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

10 In the Matter of the Appeal of: ) **HEARING SUMMARY**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **JAMES TRACY AND THERESE TRACY<sup>1</sup>** ) Case No. 505057<sup>2</sup>  
13 )  
14 )

15 Year Proposed  
16 2003 Assessment  
\$21,593

17 Representing the Parties:

19 For Appellants: Lawrence A. Jacobson, Esq.  
20 For Franchise Tax Board: Maria Brosterhous, Tax Counsel

21 **QUESTIONS:** (1) Whether appellants have shown that the FTB's capital loss audit adjustment of  
22 \$770,417 is barred by the four-year statute of limitations set forth in Revenue and  
23 Taxation (R&TC) section 19057.

25 <sup>1</sup> Appellants' appeal letter lists an address in Monterey County, California.

26 <sup>2</sup> This appeal was originally scheduled for the Board's November 16-18, 2010 oral hearing calendar. However, after this  
27 appeal was scheduled, appellants' representative and the Franchise Tax Board (FTB or respondent) notified Board  
28 Proceedings that the parties needed additional time to consider a previous Board decision that might relate to this appeal.  
Accordingly, the parties asked to postpone this appeal to allow additional time for discussion. The postponement request was  
granted. Therefore, this appeal was rescheduled to the January 26-28, 2011 oral hearing calendar.

1 (2) Whether appellants have demonstrated entitlement to the \$770,417 capital loss  
2 carryover incurred in 1988 and claimed on their 2003 tax return.

3 (3) Whether appellants have shown that the FTB's capital loss audit adjustment of  
4 \$770,417 is barred by the doctrines of estoppel and/or laches.

5 HEARING SUMMARY

6 Background

7 Appellants filed a joint 2003 California income tax return on August 21, 2004, reporting  
8 a federal adjusted gross income (AGI) of -\$1,417,171.<sup>3</sup> In addition, appellants filed various schedules  
9 and forms in which appellants reported various gains and losses. For example, in their 2003 California  
10 Schedule CA (540), appellants reported a federal Schedule E loss of -\$867,231. (See Ex. P, AOB.) In  
11 addition, appellants filed a 2003 California Schedule D (540), reporting a capital gain of \$770,000, a  
12 capital loss of -\$2,583, and a California capital loss carryover from 2002 of -\$1,859,418. (*Id.*) Finally,  
13 on their California Form 3805V, appellants reported a California taxable income of -\$1,039,195. (*Id.*)

14 Subsequently, in June 2007, the FTB examined appellants' 2003 California return (along  
15 with the accompanying forms and schedules) and requested, among other things, information  
16 substantiating appellants' basis in two separate limited liability companies and documents substantiating  
17 the capital loss carryover from 2002 of -\$1,859,418. After the FTB failed to receive such  
18 documentation, the FTB issued a Notice of Proposed Assessment (NPA) on February 22, 2008. The  
19 NPA increased appellants' 2003 California taxable income from -\$1,039,195 to \$862,739 by adding the  
20 following amounts to appellants' California taxable income: (a) a Schedule E audit adjustment of  
21 \$1,131,517, and (b) a capital loss audit adjustment of \$770,417.

22 Appellants timely protested the NPA. After considering appellants' protest, the FTB  
23 agreed to reduce the Schedule E audit adjustment from \$1,131,517 to \$543,942; however, the FTB did  
24 not make any changes to the capital loss audit adjustment of \$770,417. Accordingly, the FTB issued a  
25 Notice of Action (NOA) on June 26, 2009, revising the NPA. The NOA increased appellants' 2003  
26 California taxable income from -\$1,039,195 to \$275,164 by adding the following amounts to appellants'  
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28 <sup>3</sup> This is the date FTB asserts that appellants filed their 2003 California return. A copy of appellants' 2003 California return is attached as Exhibit P to appellants' opening brief dated November 20, 2009 (AOB).

1 taxable income: (a) a Schedule E audit adjustment of \$543,942, and (b) a capital loss audit adjustment of  
2 \$770,417. This timely appeal followed.

### 3 Contentions

4 In their appeal letter, appellants clarify that they are only disputing the FTB's capital loss  
5 audit adjustment of \$770,417; accordingly, the FTB's Schedule E audit adjustment of \$543,942 is no  
6 longer an issue in this appeal.

### 7 Appellants

8 Appellants make two arguments: First, appellants argue that the FTB's proposed  
9 assessment for the capital loss audit adjustment of \$770,417 is barred by the statute of limitations.  
10 Specifically, appellants assert that the capital loss carryover of -\$1,859,418 that they reported on their  
11 2003 California Schedule D stems from a capital loss they incurred in 1988, and therefore, appellants  
12 argue that the FTB's 2003 proposed assessment for the capital loss audit adjustment of \$770,417 is  
13 barred by the statute of limitations.

14 Second, appellants argue that the FTB's proposed capital loss audit adjustment of  
15 \$770,417 is barred by the doctrines of estoppel and/or laches, given that the FTB never questioned  
16 appellants' capital loss deductions until June 2007, even though appellants claimed an annual \$3,000  
17 capital loss deduction "for at least a decade without challenge." Likewise, appellants explain that given  
18 the amount of time since they incurred the capital loss in 1988, they no longer have documents  
19 supporting the capital loss carryover amount of -\$1,859,418.

### 20 The FTB

21 The FTB makes four arguments: First, the FTB argues that its capital loss audit  
22 adjustment of \$770,417 is not barred by the statute of limitations; the tax year at issue is 2003, the NPA  
23 was timely issued pursuant to R&TC section 19057, and the appellants have the burden of proof with  
24 respect to the carryover loss claimed on that return. In this respect, the FTB states that it "is entitled to  
25 question the underlying loss upon which the carryover deduction is based even though the loss occurred  
26 outside the statute of limitations in order to determine the proper amount of deficiency in the open year."  
27 (Citing, e.g., *Calumet Industries, Inc. v. Commissioner* (1990) 95 T.C. 257, 274; *Lone Manor Farms,*  
28 *Inc. v. Commissioner* (1974) 61 T.C. 436, 440.)

1           Second, the FTB argues that, other than appellants’ unsupported assertions (including the  
2 assertions made in appellants’ tax forms and schedules), appellants have not provided any evidence  
3 demonstrating their entitlement to the claimed loss of \$770,417.

4           Third, the FTB argues that its capital loss audit adjustment of \$770,417 is not barred by  
5 the doctrine of equitable estoppel. In this respect, the FTB argues that appellants have not established  
6 any element of the doctrine of equitable estoppel. For example, the FTB argues that appellants have not  
7 shown detrimental reliance—in this respect, the FTB argues that its failure to examine appellants’ prior  
8 returns cannot be considered an action upon which appellants are entitled to rely. Also, the FTB argues  
9 that appellants have not shown that the FTB made an incorrect or inaccurate representation—in this  
10 respect the FTB argues that just because it did not review and question appellants’ prior returns does not  
11 mean the it somehow “approved” the prior returns, such that appellants could take a capital loss  
12 deduction without retaining records of such. In addition, the FTB argues that appellants have not shown  
13 that the FTB was aware of the actual facts—in this respect the FTB argues that because it did not  
14 examine appellants’ prior returns, it was not aware that appellants claimed a capital loss prior to its  
15 examination of appellants’ 2003 return. Also, the FTB argues that appellants have not shown they were  
16 ignorant of any facts in this matter; in this regard FTB explains that both the IRS and FTB generally  
17 advise taxpayers to keep all records necessary to prove claimed deductions on a taxable year which is  
18 still in within the statute of limitations (such as here, appellants 2003 return with the claimed deduction).

19           Finally, the FTB argues that its assessment is not barred by the doctrine of laches. In this  
20 respect, the FTB reasons that its failure to examine appellants’ prior returns cannot be considered a  
21 reason to bar its capital loss audit adjustment of \$770,417 for the year at issue.

## 22           Applicable Law

### 23           Statute of Limitations

24           In general, the FTB must issue an NPA within four years of the date the taxpayer filed his  
25 or her California return. (Rev. & Tax. Code, § 19057.) However, the FTB is generally entitled to  
26 question an underlying loss upon which a carryover deduction is based in order to determine the proper  
27 amount of a deficiency in a tax year that is open to the statute of limitations. (*Lone Manor Farms, Inc.*  
28 *v. Commissioner* (1974) 61 T.C. 436, 440; *State Farming Company, Inc. v. Commissioner* (1963) 40

1 T.C. 774, 781; *Calumet Industries, Inc. v. Commissioner* (1990) 95 T.C. 257, 274.) In *Calumet*  
2 *Industries, Inc.*, the court noted that “[i]t has long been held that we may determine the correct amount  
3 of taxable income or NOL [net operating loss] for a year not in issue (whether or not the assessment of a  
4 deficiency for that year is barred) as a preliminary step in determining the correct amount of an NOL  
5 carryover to a taxable year in issue.” (*Id.* at 274.)

#### 6 Deductions

7 Income tax deductions are a matter of legislative grace, and a taxpayer who claims a  
8 deduction has the burden of proving by competent evidence that he or she is entitled to that deduction.  
9 (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Michael E. Myers*, 2001-SBE-  
10 001, May 31, 2001.)<sup>4</sup> Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof.  
11 (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

12 In general, under California’s Personal Income Tax Law, capital losses are netted against  
13 capital gains and a taxpayer is allowed to deduct capital losses in excess of capital gains up to a  
14 maximum of \$3,000 per year. (R&TC § 18151 incorporating Int.Rev. Code § 1211.) An individual can  
15 carryover the excess indefinitely but is not permitted a capital loss carryback. (*Id.*)

#### 16 Equitable Estoppel

17 Equitable estoppel is applied against the government only in rare and unusual  
18 circumstances and when its application is necessary to prevent manifest injustice. (See *Appeal of*  
19 *Richard R. and Diane K. Smith*, 91-SBE-005, Oct. 9, 1991.) The four elements of equitable estoppel  
20 are: (1) the government agency must be shown to have been aware of the actual facts; (2) the  
21 government agency must be shown to have made an incorrect or inaccurate representation to the relying  
22 party and intended that its incorrect or inaccurate representation would be acted upon by the relying  
23 party or have acted in such a way that the relying party had a right to believe that the representation was  
24 so intended; (3) the relying party must be shown to have been ignorant of the actual facts; and (4) the  
25 relying party must be shown to have detrimentally relied upon the representations or conduct of the  
26 government agency. (*Appeal of Western Colorprint*, 78-SBE-071, Aug. 15, 1978.) Where one of these  
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28 <sup>4</sup> Board of Equalization cases are generally available for viewing on the Board’s website ([www.boe.ca.gov](http://www.boe.ca.gov)).

1 elements is missing, there can be no estoppel. (*Hersch v. Citizens Savings & Loan Assn.* (1983) 146  
2 Cal.App.3d 1002, 1011.) The burden of proving estoppel is on the party asserting estoppel. (*Appeal of*  
3 *Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.) In general, the FTB's failure to examine a taxpayer's  
4 prior returns cannot be considered actions upon which a taxpayer is entitled to rely, given that each year  
5 is reviewed independently. (See *Appeal of Duane H. Laude*, 76-SBE-096, Oct. 6, 1976.)

### 6 Laches

7 In general, laches is defined as the neglect or failure of a plaintiff to assert a right for such  
8 a period of time that results in prejudice to the defendant requiring that the plaintiff's cause of action be  
9 barred in equity. (*Appeals of Charles C. and Elynor W. Renshaw*, 86-SBE-191, Nov. 19, 1986.)

10 Whether any delay by a plaintiff in bringing an action was unreasonable is a question of fact. (*Id.*) In  
11 general, the FTB's failure to examine a taxpayer's prior returns cannot be considered actions upon  
12 which a taxpayer is entitled to rely, given that each year is reviewed independently. (See *Appeal of*  
13 *Duane H. Laude, supra.*) In addition, the Ninth Circuit has stated that "laches is not a defense to the  
14 [government's] enforcement of tax claims." (*Dial v. Commissioner* (9th Cir. 1992) 968 F.2d 898, 904;  
15 see also, *United States v. First National Bank of Circle* (9th Cir. 1981) 652 F.2d 882, 890 ["[I]aches is  
16 not a defense to the enforcement of tax claims by the United States]; *Hatchett v. United States* (6th Cir.  
17 2003) 330 F.3d 875, 887 ["there is no precedent holding that the Government is subject to its own laches  
18 in tax collection actions."].)

### 19 STAFF COMMENTS

#### 20 Statute of Limitations

21 As noted above, the FTB is generally entitled to question an underlying loss upon which  
22 a carryover deduction is based in order to determine the proper amount of a deficiency in a tax year that  
23 is open to the statute of limitations. In *Calumet Industries, Inc.*, the court noted that "it has long been  
24 held that we may determine the correct amount of taxable income or NOL for a year not in issue  
25 (whether or not the assessment of a deficiency for that year is barred) as a preliminary step in  
26 determining the correct amount of an NOL carryover to a taxable year in issue." (*Calumet Industries,*  
27 *Inc. v. Commissioner, supra*, at 274.) Based on the foregoing authorities, it appears to staff that the  
28 statute of limitations does not bar the FTB's capital loss audit adjustment of \$770,417. At the oral

1 hearing, appellants' should be prepared to distinguish the authorities listed above.

2 Deductions

3 Income tax deductions are a matter of legislative grace. (See *New Colonial Ice Co. v.*  
4 *Helvering, supra; Appeal of Michael E. Myers, supra.*) Unsupported assertions are not sufficient to  
5 satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow, supra.*)

6 As noted above in footnote two, this appeal was originally scheduled for the Board's  
7 November 16-18, 2010 oral hearing calendar. However, after this appeal was scheduled, appellants'  
8 representative and the FTB notified Board Proceedings that the parties needed additional time to  
9 consider a previous Board decision that might relate to this appeal. Accordingly, the parties asked to  
10 postpone this appeal to allow additional time for discussion. The postponement request was granted.  
11 Therefore, this appeal was rescheduled to the Board's January 26-28, 2011 oral hearing calendar.

12 The previous Board decision that the parties are referring to may be a decision adopted  
13 by this Board on September 10, 1997. In that decision, the Board found, among other things, that the  
14 appellants in this current appeal (i.e., James and Therese Tracy) were entitled to a bad debt deduction of  
15 \$2,474,772 in relation to the worthlessness of their claim against Van Ness Auto Plaza, Inc. for the 1989  
16 tax year. At the oral hearing, the parties should be prepared to discuss whether the previous decision has  
17 any relevance to the current appeal.

18 Equitable Estoppel

19 As noted above, for equitable estoppel to apply, appellants must prove all four elements  
20 of the cause of action. Thus, at the oral hearing, appellants should be prepared to show that they  
21 detrimentally relied upon the actions of the FTB. However, the Board has held that FTB's failure to  
22 examine a taxpayer's prior returns cannot be considered an action upon which a taxpayer is entitled to  
23 rely. (See *Appeal of Duane H. Laude, supra.*) Appellants thus appear to be unable to demonstrate that  
24 equitable estoppel can be applied in this case.

25 Laches

26 At the oral hearing, the parties should be prepared to discuss whether the doctrine of  
27 laches applies to the facts at hand. As noted above, laches is generally defined as the neglect or failure  
28 of a plaintiff to assert a right for such a period of time that results in prejudice to defendant requiring the

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plaintiff’s cause of action be barred in equity. (*Appeals of Charles C. and Elynor W. Renshaw, supra.*)

Staff notes that, in general, the FTB’s failure to examine a taxpayer’s prior returns cannot be considered an action upon which a taxpayer is entitled to rely, given that each year is reviewed independently. (See *Appeal of Duane H. Laude, supra.*) In addition, the Ninth Circuit stated that “laches is not a defense to the [government’s] enforcement of tax claims.” (*Dial v. Commissioner, supra*, at 904; see also, *United States v. First National Bank of Circle, supra*, at 890 [“[l]aches is not a defense to the enforcement of tax claims by the United States”]; *Hatchett v. United States, supra*, at 887 [“there is no precedent holding that the Government is subject to its own laches in tax collection actions.”].)

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