

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18012101 ¹
)
MICHAEL J. GEORGE AND) Date Issued: August 8, 2018
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DONYA L. GEORGE)
_____)

DECISION ON PETITION FOR REHEARING

Representing the Parties:

For Appellants:	Hugh W. Goodwin, DLA Piper LLP (US)
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For Respondent:	Bradley W. Kragel, Tax Counsel III
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For Office of Tax Appeals:	Tom Hudson, Tax Counsel III
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T. STANLEY, Administrative Law Judge: On November 14, 2017, the California State Board of Equalization (BOE) issued a decision in which it sustained the proposed assessments from the Franchise Tax Board (FTB or respondent) of additional tax of \$7,987 for the 2008 tax year and \$17,379 for the 2009 tax year. By letter dated December 19, 2017, appellants petitioned for a rehearing of this matter. Upon consideration of appellants' petition, we conclude that the grounds set forth therein do not constitute good cause for a new hearing, as required by the precedent in the *Appeal of Wilson Development, Inc.*, 94-SBE-007, October 5, 1994,² in our recent decision in *Appeal of Sjoefinar Do*, 2018-OTA-002P, March 22, 2018, and by California Code of Regulations, title 18, section 30602(c)(5)(A-D).

In *Appeal of Wilson Development, Inc.*, *supra*, the BOE determined that good cause for a new hearing may be shown where one of the following grounds exists and the rights of the

¹ Case Number 823463 for the Board of Equalization and the California Department of Tax and Fee Administration.

² Precedential opinions of the BOE that were adopted prior to January 1, 2018, may be cited as precedential authority to the Office of Tax Appeals unless a panel removes, in whole or in part, the precedential status of the opinion as part of a written opinion that the panel issues pursuant to this section. (Cal. Code. Regs., tit. 18, § 30501(d)(3).) BOE's precedential opinions are available for viewing on the BOE's website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

complaining party are materially affected: 1) irregularity in the proceedings by which the party was prevented from having a fair consideration of its appeal; 2) accident or surprise, which ordinary prudence could not have guarded against; 3) newly discovered evidence, material for the party making the petition for rehearing, which the party could not, with reasonable diligence, have discovered and produced prior to the decision of the appeal; 4) insufficiency of the evidence to justify the decision, or the decision is against law; or 5) error in law. These standards for a petition for rehearing have been codified in the Office of Tax Appeals Rules for Tax Appeals. (See Cal. Code of Regs., tit. 18, § 30602(c)(5)(A-D).)


In their petition for rehearing, appellants argue that the BOE incorrectly concluded that appellant-husband Michael George controlled the actions of Nine Mile Hill Investment Company, Inc. (NMIC), which was the corporation that advanced the funds to appellant-husband that the BOE decision characterized as taxable shareholder distributions rather than nontaxable loans. Appellants contend in this Petition for Rehearing (PFR), as they did in the underlying appeal, that appellant-husband never owned more than 50 percent of NMIC, and his shares were held by a voting trust under an agreement requiring the unanimous agreement of appellant-husband and another “unrelated” trustee for corporate actions. Appellants contend that the BOE’s decision relied on legal precedents that are not applicable to the present appeal because those precedents involve situations where “a majority shareholder compels the distribution of fund *to himself*.” In the PFR, appellants note that appellant-husband could not “unilaterally” cause NMIC to make the disputed distributions to him.

We understand appellants’ position, but we find that these issues were briefed by the parties and they were clearly considered by the BOE in reaching its decision on November 14, 2017. Appellants contend there is insufficient evidence to justify the decision, or that the decision is against law. The question of whether the decision is contrary to law (or against law) is not one which involves a weighing of the evidence, but instead requires a finding that the decision is “unsupported by any substantial evidence.” (*Sanchez-Corea v. Bank of Am.* (1985) 38 Cal. 3d 892, 906 (*Sanchez-Corea*)). This requires a review of the decision to “indulge in all legitimate and reasonable inferences” to uphold the decision. (*Id.* at p. 907.) The relevant question is not over the quality or nature of the reasoning behind the decision, but whether the decision can or cannot be valid according to the law. (*Appeal of Nassco Holdings, Inc.*, 2010-SBE-001, Nov. 17, 2010.)

Contrary to appellants' contention in this PFR, the law relating to characterization of distributions to an S Corporation shareholder does not require a finding that appellant-husband could not have controlled the corporate distributions unless he had unilateral control. The evidence supports the BOE finding that, acting in concert with the only other controlling shareholder, appellant-husband could, and did, exercise the kind of control that would require "special scrutiny" of the transactions at issue. (See *Appeal of Nagano*, 81-SBE-170, Dec. 10, 1981.)

We note that the BOE's decision did not rely solely on the fact that appellant-husband had substantial control of the corporation. Several other factors supported the BOE's decision to treat the advances from NMIC to appellant-husband as shareholder distributions rather than bona fide loans. As explained in the BOE's decision, case law lays out a variety of factors that must be examined in order to determine whether a transaction should be treated as a loan or a shareholder distribution, and no single factor is determinative. (*Welch v. Comm'r*, (9th Cir. 2000) 204 F.3d 1228; *Alterman Foods, Inc. v. United States* (5th Cir. 1974) 505 F.2d 873, 877, fn. 7; *Jones v. Comm'r*, T.C. Memo 1997-400.) In reaching its decision, the BOE weighed each of those factors. It found that there was no ceiling on the amount advanced by NMIC, that appellant-husband failed to adhere to the terms of the original or amended promissory notes, that appellant-husband failed to pay the required interest on the purported loans, that no security was given for the purported loans, that the maturity date for the purported loans was extended after the audit was commenced, that NMIC made no effort to compel appellant-husband to repay the loans or the accrued interest, that appellant-husband failed to substantiate his contention that he was in a position to repay the loans quickly, and that appellant-husband did not repay any portion of the loans until after the audit commenced. Therefore, regardless of whether appellant-husband controlled the corporation (which issue is not dispositive by itself), the BOE's decision to characterize the purported loans as shareholder distributions is not contrary to law. The BOE's decision was supported by sufficient evidence.

For the foregoing reasons, appellant's petition for rehearing is hereby denied.

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 Teresa A. Stanley
 Administrative Law Judge

We concur:

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Michael F. Geary

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Michael F. Geary

Administrative Law Judge

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Neil Robinson

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Neil Robinson

Administrative Law Judge