such a plea. [Cases: Pleading § 115. C.J.S. *Pleading* § 185.]

"The general issue is a denial of the legal conclusion sought to be drawn from the declaration. It denies by a general form of expression the defendant's liability, and enables the defendant to contest, without specific averments of the defense to be asserted, most of the allegations which the plaintiff may be required to prove to sustain his action, and in some actions to raise also various affirmative defenses. It fails to perform the functions of pleading, either in giving notice or in reducing the case to specific issues." Benjamin J. Shipman, *Handbook of Common-Law Pleading* § 169, at 304 (Henry Winthrop Ballantine ed., 3d ed. 1923).

immaterial issue. An issue not necessary to decide the point of law. Cf. *material issue*.

informal issue. *Rare*. An issue that arises when a defendant does not properly or fully plead in answer to a material allegation.

issue of fact. A point supported by one party's evidence and controverted by another's. — Also termed *fact issue*.

issue of law. A point on which the evidence is undisputed, the outcome depending on the court's interpretation of the law. — Also termed *legal issue*.

legal issue. 1. A legal question, usu. at the foundation of a case and requiring a court's decision. 2. See *issue of law*.

material issue. An issue that must be decided in order to resolve a controversy. • The existence of a material issue of disputed fact precludes summary judgment. Cf. *immaterial issue*.

multifarious issue. An issue that inquires about several different points (esp. facts) when each one should be inquired about in a separate issue.

special issue. 1. At common law, an issue arising from a specific allegation in a pleading. • Special issues are no longer used in most jurisdictions. 2. See *special interrogatory* under INTERROGATORY.

surface issue. A superficially stated issue phrased in a single sentence, without many facts, and usu. beginning with the word *whether*. Cf. *deep issue*.

ultimate issue. A not-yet-decided point that is sufficient either in itself or in connection with other points to resolve the entire case. — Also termed *ultimate question*.

2. A class or series of securities that are simultaneously offered for sale. — Also termed *bond issue*; *stock issue*. See OFFERING.

hot issue. A security that, after an initial or secondary offering, is traded in the open market at a substantially higher price. — Also termed *hot stock*.

new issue. A stock or bond sold by a corporation for the first time; often to raise working capital. See BLUE-SKY LAW.

original issue. The first issue of securities of a particular type or series.

Black's Law Dictionary®

Eighth Edition

Bryan A. Garner
Editor in Chief

THOMSON
—★—
WEST

Mat #40231642
Mat #40235008—deluxe

EXHIBIT: C
PAGE 2 OF 2

<DOCUMENT>
<TYPE>10-K
<SEQUENCE>1
<FILENAME>0001.txt
<DESCRIPTION>ANNUAL REPORT
<TEXT>

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)
 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2000
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
OR
 For the transition period from ----- to -----

Commission File Number: 0-13107

Autonation, Inc.
(Exact Name of Registrant as Specified in its Charter)

<TABLE>
<S>
DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)
110 S.E. 6TH STREET,
FORT LAUDERDALE, FLORIDA
(Address of Principal Executive Offices)
73-1105145
(I.R.S. Employer
Identification No.)

</TABLE>
(954) 769-6000
33301
(Zip Code)

(Registrant's Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

<S> <C> PART I <C>

Item 1.	Business	1
Item 2.	Properties	15
Item 3.	Legal Proceedings	15
Item 4.	Submission of Matters to a Vote of Security Holders	16

PART II

Item 5.	Market for the Registrant's Common Equity and Related Stockholder Matters	17
Item 6.	Selected Financial Data	18
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 8.	Financial Statements and Supplementary Data	37
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	71

PART III

Item 10.	Directors and Executive Officers of the Registrant	71
Item 11.	Executive Compensation	71
Item 12.	Security Ownership of Certain Beneficial Owners and Management	71
Item 13.	Certain Relationships and Related Transactions	71

PART IV

Item 14.	Exhibits, Financial Statement Schedules and Reports on Form 8-K	71
----------	---	----

PART I

ITEM 1. BUSINESS

INTRODUCTION

AutoNation, Inc. is the largest automotive retailer in the United States. As of December 31, 2000, we owned and operated approximately 400 new vehicle franchises from dealership locations in major metropolitan markets in 18 states, predominantly in the Sunbelt. Our dealerships offer new and used vehicles for sale. We also offer financing for vehicle purchases, extended service contracts and other finance and insurance products, as well as other aftermarket products such as vehicle accessories, upgraded sound systems and theft deterrent systems. We also offer a wide range of vehicle maintenance and repair services and we operate collision repair centers in most of our key markets. The core brands of vehicles that we sell, representing almost 90% of

EXHIBIT: D
PAGE 2 OF 4

properties. In November 2000, we completed the divestiture of our outdoor media business, which operated under the name Republic Media, for a sale price of approximately \$104.0 million. In connection with the sale of Republic Media, we entered into a pre-paid

<PAGE>

\$15.0 million advertising agreement with respect to the purchaser's radio stations, billboards and other outdoor advertising media, and, accordingly, we received net proceeds of approximately \$89.0 million in connection with the transaction. During 2000, we also completed the sale of various non-core franchised new vehicle dealerships for an aggregate sale price of approximately \$89.7 million. With the sale of our Flemington Automotive Group in New Jersey, which we expect to complete in April 2001, we believe that our disposition of significant non-core assets will be substantially complete.

BUSINESS STRATEGY

Our business strategy consists of the following key elements:

- o Expand our margins by focusing on higher-margin products and services.
- o Continue to leverage our significant scale to improve our operating efficiency, including by managing costs of our business and improving the utilization of our assets.
- o Effectively use our free cash flow to reinvest in our business through capital investments, strategic dealership acquisitions and share repurchases.
- o Continue to grow and leverage our e-commerce business.

Expand Our Margins

While new vehicle sales will continue to be a significant component of our operations, we intend to continue to focus on developing the areas of our automotive retail business that produce the highest margins. In general, parts and service sales, used vehicle sales and sales of finance, insurance and other aftermarket products yield relatively high margins as a percentage of sales compared to new vehicle sales. We intend to emphasize higher-margin areas of our business with the following strategic initiatives:

(arrow) PARTS AND SERVICE SALES AND COLLISION REPAIR SERVICES:

Almost all of our dealerships have service facilities that provide a wide range of vehicle maintenance and repair services. Additionally, we operate collision repair centers in most of our key markets. We intend to increase our parts and service sales by, among other things: (1)

S, G EA - Store	3,032.5	14.7	2,928.6	14.6	1,931.6	15.3
S, G EA - Corporate	2,021.6	9.8	2,089.4	10.4	1,301.8	10.3
Store performance	1,010.9	4.9	839.2	4.2	629.8	5.0
S, G EA - Property carrying costs	125.2	.6	190.0	1.0	86.5	.7
S, G EA - Depreciation	30.9	.1	--	--	--	--
Amortization	54.7	.3	60.1	.3	40.3	.3
Asset impairment charges (recoveries), net	79.1	.4	62.9	.3	39.6	.3
Operating Income	(3.8)	--	416.4	2.1	--	--
Retail vehicle unit sales:						
New	489,000		469,000		266,000	
Used	255,000		315,000		244,000	
	744,000		784,000		510,000	

</TABLE>

Total revenue was \$20.61 billion, \$20.11 billion and \$12.66 billion for the years ended December 31, 2000, 1999 and 1998, respectively. Gross margins were \$3.03 billion, \$2.93 billion and \$1.93 billion for the years ended December 31, 2000, 1999 and 1998, respectively. The primary components of these changes are described below.

New vehicle revenue was \$12.49 billion, \$11.48 billion and \$6.78 billion for the years ended December 31, 2000, 1999 and 1998, respectively. New vehicle gross margins were \$1.06 billion, \$962.3 million and \$588.6 million or, as percentages of new vehicle revenue, 8.5%, 8.4% and 8.7% for the years ended December 31, 2000, 1999 and 1998, respectively. Increases are attributable to acquisitions and higher pricing. New vehicle revenue was also impacted by an increase in same store unit sales in 1999 and a modest decrease in same store unit sales in 2000.

Used vehicle revenue was \$3.86 billion, \$4.43 billion and \$3.19 billion for the years ended December 31, 2000, 1999 and 1998, respectively. Used vehicle gross margins were \$438.6 million, \$449.6 million

<PAGE>

and \$379.4 million or, as percentages of used vehicle revenue, 11.4%, 10.1% and

1 OF 1 RECORD(S)

California Secretary of State

Corporate Filing

Business Information

Filing Number: C2194503
Name: LEBO AUTOMOTIVE, INC.
Name Type: LEGAL
STANDARD MAILING Address: 2425 E CAMELBACK RD STE 1155
PHOENIX, AZ 85016-9266
ORIGINAL MAILING Address: 2425 E CAMELBACK RD STE 1155
PHOENIX
AZ
85016
Business Type: CORPORATION
Filing Type: STATEMENT & DESIGNATION BY FOREIGN CORPORATION
Status: ACTIVE
Foreign State of Incorporation: DELAWARE
Foreign/Domestic: FOREIGN
Foreign Incorporation Date: 07/13/2000
For Profit: YES
Tax Program: NOT SUSPENDED (GOOD STANDING)

Registered Agent

Name: REEVES, PENNY L
Title: REGISTERED AGENT
Registered Agent Address 5750 WILSHIRE BLVD STE 655
LOS ANGELES, CA 90036-3637

Stock Information

Stock

Additional Information: STOCK

Historical Registered Agents

Name: REEVES, PENNY L
Title: REGISTERED AGENT
Registered Agent Address 5750 WILSHIRE BLVD STE 655
LOS ANGELES, CA 90036-3637

Officers

Name: PIERCE, MITCHELL D
Title: PRESIDENT
Contact Type: OFFICER
Standard Address: Type: CONTACT
2425 E CAMELBACK RD STE 1155
PHOENIX, AZ 85016-9266
Original Address: 2425 E CAMELBACK RD STE 1155
85016
PHOENIX
AZ

Historical Contacts

EXHIBIT: E
PAGE 1 OF 2

Historical Contacts

Name: BOESE, LEO R
Title: PRESIDENT
Contact Type: OFFICER

Standard Address: Type: CONTACT
1500 N SEPULVEDA BLVD
MANHATTAN BEACH, CA 90266-5110
Original Address: 1500 N SEPULVEDA BLVD
MANHATTAN BEACH, CA

Filing History

Filing Date: 06/04/2001
Filing Type: FILING
Ref No: 0672047
Description: STATEMENT OF OFFICERS

Filing Type: FILING
Ref No: 0687423
Description: STATEMENT OF OFFICERS

Important: The Public Records and commercially available data sources used on reports have errors. Data is sometimes entered poorly, processed incorrectly and is generally not free from defect. This system should not be relied upon as definitively accurate. Before relying on any data this system supplies, it should be independently verified. For Secretary of State documents, the following data is for information purposes only and is not an official record. Certified copies may be obtained from that individual state's Department of State.

Your DPPA Permissible Use is: Government Agency
Your GLBA Permissible Use is: Legal Compliance

Copyright© 2010 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

EXHIBIT: E
PAGE 2 OF 2

1 STATE OF CALIFORNIA
FRANCHISE TAX BOARD
2 Legal Division
Ann H. Hodges, Tax Counsel IV
3 P. O. Box 1720
Rancho Cordova, CA 95741-1720
4 (916) 845-3088

5 Respondent's Representative

6
7 BEFORE THE STATE BOARD OF EQUALIZATION
8 OF THE STATE OF CALIFORNIA

9
10 In the Matter of the Appeal of:

} Appeal Case ID No. 547667
}
}
}

11
12 LEO R. BOESE

13
14 Refund

15 Year¹

Amount

16 2007

\$2,658,342

RECEIVED

MAR 10 2011

Board Proceedings

17
18
19
20
21
22
23 RESPONDENT'S REPLY BRIEF

24
25
26
27 ¹ This amount represents the exclusion of gain from the sale of stock reported by appellant on his
28 amended return and not the amount of tax paid of \$250,206 for which appellant is requesting a
refund.

1 Appellant is not entitled to the qualified small business stock exclusion because he
2 cannot do indirectly that which he cannot do directly. Furthermore, the transaction could only be
3 treated in the manner in which appellant contends if certain technical tax requirements are met.
4 As will be explained in detail below, appellant has not demonstrated that he met these
5 requirements.

6 FACTS/ARGUMENT

7 In his reply brief, appellant's representative states that:

8 The Respondent cites the facts as he understands them and relies on
9 previous assertions made by the taxpayer's representative. The focus
10 of this response is to outline the facts as they truly happened and not
11 as they may have been assumed or thought to have happened.

(Reply Brief, page 2.)

12 For ease of understanding, respondent will set forth the facts of the case, and as
13 relevant, will discuss appellant's contentions that respondent has incorrectly stated the facts.

14 The business that was ultimately sold by appellant and for which he took the
15 qualified small business stock exclusion, was a Toyota Dealership located in Manhattan Beach,
16 California that had been in existence approximately 11 years when appellant purchased it in 2000.
17 (Exhibit G, California Secretary of State's Summary of Corporate Filings for Manhattan Beach
18 Motors, Inc. dba Manhattan Toyota which states it was incorporated in 1989.) Appellant acquired
19 the Toyota Dealership by purchasing its stock from AutoNation, which was the largest automotive
20 retailer in the United States. (ROB, 3:10.) AutoNation acquired the Toyota Dealership sometime
21 after 1989 and prior to 2000. (*Id.*)

22 1. Appellant Enters Into Stock Purchase Agreement As an Individual to Purchase Toyota 23 Dealership ("Old Manhattan Beach Toyota"):

24 In April of 2000, appellant, as an individual, entered into a stock purchase
25 agreement with AutoNation to purchase the stock of Old Manhattan Beach Toyota. (Appeal Letter,
26 Exhibit B, Amended and Restated Stock Purchase Agreement dated April 14, 2000.) Specifically,
27 the agreement provided:

28 ///

1 This AMENDED AND RESTATED STOCK PURCHASE AGREEMENT (this
2 "Agreement") is effective as of April 14, 2000, by and between
3 (i) AutoNation, Inc., a Delaware corporation ("AutoNation"), and
4 (ii) *Mr. Leo Bose ("Buyer")*. [Emphasis added.]

5 ***

6 **1.2 The Purchase.** The acquisition of the outstanding capital stock of
7 Manhattan Toyota described in this Section is referred to herein as the
8 "**Purchase**".Subject to the terms and conditions of this Agreement,
9 at the Closing AutoNation shall cause its wholly-owned subsidiary,
10 AutoNation Enterprises Incorporated ("AEI"), to sell, assign, transfer
11 and convey to Buyer all of the outstanding capital stock of Manhattan
12 Toyota, which consists of 100 shares of common stock, par value
13 \$1,000 per share (the "Shares"). The Shares conveyed hereunder
14 shall be free and clear of all liens, other than such restrictions as may
15 be imposed pursuant to state or federal securities laws or such
16 restrictions as may be imposed by Toyota Motor Sales, U.S.A., Inc. or its
17 distributor (the "Factory").

18 **1.3 Purchase Price.** At Closing, Buyer shall pay to AEI the amount of
19 Five Million Eight Hundred Fourteen Thousand Dollars (\$5,814,000)
20 (the "Purchase Price") in consideration of the sale, assignment and
21 transfer of the Shares, by wire transfer of immediately available funds,
22 subject to adjustment as set forth in this Agreement.

23 (Appeal Letter, Exhibit B, page 1, et seq.)

24 The closing date was either the date certain conditions were met or waived or by
25 mutual agreement. (*Id.* at ¶ 1.1, The Closing.) Appellant has not established the exact closing date
26 but it appears to be sometime prior to July 13, 2000.

27 **2. Appellant Forms New Corporation (Lebo Automotive or "New Manhattan Beach Toyota")**
28 **June 20, 2000 and July 13, 2000):**

On June 20, 2000, appellant's new corporation, Lebo Automotive, Inc. dba
Manhattan Beach Toyota incorporated in Delaware. (Appeal Letter, Exhibit D, Delaware Certificate
of Incorporation for Lebo Automotive dated June 20, 2000.) On July 13, 2000, Lebo Automotive
qualified to do business in California. (ROB, Exhibit E.)

3. The Toyota Dealership Appellant Purchased Merges Into His New Company:

In its opening brief, respondent quoted appellant's representative's correspondence
to its auditor which explained how appellant's new corporation (the one for which he is claiming a
small business stock exclusion) obtained Old Manhattan Beach Toyota:

///

1 On April 14, 2000, Mr. Leo Boese (buyer) and AutoNation, Inc. (seller)
2 entered into a stock purchase agreement for the acquisition of all the
outstanding common stock of [Old Manhattan Beach Toyota].***

3 Lebo Automotive, Inc. [New Manhattan Beach Toyota] was
4 incorporated in the State of Delaware on June 20, 2000. On
5 July 17, 2000, [Old] Manhattan Beach Toyota] was merged into Lebo
6 Automotive, Inc. [New Manhattan Beach Toyota] under the Delaware
7 merger statute and §368(a) of the Internal Revenue Code. Mr. Boese
8 was issued 17,000 shares, with the par value determined based on
9 the fair market value of assets and cash contributed in the merger.
10 The total value of Mr. Boese's stock was \$1,700,000. ***

11 ***The Lebo Automotive [New Manhattan Beach Toyota] stock did not
12 exist until Mr. Boese exchanged the [Old] Manhattan Beach [Toyota]
13 Stock for it.***

14 (Exhibit F, Correspondence from Appellant's Representative to Respondent's Auditor dated
15 May 17, 2010, page 1, et seq.)

16 In its reply, appellant contends that respondent has incorrectly stated the facts and
17 instead of appellant purchasing the stock of the Toyota Dealership as an individual as previously
18 represented, appellant now asserts that his newly formed corporation, Lebo Automotive or New
19 Manhattan Beach Toyota purchased the assets of the Toyota Dealership:

20 First, the facts as outlined by the respondent . . . attributes to the
21 representative for Lebo Automotive as stating "[Old] Manhattan Beach
22 Toyota] was merged into Lebo Automotive, Inc. [New Manhattan Beach
23 Toyota] under the Delaware merger statute and Sec. 368(a) of the
24 Internal Revenue Code. This statement is factually incorrect as both
25 Lebo Automotive and AutoNation both knew that this purchase was to
26 be accounted for as an asset purchase under Sec 338(h)[10]² of the
27 Internal Revenue Code. [For evidence of the 338(h)(10) election] refer
28 to:

- 29 1. The Stock purchase agreement, page 18 Sec. 5.9(d) provided
30 for the making of a Sec. 338(h)(10) election treating the entire
31 transaction as an asset purchase.
- 32 2. The tax year 2000 tax return for Lebo Automotive, Inc. shows a
33 beginning date of July 17, 2000 through December 31, 2000
34 as its taxable year. This is consistent with a split of the tax year
35 between old Manhattan Beach Toyota (with Auto Nation picking
36 up the January 1 through January 16, 2000 income on its
37 consolidated tax return) and the Lebo Automotive Inc.

38 ///

39 ² California incorporates Section 338 by reference through Revenue and Taxation Code section
40 24451.

- 1 3. The Lebo Automotive, inc. tax year 2000 tax return statement 1
2 shows that the Sec. 338(h)(10) election was properly made on
3 a timely filed tax return.
4 4. No merger documents were filed with the Lebo Automotive, Inc.
5 2000 tax return nor with the Delaware Secretary of State office.

6 (Appellant's Reply Brief, page 3.)

7 With respect to the contention that appellant's new corporation was the purchaser in
8 the acquisition of the Toyota Dealership, as set forth above, the stock purchase agreement clearly
9 identifies the purchaser as Leo Boese, i.e., as an individual and not a corporation. Appellant's new
10 corporation, Lebo Automotive ("New Manhattan Beach Toyota") is not referenced anywhere in the
11 purchase agreement and there are no documents demonstrating when or how it became the
12 purchaser, or that it actually purchased the shares. Furthermore, Lebo Automotive was
13 incorporated in June of 2000 which was approximately two months after appellant entered into the
14 stock purchase agreement in April of 2000. Therefore, appellant has not established that his new
15 corporation, Lebo Automotive, was the purchaser of the Toyota Dealership.

16 Furthermore, appellant is contending that despite the fact that the agreement
17 provides it was a "stock purchase agreement" and that Lebo Automotive's tax return stated it
18 acquired the stock of the Toyota Dealership, by application of a section 338(h)(10), the transaction
19 should be treated as an asset sale.³ Appellant is correct that if all the requirements are properly
20 met, section 338(h)(10) treats a transaction that is structured as stock purchase as an asset
21 purchase for tax purposes.⁴ In general, the mechanics and effect of a 338(h)(10) election are:

22 ³ Section 338 contains provisions for two types of elections with respect to transactions that are
23 structured as stock purchases: 1) an election that is made by the purchaser alone (338(g)) which
24 does not affect the seller and 2) a joint election made by both the seller and the purchaser
25 (338(h)(10)).

26 ⁴ If a section 338 election is not made, the effect of the transaction is as follows:

27 When an *acquiring corporation* purchases the stock of a target corporation [Old
28 Manhattan Beach Toyota] ...the acquiring corporation's basis for the target's stock ...
is ordinarily the amount paid for the stock, regardless of the target's so-called inside
basis (i.e., the basis for the assets), and the assets retain that historical inside basis
even if the target distributes them to the new parent in complete liquidation, unless
the parent elects under § 338 to step-up basis to the amount paid by it for the
target's stock. [footnote omitted]

(Bittker and Eustice, Federal Income Taxation of Corporations and Their Shareholders, ¶ 10.40
Asset Acquisitions: Allocation of Purchase Price in Computing Basis and Related Problems,
¶ 10.40[1] In General.)

1 [T]he "old target" [fn. omitted] corporation is first treated as having
2 sold all its assets at the close of the "acquisition date" [fn. omitted] at
3 fair market value in a single transaction [footnote omitted] and is then
4 treated as a separate and distinct "new target" corporation that
5 purchased all the said assets as of the beginning of the day after the
6 acquisition date. [fn. omitted] Thus, the old target, which is owned by
7 the "purchasing corporation" on the day of the deemed sale, [footnote
8 omitted] will incur gain or loss and owe tax on its net gain ... and it will
9 acquire a deemed cost basis in its assets [fn. omitted]

6 The consequences of the § 338(h)(10) election are similar to the
7 regular § 338 election. The target's deemed asset sale is for fair
8 market value [and] the tax on the sale falls on the seller.... Thus, the
9 stock sale gain or loss is ignored, [fn. omitted] the deemed asset sale
10 is reported in the selling group's consolidated return, [fn. omitted] the
11 target is deemed to liquidate into the selling parent under § 332
12 immediately after the deemed asset sale, [footnote omitted] and the
13 new target's basis in its assets is determined under the same rules as
14 for the conventional § 338 election. [fn. omitted]

11 (Bittker and Eustice, at ¶ 10.42 Section 338: *The Election and Its Effects*, ¶ 10.40[1] In General
12 and ¶ 10.42 Section 338: *The Election and Its Effects*, ¶ 10.42[1][a] In General.)⁵

13 Finally, a Section 338(h)(10) election must be made not later than the 15th day of the
14 9th month beginning after the month in which the "acquisition date" occurs. (Int. Rev. Code section
15 338(g)(1) and Treas. Reg. § 1.338(h)(10)-1T(c)(2).) Acquisition date means the first day on which
16 there is a qualified stock purchase (acquisition of stock). (Int. Rev. Code section 338(h)(2).) A
17 "qualified stock purchase" is the acquisition of the stock of a *corporation by another corporation*.
18 (Int. Rev. Code Section 338(d)(3).)

19 Appellant has not established that the section 338 (h)(10) requirements were met.
20 The stock purchase agreement provides that *at the Buyer's written notice*, a section 338(h)(10)
21 election could be made:

22 ///

23 ///

24 ///

25 ///

26 _____
27 ⁵ A joint election under section 338(h)(1) is desirable "if the seller has a substantial gain on its
28 subsidiary's stock and the subsidiary also has a substantial gain on its assets; and it is even more
advantageous if the subsidiary's inside asset gain is lower than the parent's outside stock gain."
(*Id.*)

1 (d) 338(h)(10) Election. AutoNation hereby agrees and acknowledges
2 that, at Buyer's option exercisable by written notice to AutoNation no
3 later than the 15th day of the ninth month following the month in which
4 the Closing Date occurs, AutoNation shall join Buyer in making a
5 338(h)(10) election with respect to the transactions contemplated
6 herein. [Emphasis added.]

7 (Id. at Section 5.9 Tax Matters, page 18.)

8 As substantiation that the Buyer made the election, appellant does not provide the
9 written notice or cooperative documents referenced in the stock purchase agreement, but instead
10 refers to Statement 1 on Lebo Automotive, Inc.'s 2000 tax return. Lebo Automotive, Inc.'s 2000 tax
11 return is unsigned, but dated September of 2001. (See Appeal Letter, Exhibit C.) Statement 1
12 reads in relevant part as follows:

13 On July 17, 2000, Lebo Automotive (Purchasing Corporation) acquired
14 100% of outstanding shares of common stock in Manhattan Beach
15 Motors, Inc. DBA Manhattan Beach Toyota (EIN 95-4224776).
16 Manhattan Beach Motors, Inc. was subsequently merged into an
17 existing Delaware Corporation, Lebo Automotive, Inc. on July 17, 2000.

18 Lebo Automotive, Inc. (Buyer) and Autonation, Inc. (Seller) have agreed
19 to IRS Code 338(h)(10) election.

20 All financial reporting transactions have been reported under EIN
21 95-4224776 (Manhattan Beach Motors, Inc.). Lebo Automotive, Inc.
22 received an IRS notification dated January 23, 2001 informing Lebo
23 Automotive, Inc. of the assignment of EIN 95-4838290. All financial
24 report[ing] transactions by Lebo Automotive in tax year 2001 will be
25 submitted under EIN 95-4838290. [In its original form, Statement 1
26 was entirely capitalized; respondent reformatted Statement 1 for ease
27 of reading.]

28 (See Appellant's Appeal Letter, Exhibit C.)

As a threshold matter, elections under section 338 may only be made if the
purchaser is a **corporation**. However, the stock purchase agreement provides that the buyer was
appellant, Leo Boese, as an individual. Therefore, appellant has not established how his new
corporation, which did not even exist until several months after the stock purchase agreement was
executed, could be the buyer of the Toyota Dealership.

Furthermore, appellant has not established that the 338 (h)(10) election was either
actually or timely made. The stock purchase agreement provided that at the option of the buyer, a
section 338(h)(10) election could be made. By law, the election must be filed with the Internal

1 Revenue Service by the 15th day of the 9th month after the acquisition date. The acquisition date of
2 the Toyota stock was approximately July of 2000 and nine months after that date is April of 2001.

3 The only evidence that the election may have been made is the statement on Lebo
4 Automotive's federal income tax return for tax year 2000. In addition to the fact that the return is
5 unsigned, it was dated as of September of 2001 which is well after the April of 2001 due date.
6 Substantiation that the election was properly and timely made would be at a minimum the written
7 notice to the Seller and the federal Form 8023, Elections Under Section 338 for Corporations
8 Making Qualified Stock Purchases. (See e.g., Exhibit H, Internal Revenue Service Form 8023,
9 Rev. 2-2006.) Neither of these documents has been provided.

10 Finally, the section 338(h)(10) regulations contain a provision to ensure that
11 taxpayers are not circumventing the requirement that a corporation (rather than an individual)
12 must be the purchaser of a qualified target stock. Specifically, while the regulations state that an
13 individual cannot make a section 338(h)(10) election, they provide that an individual may form a
14 new corporation (i.e., Lebo Automotive) to purchase the stock of the target (Old Manhattan Beach
15 Toyota). However, the new corporation will not be treated as the purchaser if the new corporation
16 quickly liquidates, or otherwise disposes of the target. Specifically, the regulations provide that:

17 (b) Rules relating to qualified stock purchases – (1) Purchasing
18 corporation requirement. An individual cannot make a qualified stock
19 purchase of target. Section 338(d)(3) [26 USCS § 338(d)(3)] requires,
20 as a condition of a qualified stock purchase, that a corporation
21 purchase the stock of target. If an individual forms a corporation
22 (new P) to acquire target stock, new P can make a qualified stock
purchase of target if new P is considered for tax purposes to purchase
the target stock. Facts that may indicate that new P does not purchase
the target stock include new P's merging downstream into target,
liquidating, or otherwise disposing of the target stock following the
purported qualified stock purchase.

23 (Treas. Reg. § 1.338-3(b)(1).)

24 In this case, the stock purchase took place between April of 2000 when the stock
25 purchase agreement was entered into and the closing date of approximately July 18, 2000. Less
26 than one month later, on August 9, 2000, appellant's new corporation requested a Tax Clearance
27 Certificate for the target, Manhattan Beach Toyota, which certificate was issued October 5, 2000.
28 (Exhibit I.) The Tax Clearance Certificate indicated that Manhattan Beach Toyota ceased doing

1 business on July 18, 2000. (*Id.*) In addition, the Secretary of State's records indicate that
2 Manhattan Beach Toyota was merged into Lebo Automotive as of October of 2000. (Exhibit G.)
3 These are clearly facts that indicate that Lebo Automotive should not be considered as purchasing
4 the stock of Old Manhattan Beach Toyota for purposes of section 338(h)(10).

5 In effect, the regulations are applying the step transaction doctrine to recast a
6 transaction in which the individual is the true purchaser of the stock. The step transaction doctrine
7 treats interrelated yet formally distinct steps of an integrated transaction as a single transaction
8 when the steps are interrelated, interdependent, and intended from the outset to reach an ultimate
9 result. (*Commissioner v. Court Holding Co.* (1945) 324 U.S. 331, 334; *Minnesota Tea Co v.*
10 *Helvering* (1937) 302 U.S. 609, 613.) As succinctly stated in *Commissioner v. Court Holding*,
11 *supra*, 324 U.S. at p. 334:

12 The incidence of taxation depends upon the substance of the
13 transaction." ... "To permit the true nature of a transaction to be
14 disguised by mere formalisms, which exists solely to alter tax liabilities
would seriously impair the effective administration of the tax policies of
Congress.

15 Courts have developed several different tests under the nomenclature "step
16 transaction" to determine if the steps should be viewed as a whole. Under the "end result" test, a
17 series of transactions will be stepped together whenever the evidence shows that the parties'
18 intent at the outset was to achieve the particular result, and that the separate steps were all
19 entered into as means of achieving that result. (See *Kuper v. Commissioner*, (5th Cir. 1976) 533
20 F.2d 152; *Minnesota Tea Co. v. Helvering, supra*, 302 U.S. 609,613.)

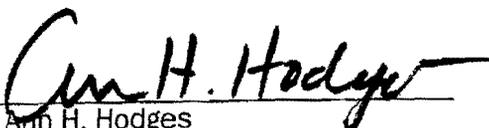
21 Therefore, in accordance with the 338(h)(10) regulations and general principles of
22 tax law, viewing the steps as a whole in this transaction, the actual purchaser was appellant
23 Leo Boese as an individual. Appellant purchased the Toyota Dealership stock, rather than its
24 assets. Therefore, appellant has not demonstrated how he met the original acquisition
25 requirements such that he should be entitled to the exclusion of gain. As a policy matter, not
26 allowing appellant to do indirectly what he could not do directly is consistent with legislative intent
27 as appellant did not create a new business or make a new investment in an existing business as
28 contemplated by the statute.

CONCLUSION

For the reasons stated above, respondent requests that its action be sustained.

Respectfully submitted,

FRANCHISE TAX BOARD

By 
Ann H. Hodges
Tax Counsel IV

Date: 03.10.11

Case Unit No. 18570389976875166
Appeals\Correspondence\Reply Brief

1 OF 1 RECORD(S)

California Secretary of State

Corporate Filing

Business Information

Filing Number: C1463160
Name: MANHATTAN BEACH MOTORS, INC.
Name Type: LEGAL
STANDARD MAILING Address: 110 S E SIXTH ST FLR 20TH
FT LAUDERDALE, FL 33301
ORIGINAL MAILING Address: 110 S E SIXTH ST 20TH FLR
FT LAUDERDALE
FL
33301
Business Type: CORPORATION
Filing Type: ARTICLES OF INCORPORATION
Status: MERGED OUT
Place Incorporated: CALIFORNIA
Date Incorporated: 06/12/1989
Foreign/Domestic: DOMESTIC
For Profit: YES
Tax Program: NOT SUSPENDED (GOOD STANDING)

Registered Agent

Name: SYSTEM, C T CORPORATION
Title: REGISTERED AGENT
Registered Agent Address 818 W 7TH ST
LOS ANGELES, CA 90017-3407

Stock Information

Stock

Additional Information: STOCK

Historical Registered Agents

Name: SYSTEM, C T CORPORATION
Title: REGISTERED AGENT
Registered Agent Address 818 W 7TH ST
LOS ANGELES, CA 90017-3407

Name: C T CORPORATION SYSTEM
Title: REGISTERED AGENT
Registered Agent Address 818 W 7TH ST
LOS ANGELES, CA 90017-3407

Officers

Name: HEUER, JERRY
Title: PRESIDENT
Contact Type: OFFICER
Standard Address: Type: CONTACT
1510 N SEPULVEDA BLVD
MANHATTAN BEACH, CA 90266-5110
Original Address: 1510 N SEPULVEDA BLVD
MANHATTAN BEACH

EXHIBIT: G
PAGE 1 OF 2

Officers

CA
90266

Filing History

Filing Date: 10/05/2000
Filing Type: FILING
Description: MERGER;OUTGOING-MERGED INTO Q DE; LEBO AUTOMOVIVE, INC.

Filing Date: 10/05/2000
Filing Type: FILING
Ref No: D0630232
Description: MERGER;OUTGOING-MERGED INTO Q DE;LEBO AUTOMOVIVE, INC.

Filing Date: 03/20/1998
Filing Type: FILING
Corp No.: C2057471
Description: MERGER;MERGED IN C2057471; RI/MEM MERGER CORP.

Filing Date: 03/20/1998
Filing Type: FILING
Ref No: A0506313
Corp No.: C2057471
Description: MERGER;MERGED IN C2057471;RI/MEM MERGER CORP.

Filing Type: FILING
Ref No: 0699616
Description: STATEMENT OF OFFICERS

Important: The Public Records and commercially available data sources used on reports have errors. Data is sometimes entered poorly, processed incorrectly and is generally not free from defect. This system should not be relied upon as definitively accurate. Before relying on any data this system supplies, it should be independently verified. For Secretary of State documents, the following data is for information purposes only and is not an official record. Certified copies may be obtained from that individual state's Department of State.

Your DPPA Permissible Use is: Government Agency
Your GLBA Permissible Use is: Legal Compliance

Copyright © 2011 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.

EXHIBIT: 6
PAGE 2 OF 2

**Elections Under Section 338 for
 Corporations Making Qualified Stock Purchases**

OMB No. 1545-1428

▶ See separate instructions.

Section A-1—Purchasing Corporation

1a Name and address of purchasing corporation	1b Employer identification number	
	1c Tax year ending	1d State or country of incorporation

Section A-2—Common Parent of the Purchasing Corporation

2a Name and address of common parent of purchasing corporation	2b Employer identification number	
	2c Tax year ending	2d State or country of incorporation

Section B—Target Corporation

3a Name and address of target corporation	3b Employer identification number	
	3c Tax year ending	3d State or country of incorporation

**Section C—Common Parent of Selling Consolidated Group, Selling Affiliate,
 S Corporation Shareholder, or U.S. Shareholder**

Complete only for a section 338(h)(10) election or if target was a member of a consolidated group or a controlled foreign corporation (CFC) or had been a CFC within the preceding five years.

4a Name and address of common parent of the selling consolidated group, selling affiliate, U.S. shareholder(s) of foreign target corporation, or S corporation shareholder(s)	4b Identifying number(s)
	4c Tax year ending

Section D—General Information

5a Acquisition date	5b What percentage of target corporation stock was purchased: (i) During the 12-month acquisition period? _____ % (ii) On the acquisition date? _____ %
---------------------	---

EXHIBIT: A
 PAGE 1 OF 5

Section E—Elections Under Section 338

- 6 Check here to make a section 338(h)(10) election for the target corporation listed in Section B on page 1
- 7 Check here to make a section 338 election (other than a section 338(h)(10) election) for the target corporation listed in Section B on page 1.
- 8 If the box on line 7 is checked for the target corporation listed in Section B on page 1, check here to make a gain recognition election for that corporation (see instructions)
- 9 Check here if this form is filed to make a section 338 election for any target corporation in addition to the one listed in Section B on page 1.

Purchasing Corporation(s) Signature(s)

Under penalties of perjury, I state and declare that I am authorized to make the election(s) on lines 6, 7, 8, and 9 on behalf of the purchasing corporation(s).

Signature of authorized person for purchasing corporation(s)	Date	Title
--	------	-------

Consolidated Selling Group or Selling Affiliate Signature (Section 338(h)(10) Election)

Under penalties of perjury, I state and declare that I am authorized to make the section 338(h)(10) election on line 6 on behalf of the common parent of the selling consolidated group or on behalf of the selling affiliate.

Signature of authorized person for the common parent or selling affiliate	Date	Title
---	------	-------

S Corporation Shareholder(s) Signature(s) (Section 338(h)(10) Election)

Under penalties of perjury, I state and declare that I am a shareholder of the S corporation target or that I am authorized to make the section 338(h)(10) election on line 6 on behalf of that shareholder. If more than one shareholder, attach a schedule with other signatures.

Signature of S corporation shareholder	Date	Title
--	------	-------

EXHIBIT: H
PAGE 2 OF 5

Instructions for Form 8023

(Rev. February 2006)



Department of the Treasury
Internal Revenue Service

Elections Under Section 338 for Corporations Making Qualified Stock Purchases

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Use Form 8023 to make elections under section 338 for a corporation (the "target" corporation) if the purchasing corporation has made a qualified stock purchase (QSP) of the target corporation.

If a section 338(g) election is made for the target, the target is treated for purposes of Subtitle A of the Code as having sold all of its assets on the acquisition date and then as having purchased the assets as a new corporation ("new" target) on the day after the acquisition date. (For periods on or before the acquisition date, the target is sometimes referred to as the "old" target.) In addition, the target must recognize gain or loss on the deemed sale of its assets.

If a section 338(h)(10) election is made for the target, the target generally is treated as making the deemed sale and liquidating. The treatment of the target shareholders generally is consistent with the sale and liquidation treatment. A section 338(h)(10) election cannot be made for a target corporation unless it is acquired from a selling consolidated group, a selling affiliate (as defined in Regulations section 1.338(h)(10)-1(b)(3)), or an S corporation shareholder (or shareholders).

Who Must File

Generally, a purchasing corporation must file Form 8023 for the target. If a section 338(h)(10) election is made for a target, Form 8023 must be filed jointly by the purchasing corporation and the common parent of the selling consolidated group (or the selling affiliate or an S corporation shareholder(s)). If the target is an S corporation, a section 338(h)(10) election must be made by all of the shareholders of the target, including shareholders who do not sell target stock in the QSP.

When and Where To File

File Form 8023 by the 15th day of the 9th month after the acquisition date to make a section 338 election for the

target corporation. In the case of a Foreign Purchasing Corporation, see *Special Instructions for Foreign Purchasing Corporations* on page 2. File Form 8023 with the Internal Revenue Service, Submission Processing Center, P.O. Box 9941, Mail Stop 4912, Ogden, UT 84409.

Elections for Multiple Targets

One Form 8023 (rather than multiple forms) may be used for targets that meet these three requirements:

1. Each has the same acquisition date,
2. Each was a member of the same affiliated group (defined below) immediately before the acquisition date, and
3. Each is a member of the same affiliated group immediately after the acquisition date.

All of the information that would be required for the additional targets if a separate Form 8023 were filed must be provided for that target in schedules attached to the form. If a form is used to make an election under section 338 for more than one target, check the box on line 9. In an attached schedule, provide the information requested in Sections A-1, A-2, B, C, and D for each target corporation other than the one shown in Section B of the form. In the schedule, also state which elections are made for each target (i.e., information corresponding to lines 6, 7, 8, and 9 of Section E). Include the appropriate signature or signature attachment for each target. See *Signature(s)* on page 2.

One special instruction applies to section 338 elections for lower-tiered targets, whether one or more Forms 8023 are filed to make the elections. If, for example, P purchases target A, target A owns target B, and P makes a section 338 election for target A, this results in a deemed QSP of target B. To make an election for target B, complete and sign Form 8023 as if the purchasing corporation(s) of the directly purchased target were the purchasing corporation(s) of the lower-tiered target.

Definitions

A **qualified stock purchase (QSP)** is the purchase of at least 80% of the total voting power and value of the stock of a corporation by another corporation during a 12-month acquisition period. Preferred stock (as described in section 1504(a)(4)) is not included in computing voting power or value. See section 338(h)(3) for the definition of "purchase."

The **acquisition date** is the first day on which a QSP has occurred.

In general, the **12-month acquisition period** is the 12-month period beginning with the first acquisition by purchase of stock included in the QSP. See section 338(h)(1) for additional rules. Also see Regulations section 1.338-8(j)(2).

The term **affiliated group** means an affiliated group as defined in section 1504(a), determined without regard to the exceptions contained in section 1504(b).

Specific Instructions

Employer identification number.

An employer identification number (EIN) must be included for each corporation identified in Section A-1, A-2, B, or C or on attached schedules. An EIN is not required if the corporation does not have, and is not otherwise required to have, an EIN.

Country of incorporation. When identifying the country of incorporation, include political subdivisions, if any.

Tax year ending. The tax year ending date of any corporation is determined without regard to any QSP.

Section A-1—Purchasing Corporation

If more than one member of an affiliated group purchases stock of the target corporation listed in Section B (or identified on an attached schedule), enter in Section A-1 the name of the corporation that acquired the largest percentage (by value) of the target's stock in the QSP. If two

EXHIBIT: H
PAGE 3 OF 5

or more affiliates acquired equal amounts of target stock, insert the name of any one of them in Section A-1. On an attached schedule, provide the information requested on this form for each purchasing corporation other than the one listed in Section A-1. Also provide a schedule that lists which target stock was acquired by each purchasing corporation.

Section A-2—Common Parent of the Purchasing Corporation

If the purchasing corporation is a member of a consolidated group, complete Section A-2.

Section C—Common Parent of Selling Consolidated Group, Selling Affiliate, S Corporation Shareholder, or U.S. Shareholder

If Form 8023 is filed to make a section 338(h)(10) election for a target that is an S corporation, the information requested in Section C must be provided for each shareholder of the S corporation target. Attach a schedule with respect to the other shareholders. If Form 8023 is filed to make a section 338 election for a target that is or was a controlled foreign corporation (CFC), enter in Section C the name of the U.S. shareholder that owned the largest percentage (by value) of the target's stock immediately before the acquisition date. If two or more U.S. shareholders acquired equal amounts of target stock, enter the name of any one of them in Section C. On an attached schedule, provide the information requested on this form for each U.S. shareholder other than the one listed in Section C. If a U.S. shareholder is a member of a consolidated group other than the common parent, also provide the name and EIN for the common parent of the U.S. shareholder's group.

Line 4b. Identifying number. Enter the social security number (SSN) for an individual. Enter the EIN for a corporation.

Section E—Elections Under Section 338

Line 8. Gain recognition election. If a gain recognition election is made for a target, it applies to the purchasing corporation and all members of its affiliated group that hold nonrecently purchased target stock (that is, stock in the target

acquired prior to the 12-month acquisition period). See Regulations section 1.338-5(d). If a section 338(h)(10) election is made for a target, a gain recognition election is deemed made by each purchasing group member.

If a gain recognition election is actually made (not deemed made) for a target corporation, attach a schedule providing the target corporation's name and the name, address, and EIN of each purchasing group member holding nonrecently purchased stock. The schedule must also contain the following declaration (or a substantially similar declaration): "EACH CORPORATION HOLDING STOCK SUBJECT TO THIS GAIN RECOGNITION ELECTION AGREES TO REPORT ANY GAIN UNDER THE GAIN RECOGNITION ELECTION IN ITS FEDERAL INCOME TAX RETURN (INCLUDING AN AMENDED RETURN, IF NECESSARY) FOR THE TAX YEAR IN WHICH THE ACQUISITION DATE OF THE TARGET OCCURS."

The schedule must be signed on behalf of each purchasing group member holding nonrecently purchased target stock by a person who states under penalties of perjury that he or she is authorized to act on behalf of the corporation.

A gain recognition election for the target also applies to any target affiliate that has the same acquisition date as the target and for which a section 338 election is made. Attach a schedule with the information requested above for each such target affiliate.

Signature(s)

If the common parent of a consolidated group is the agent of the purchasing corporation under Regulations section 1.1502-77, the person authorized to sign the statement of section 338 election is the person authorized to act on behalf of that common parent.

If a QSP of a target corporation is made by two or more corporations that are members of the same affiliated (but not consolidated) group, Form 8023 must be signed by a person authorized to sign on behalf of each corporation.

If a section 338(h)(10) election is made for an S corporation, Form 8023 must be signed by each S corporation shareholder regardless of whether the shareholder sells his interest in target stock in the QSP.

If multiple signatures are required, the signatures must be provided on a "SIGNATURE ATTACHMENT" to the form under the appropriate "declaration under penalties of perjury" (this is the statement that appears on Form 8023 immediately above the relevant signature line). Write "See attached" in the signature area of the Form 8023.

Special Instructions for Foreign Purchasing Corporations

Unless otherwise specifically noted, the general rules and requirements in these instructions apply to foreign purchasing corporations.

Who must file. Generally, the purchasing corporation must file Form 8023. However, the U.S. shareholders of controlled foreign purchasing corporations described in Regulations section 1.338-2(e)(3) may make the section 338 election for the purchasing corporation. The shareholders may make this election only if the purchasing corporation is not required under Regulations section 1.6012-2(g) to file a U.S. income tax return for the tax year that includes the acquisition date.

To make this election, complete Form 8023 and attach a statement to the form showing the name, address, identifying number, country in which organized, and stock interest of each U.S. shareholder. The statement must be signed by each U.S. shareholder. When signing the statement, each U.S. shareholder must state under penalties of perjury that the stock interest for that shareholder specified in the statement is correct. Write "See attached" in the signature area of Form 8023.

As an alternative to a jointly signed statement, the shareholder signatures may be shown on separate statements attached to Form 8023. If a U.S. shareholder is not an individual or does not have delegated authority to sign the statement, the person signing must state under penalties of perjury that he or she is authorized to sign the statement for the U.S. shareholder. File Form 8023 for the foreign purchasing corporation's tax year that includes the acquisition date.

Form 8883. Each U.S. shareholder must also file Form 8883, Asset Allocation Statement Under Section 338, with Form 5471, Information

Return of U.S. Persons With Respect to Certain Foreign Corporations. See the Instructions for Form 8883.

When to file. Special rules may apply to foreign purchasing corporations. The time during which a qualifying foreign purchasing corporation may make a section 338 election for a qualifying foreign target is described in Regulations section 1.338-2(e)(1).

Special Instructions for Foreign Targets

Unless otherwise specifically noted, the general rules and requirements in these instructions apply to foreign targets.

A section 338 election will not be valid for a target that is a controlled foreign corporation, a passive foreign investment company, or a foreign personal holding company unless affected U.S. persons who own stock in these targets are notified, in writing, as set forth in Regulations section 1.338-2(e)(4).

Form 8883. Each U.S. shareholder must also file Form 8883 with Form 5471. See the Instructions for Form 8883.

Attachments. Attach a schedule listing the date of each purchase of foreign target stock, each purchaser's name, the percentage purchased by each purchaser, and the name and place of incorporation of any selling entities. If affected U.S. persons owning stock in the target are notified, attach a schedule containing the name and EIN or SSN of each U.S. person.

Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become

material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this tax form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	9 hr., 19 min.
Learning about the law or the form	1 hr., 35 min.
Preparing and sending the form to the IRS	1 hr., 48 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave., NW, IR-6406, Washington, DC 20224. Do not send this form to this address. Instead, see *When and Where To File* on page 1.

REC'D AUG 11 2000 SAC

EXPRESS



KARIS

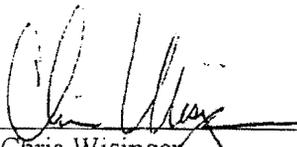
REQUEST FOR TAX CLEARANCE

August 09, 2000

Tax Clearance Unit
Franchise Tax Board
9645 Butterfield Rd
Sacramento CA 95827

RE: MANHATTAN BEACH MOTORS, INC.

Enclosed is the Request for Tax Clearance form for the above named entity(ies). Please issue tax clearance as soon as possible. If you have any questions or concerns, please call me at (916) 497-0737. Thank you in advance for your assistance with this matter.


Chris Wisinger
Customer Service

Karis Corporate Services
1005 12th Street, Suite G
Sacramento, CA 95814

toll free 888-595-2747
phone 916-497-0737
fax 888-955-2747

EXHIBIT: I
PAGE 1 OF 7

Request for Tax Clearance Certificate — Corporations

CALIFORNIA FORM

3555

Corporation name MANHATTAN BEACH MOTORS, INC.		California corporation number
Current address 1510 No. Sepulveda Blvd. Manhattan Beach, CA 90266	Phone number (310) 546-4848	D [redacted]
Date business commenced in California: 6/12/89	Date business ceased or will cease in California: 7/18/00	[redacted] for which a California return has been filed: 1999

The Franchise Tax Board will issue a tax clearance certificate when all taxes have been paid or secured. If a final return has not been filed, one should be filed within 2 months and 15 days after the close of the month in which the dissolution or withdrawal takes place. All returns remain subject to audit until expiration of the normal statutes of limitation.

Please indicate the status of ANY IRS activity:

INV

Has the IRS redetermined the corporation's income tax liability for any prior year(s) that you have not previously reported to us? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <i>If yes, send us a copy of the Revenue Agent's Report.</i>	Is the IRS currently examining the corporation or has the corporation been notified of a pending examination? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <i>If yes, indicate the years involved:</i> Current examination: _____ Pending examination: _____
--	---

COMPLETE PAGES 2 AND 3 OF THIS FORM FOR AN INDIVIDUAL OR OTHER ENTITY ASSUMPTION OF TAX LIABILITY. COMPLETE PAGE 4 FOR A CORPORATION, LIMITED LIABILITY COMPANY, OR LIMITED LIABILITY PARTNERSHIP ASSUMPTION OF TAX LIABILITY.

If the tax clearance certificate is to be issued on a taxes paid basis, check this box and provide a copy of your final tax return.

Supplemental Information. Please furnish the following information if the business conducted in California will be continued by another corporation after the merger of the original corporation.

Name of transferee N/A	California corporation number of transferee
Date assets transferred to transferee	Section of the Internal Revenue Code applicable to the transfer of Taxpayer's Business or assets: _____

If the tax clearance certificate is to be mailed to someone other than the corporation listed above, complete the following:
(A copy of the tax clearance certificate will be sent to the Secretary of State.)

Name CHRIS - BARONE		_____
Address 1005 12th St. Suite G Sacramento CA 95814		_____
888.595.2747	Phone number (949) 759-7888	

Mail completed form to: **DOCUMENT FILING SUPPORT UNIT
SECRETARY OF STATE - BUSINESS FILINGS
1500 ELEVENTH ST
SACRAMENTO CA 95814**

For more information concerning this form, telephone the Franchise Tax Board at (916) 845-4124.

Assistance for persons with disabilities: We comply with provisions of the Americans with Disabilities Act. Persons with hearing or speech impairments, call: from voice phone (800) 735-2922, or from TTY/TDD (800) 822-6268.

EXHIBIT: I
PAGE 2 OF 7

CORPORATION, LIMITED LIABILITY COMPANY, OR LIMITED LIABILITY PARTNERSHIP ASSUMPTION OF TAX LIABILITY

The Assumption of Tax Liability

of (1) MANHATTAN BEACH MOTORS, INC.)
 _____)
 A corporation) 1463160
 _____)
 Corporation no.)
 by (2) LEBO AUTOMOTIVE, INC. / 1/12/00)
 _____)
 _____)
 _____)
 Corporation no. or SOS file no.*

incorporated, organized, or qualified to do business within the State of California, unconditionally agrees to file with the Franchise Tax Board all returns and data that is required and unconditionally agrees to pay in full all tax liabilities, penalties, interest and fees of (1) _____

MANHATTAN BEACH MOTORS, INC.;

(2) LEBO AUTOMOTIVE, INC.

 Exact corporation, LLC, or LLP name
 By: [Signature]

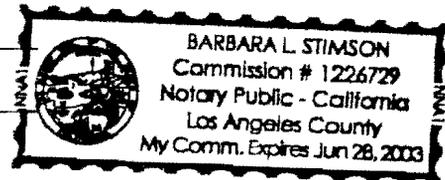
 Signature and title of officer/manager/partner
 Leo Boese, President

State of California
 County of Los Angeles
 On August 14th 2000 before me, the undersigned, a Notary Public in and for
 said State, personally appeared Leo R. Boese III

personally known to me (or proved to me on the basis of satisfactory evidence) to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the entity upon behalf of which the person(s) acted, executed the instrument.

WITNESS my hand and official seal.

Signature [Signature]
 Name Barbara L. Stimson
 (typed or printed)
BARBARA L. STIMSON



*LLC and LLP assumers must provide a financial statement.

EXHIBIT: I
 PAGE 3 OF 7



STATE OF CALIFORNIA
 FRANCHISE TAX BOARD
 P O BOX 1468
 SACRAMENTO CA 95812-1468

In reply refer to
 [REDACTED]

September 19, 2000

KARIS CORPORATE SERVICES
 CHRIS BARONE
 1005 12TH ST STE G
 SACRAMENTO CA 95814

ENTITY ID : [REDACTED]
 MANHATTAN BEACH MOTORS, INC.

We acknowledge your request for a Tax Clearance Certificate.

A corporation is required to file a return for each year and pay at least the minimum tax until it is dissolved or withdrawn through the Office of the Secretary of State. The dissolution or withdrawal cannot be completed until a Tax Clearance Certificate is issued by this office indicating all taxes have been paid or are otherwise secured.

A minimum tax of \$800.00 must be paid for each accounting period even though the corporation is inactive or operated at a loss.

We reviewed the Assumption of Tax Liability that you submitted to the Franchise Tax Board. To complete the dissolution process, please submit a financial statement providing the net worth of the assumer, Lebo Automotive Inc. #2194503. We require this information when the assumer is a newly qualified corporation or a limited liability company..

The corporation must provide an assumer or file a final tax return and request a Tax Clearance Certificate on a taxes paid basis. (Refer to enclosed FTB 1038).

A Tax Clearance Certificate may be issued if the balance due as stated below is paid:

INCOME YEAR ENDED	DESCRIPTION OF UNPAID LIABILITY	AMOUNT
02/29/00	Assessment based on data furnished Tax \$ 800.00	

EXHIBIT: I
 PAGE 4 OF 7

September 19, 2000
KARIS CORPORATE SERVICES
ENTITY ID : ██████████
Page 2

Penalty	254.64	
Interest	34.00	
Balance due		\$1,088.64

Before a Tax Clearance Certificate may be issued, the corporation must file return(s) for the period(s):

From 03/01/98, to 02/28/99.

File the return(s) on the enclosed form(s).

When filing the return, take credit for \$800.00 in the account.

Please return a copy of this letter with your response, using the enclosed envelope.

Tax Clearance Unit
Special Activities Group
P. O. Box 1468
Sacramento, CA 95812-1468

S KANTNER
GENERAL TAX AUDIT
TELEPHONE (916) 845-6057

██████████

EXHIBIT: I
PAGE 5 OF 7

COPY



STATE OF CALIFORNIA
FRANCHISE TAX BOARD
PO BOX 1468
SACRAMENTO CA 95812-1468

TAX CLEARANCE CERTIFICATE

EXPIRATION DATE: January 12, 2001

October 5, 2000

KARIS CORPORATE SERVICES
CHRIS BARONE
1005 12TH ST STE G
SACRAMENTO CA 95814-3940

ISSUED TO : MANHATTAN BEACH MOTORS, INC.
ENTITY ID :

This letter certifies that all taxes imposed under the Bank and Corporation Tax Law on this corporation have been paid or are secured by bond, deposit, or other security.

Please note the following:

- * A final tax return, if not already filed, is due two months and 15 days after the close of the month in which dissolution or withdrawal takes place. If the corporation was inactive prior to that date, attach a statement to the tax return giving the date it became inactive.
- * Filed tax returns remain subject to audit until the expiration of the statute of limitations.
- * If the corporation does not file the tax returns, we may issue additional assessments.

We sent a copy of this Tax Clearance Certificate to the Secretary of State. Please retain this letter for your records.

PLEASE NOTE: By the expiration date above, the corporation must file all documents required by the Secretary of State to dissolve, withdraw, or merge. If the corporation does not complete this process, it will remain subject to the filing requirements of the Bank and Corporation Tax Law.

To obtain these documents, please write to:

SECRETARY OF STATE
1500 11th St., 3rd Floor
SACRAMENTO, CA 95814-5701

You can also call them at (916) 657-5448 or access their website at www.ss.ca.gov

EXHIBIT: I
PAGE 6 OF 7

October 5, 2000
KARIS CORPORATE SERVICES
ENTITY ID : ██████████
Page 2

Franchise Tax Board
Telephone (800) 852-5711

Tax Clearance Unit
Taxpayer Services Center
Telephone (800) 852-5711

EXHIBIT: I
PAGE 7 OF 7

COPY