OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18010245
	)	
GILBERT P. HYATT	)	Date Issued: January 15, 2019
	)	
	)	
	)	

OPINION ON PETITION FOR REHEARING[1]

Representing the Parties:

For Appellant:	Edwin P. Antolin, Antolin Agarwal, LLP
For Respondent:	William C. Hilson, Jr., Deputy Chief Counsel
For Office of Tax Appeals:	Josh Lambert, Tax Counsel

K. GAST, Administrative Law Judge: On August 29, 2017, the BOE held an oral hearing on this matter. For the 1992 tax year, the BOE considered three issues and made the following determinations: (1) Gilbert P. Hyatt (appellant) established he was a California nonresident for the entire tax year; (2) appellant's licensing income was not subject to California tax because it was not derived from a California source; and (3) appellant was not subject to the fraudulent failure-to-file penalty. Because the BOE determined that appellant owed no taxes or penalty, no interest was due and therefore, unlike the appeal for the 1991 tax year, the issue of whether he demonstrated a basis for abatement of interest was moot.

Because the BOE had ruled against it on all three issues, on September 28, 2017, the Franchise Tax Board (FTB or respondent) filed a timely petition for rehearing under California

[1] We have also issued an Opinion on Petition for Rehearing for Office of Tax Appeals (OTA) Case Number 18010244, which deals with the 1991 tax year. The factual and legal issues in that case are related to this one, which deals with the 1992 tax year, but the two tax years were heard as separate appeals by the Board of Equalization (BOE). Consequently, respondent filed two separate petitions for rehearing for the two tax years in dispute. Accordingly, we have issued two separate opinions on respondent's petitions for rehearing.

Revenue and Taxation Code section 19048.[2] Upon consideration of respondent's petition for rehearing, we conclude its proffered grounds for a rehearing do not meet the requirements under Regulation section 30604.[3] (See also *Appeal of Sjofinar Masri Do*, 2018-OTA-002P, Mar. 22, 2018,[4] and *Appeal of Wilson Development, Inc.*, 94-SBE-007, Oct. 5, 1994.[5])

Background

During 1992, appellant earned a substantial amount of income from the licensing of his patents. Appellant did not file a California tax return for the 1992 tax year, because he took the position he was a nonresident for the entire year, and, on appeal, argued that his licensing income was not derived from sources within California.

In 1993, respondent initiated an audit of appellant's residency status for the 1992 tax year. Four years later, in 1997, respondent issued a Notice of Proposed Assessment (NPA), concluding that appellant was a California resident through April 2, 1992, and, as such, taxable on income from all sources through that date. The NPA, thus, assessed additional tax of $5,669,021, and a fraudulent failure-to-file penalty of $4,251,765.75, plus interest. Appellant timely protested the NPA.

A decade later, in 2007, respondent issued a Notice of Action (NOA), affirming the NPA.[6] The NOA also concluded appellant was a California resident through April 2, 1992, and, as such, subject to tax on his income from all sources through that date, which included his 1992 licensing income. The assessment was alternatively sustained on the basis that appellant's intellectual property (i.e., patents) had acquired a business situs in California for the entire taxable year, and, therefore, his licensing income therefrom constituted taxable income because it was derived from sources within the state. Appellant timely filed an appeal with the BOE,

[2] Unless otherwise indicated, all "section" or "§" references are to sections of the California Revenue and Taxation Code, and all regulation references are to the California Code of Regulations, title 18, for the tax year at issue.

[3] OTA has jurisdiction to decide this matter under Regulation section 30106.

[4] OTA opinions are generally available for viewing on its website: <http://www.ota.ca.gov/opinions/>.

[5] BOE opinions are generally available for viewing on its website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

[6] One of the primary reasons for this long lapse in time between the issuance of the NPA and NOA was that appellant sued respondent in the Nevada courts in 1998 for tortious acts respondent allegedly committed during the audit.

contesting the residency, sourcing, and fraud penalty issues, as well as requesting abatement of interest.

For the 1992 tax year, the BOE considered substantial amounts of evidence provided by both parties, including declarations and affidavits from appellant, his friends, associates, and various contracts, documents, and testimony related to appellant's licensing activities. The BOE concluded that appellant was a California nonresident for the entire 1992 tax year, his licensing income received in 1992 was not derived from California sources and therefore not subject to California tax on that basis, and the fraudulent failure-to-file penalty was inapplicable.[7] In addition, because the BOE determined that appellant owed no taxes or penalty, no interest was due. The BOE issued official notice of its action in a Notice of Board Determination, dated August 31, 2017.

Standard of Review

A rehearing may be granted where one of the following grounds exists, and the substantial rights of the complaining party are materially affected: (1) an irregularity in the appeal proceedings which occurred prior to the issuance of the written opinion and prevented fair consideration of the appeal; (2) an accident or surprise which occurred during the appeal proceedings and prior to the issuance of the written opinion, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the party could not have reasonably discovered and provided prior to the issuance of the written opinion; (4) insufficient evidence to justify the written opinion or the opinion is contrary to law; or (5) an error in law. (Regulation § 30604(a)-(e).)

In its petition, respondent requests a rehearing on the issues of residency, sourcing of the licensing income, and the fraudulent failure-to-file penalty. Respondent primarily asserts there were irregularities in the BOE's proceedings by which respondent was prevented from having a fair consideration of its case and in violation of its due process rights. Respondent also appears to assert the BOE's determinations were unjustified due to insufficient evidence or factual support and were contrary to law. We consider each argument in turn as it applies in the context of the residency, income sourcing, and fraud penalty issues.

[7] The BOE heard the appeals for the 1991 and 1992 tax years on the same day, with the 1991 appeal heard first, which lasted nearly 10 hours, and this appeal heard second, which lasted nearly 3 hours.

Residency

Regulation section 30604(a) provides that a rehearing may be granted when an irregularity in the appeal proceedings occurred prior to the issuance of the written opinion that prevented fair consideration of the appeal. This regulatory provision is patterned after Code of Civil Procedure section 657(1), which has been interpreted as sufficiently broad to include any departure by the court (or, here, the BOE) from the due and orderly method of disposition of an action by which the substantial rights of a party have been materially affected. (*Jacoby v. Feldman* (1978) 81 Cal.App.3d 432, 446.)

On this ground, respondent contends that the BOE failed to allow it to present evidence on the issue of whether appellant was a California resident from January 1, 1992, through April 2, 1992. Respondent argues that after the BOE determined appellant received California source income during the portion of the hearing addressing the 1991 tax year, the BOE would not entertain presentations from either party on the residency issue for the 1992 tax year. Instead, respondent asserts, the BOE initiated, renewed, and approved its motion to limit the issues for the 1992 appeal, after it swiftly determined, by majority vote, that appellant was not a California resident for the 1992 tax year. Respondent further contends that since the inception of the appeal, appellant has continually asserted that the 1991 and 1992 tax years were entirely separate cases that had to be treated independently of each other, which the BOE agreed to.

Respondent's contentions are unconvincing. In essence, respondent alleges the BOE never heard evidence or oral arguments on the 1992 residency issue. However, this allegation is not true. The hearing transcript for the 1991 tax year shows the parties and the BOE discussed and considered 1992 facts related to the residency issue when the BOE concluded on that issue for the 1991 tax year. When faced with that same issue for the 1992 tax year, the BOE apparently believed no material facts had changed that would have established appellant as a full or part-year resident during that year. Thus, for the 1992 appeal year, the BOE reaffirmed its conclusion reached during the 1991 appeal year hearing that appellant became a California nonresident and nondomiciliary on October 20, 1991.

To be sure, it is a well-settled principle in tax law that each tax year stands on its own and must be reviewed separately. (See *Burnett v. Sanford & Brooks Co.* (1931) 282 U.S. 359, 365-366.) In addition, it appears the BOE did take a holistic approach by considering the residency facts for both the 1991 and 1992 tax years together, even though those years were the subject of

two separate appeals. However, the BOE majority, as a fact-finder, was still well within its authority and discretion when determining it would have been "redundant in this process" to reconsider the residency facts again for the 1992 tax year, when it had already reviewed all the facts in the record for both tax years in dispute for the 1991 appeal. (See Regulation § 5523.6(b) ["The [BOE] may refuse to allow the presentation of evidence that it considers irrelevant . . . or unduly repetitious"].) We, therefore, find no irregularity in the BOE's proceeding.

As noted above, the BOE considered substantial amounts of evidence provided by both parties. This voluminous evidence was *not* solely related to the 1991 tax year. Rather, the thousands of pages of evidence also undisputedly related to the 1992 tax year, which had similar, if not identical, factual and legal issues to those in the 1991 tax year. Thus, the written record, which the BOE fully reviewed and considered, was replete with facts supporting its California non-residency conclusion in both tax years. Therefore, respondent has also failed to show how its substantial rights were materially affected and that it was prevented from having a fair consideration of its case.

Finally, based on the foregoing reasons, we also reject respondent's contention that the BOE violated its due process rights. On this point, however, we note that OTA is generally prohibited from considering such (state and/or federal) constitutional arguments. (See Regulation § 30104.) Accordingly, we conclude there was no irregularity in the BOE's proceedings that prevented respondent from having a fair consideration of its case or that was in violation of its due process rights.[8]

Sourcing of Licensing Income

In the context of this issue, we initially note that because the BOE had first determined appellant was a California nonresident for the entire 1992 tax year, this meant respondent was precluded from taxing all his patent licensing income, without regard to the geographical source of that income. Thus, the BOE had to next address whether appellant's 1992 licensing income could be taxed in California on a source—as opposed to a residence—basis, which the BOE

[8] Appellant argues, as he does for the 1991 appeal, that respondent waived its objections and arguments with respect to irregularities in the proceedings in its petition for rehearing because it could have raised these same objections and arguments during the hearing. We are not aware of any authority, however, that supports a contention that any party's failure to raise an objection or argument at a BOE hearing with respect to claims of irregularities will prevent consideration of such objections or arguments in a petition for rehearing. (See Regulation § 30604.)

ultimately concluded it could not. Before addressing the merits of respondent's contentions for a rehearing on this issue, we first briefly set forth the applicable law on the nonresident sourcing of income from intangible personal property.

California residents are subject to tax on their entire taxable income, regardless of where that income is earned or sourced. (§ 17041(a)(1).) However, nonresidents, such as appellant, are taxed only on income "derived from sources within" California. (§ 17041(b) & (i)(1)(B).)

As relevant here, the general rule is that income of nonresidents from intangible personal property, such as the licensing of patents, is not income from sources within California. (§ 17952; see also Regulation § 17952(a).) Thus, the fiction sometimes referred to as *mobilia sequuntur personam* (i.e., movables follow the person) controls, which means the taxable situs of the income from intangible personal property is the domicile of the owner (here, Nevada). (See *Miller v. McColgan* (1941) 17 Cal.2d 432, 443.)

However, the exception to this general rule is where the intangible personal property has acquired a business situs in California. (§ 17952.) This occurs if the property is employed as capital in California or the possession and control of the property has been localized in connection with a business, trade or profession in California so that its substantial use and value attach to and become an asset of the business, trade, or profession in California. (Regulation § 17952(c).) If intangible personal property has acquired a business situs in California, the entire income from that property, regardless of where the sale is consummated, is income from sources within California. (*Ibid.*)

Another way a nonresident's income, such as income from intangible personal property, can be sourced to California is if the nonresident sole proprietor is operating a unitary business, trade, or profession within and without the state. (Regulation § 17951-4(c).) These rules employ allocation and apportionment sourcing provisions that are applicable to business entities operating a multistate business. (Regulation § 17951-4(c)(2); see also § 25120 et seq. [where California's version of the Uniform Division of Income for Tax Purposes Act is codified].)

1) There Were No Irregularities in the BOE's Proceedings that Prevented Respondent from Having a Fair Consideration of its Case.

Here, respondent contends that the subject patent licensing income appellant received from various foreign (non-U.S.) third-parties—i.e., Sony Corporation, NEC Corporation, Sharp Corporation, Oki Electric Industry Co., Ltd.—should have been sourced to California for the

1992 tax year. Essentially, respondent appears to be arguing that appellant had earned (and therefore had constructive receipt of) this income towards the end of 1991, even though he did not physically receive the monies until 1992. Respondent appears to be further asserting that the BOE should have looked to these 1991 facts when analyzing and concluding on the sourcing issue for 1992, and that the 1991 facts would have established, like they did for the 1991 appeal year, that appellant was operating a licensing business in California for the 1992 tax year.

As specific factual support for this contention, respondent maintains that, pursuant to a tax planning strategy, appellant's licensing proceeds were in the physical possession of U.S. Philips Corporation (Philips)—a New York-based, third-party exclusive licensor of appellant's patents—during 1991, and that Philips did not pay these monies to appellant until January 1992. Respondent argues this caused the monies to not be reported on appellant's 1991 California return. Further, with respect to the payment from another foreign, third-party company called Hitachi Ltd., respondent contends the BOE's conclusion that it was not California source income was devoid of and contrary to the objective, contemporaneous evidence it presented. All of this, according to respondent, constituted an irregularity in the BOE's proceedings.

None of respondent's arguments, however, persuade us that this constituted an irregularity in the BOE's proceedings. Rather, they simply represent respondent's disagreement with the BOE's factual findings and legal conclusions. In addition, the written record, as it was for the non-residency issue, and the 1992 oral hearing transcript, were replete with facts and testimony supporting the BOE's non-California source income conclusion. Accordingly, respondent has also failed to show how its substantial rights were materially affected and that it was prevented from having a fair consideration of its case.

2) There Was Sufficient Evidence to Justify the BOE's Decision.

At the trial court level, the equivalent of a petition for rehearing is a motion for a new trial. Code of Civil Procedure section 657 sets forth the grounds for granting a new trial, which has been codified in OTA's Rules for Tax Appeals. (See Regulation § 30604(a)-(e); see also *Appeal of Sjofinar Masri Do*, *supra* and *Appeal of Wilson Development, Inc.*, *supra*.) As applicable to administrative bodies, such as this one, a rehearing should not be granted on the grounds of insufficiency of the evidence unless, after weighing the evidence, we are convinced from the entire record, including reasonable inferences therefrom, that the BOE clearly should have reached a different decision. (Code Civ. Proc., § 657.) In addition, insufficiency of the

evidence as ground for a rehearing means "the insufficiency that arises in the mind[s] of the [administrative law judges] when [they] weigh[] the conflicting evidence and find[] that which supports the [decision] weighs, in [their] opinion, less than that which is opposed to it." (*Bray v. Rosen* (1959) 167 Cal.App.2d 680, 683.)

After weighing the evidence, however, we are not convinced from the entire record, including reasonable inferences therefrom, that the BOE clearly should have reached a different decision. Instead, we believe the BOE relied on sufficient evidence to reach its conclusion that appellant did not derive California source income for the 1992 tax year.

Specifically, by majority vote, the BOE majority noted that the following facts, among others, were unlike the facts found applicable in the 1991 tax year, and therefore supported its sourcing determination for the 1992 tax year: (1) appellant was not in the business of licensing his patents because he had contracted out that activity to Philips when he changed his domicile and residency to Nevada during the end of 1991; (2) Philips handled most of the licensing contract negotiations; (3) simply having an attorney based in Los Angeles, California, who helps with, e.g., the execution of the licensing contracts, does not, without more, establish a business in the state; and (4) the licensing contracts were negotiated outside of California. In short, the BOE majority appeared to find that, unlike the 1991 tax year, appellant, a Nevada resident, was simply a passive holder of his patents, collecting royalty income.

We conclude these facts, in addition to the many others in the record, were sufficient to support the BOE's determination that neither appellant's patents had acquired a California business situs under section 17952 nor was appellant operating a licensing business in the state under Regulation section 17951-4. While respondent did present compelling evidence of its own, we do not believe the BOE, as a fact-finder, *clearly* should have reached a different conclusion.

3) The BOE's Decision Was Not Contrary to Law.

The question of whether a decision is contrary to law (or against the law) is not one which involves a fact-finder weighing the evidence and finding a balance against the decision, as it does in considering the ground of insufficiency of the evidence, discussed above. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906 (*Sanchez-Corea*).) Rather, what is required is a finding that the decision was unsupported by any substantial evidence. (*Ibid.*) This requires a review of the decision that "indulg[es] in all legitimate and reasonable inferences" to uphold it.

(*Id.* at p. 907.) Thus, the relevant question here does not involve the quality or nature of the reasoning behind the decision, but whether the decision is or is not supportable by substantial evidence in the record. (*Appeal of NASSCO Holdings, Inc*., 2010-SBE-001, Nov. 17, 2010.) In our review, we consider the evidence in the light most favorable to the prevailing party (here, appellant). (*Sanchez-Corea*, 38 Cal.3d at p. 907.)

Here, respondent essentially presents the same evidence and arguments made prior to the BOE's determination. As noted above, a petition for rehearing is not an opportunity to reargue the underlying appeal. Appellant provided voluminous documentary evidence, affidavits, and testimony to establish his licensing income at issue was not California source income for the 1992 tax year. When viewing appellant's extensive evidence in the light most favorable to him, we find there was substantial evidence to support the BOE's determination was not contrary to law.

Fraudulent Failure-to-File Penalty

As with the residency issue, respondent contends that there was an irregularity in the BOE's proceedings that prevented respondent from having a fair consideration of its case and that was in violation of its due process rights. Respondent asserts that the BOE deprived it of the opportunity to present evidence demonstrating that its assessment of the fraudulent failure-to-file a tax return penalty under section 19131(d) was appropriate. According to respondent, if the BOE had afforded it the opportunity to fully and fairly present its case, the fraud penalty would have been considered in the context of all the evidence pertaining to 1992, including respondent's evidence and arguments regarding appellant's residence and the sources of his income during 1992.

Here, too, respondent's contentions are without merit for many of the same reasons we expressed above related to the 1992 residency issue. Specifically, it appears, based on the hearing transcript, the BOE's conclusion to not impose the fraud penalty was not only the result of its determination that appellant was a California nonresident for the 1992 tax year, but also its consideration of all the evidence before it, including those from the 1991 tax year and the fact that the BOE did not find fraud on similar facts for the 1991 appeal. Therefore, we find no irregularity in the BOE's proceedings.

In addition, the parties discussed the fraudulent failure-to-file penalty extensively in their briefs, and, prior to the oral hearing, the BOE reviewed all the arguments and evidence in the

record, including those related to the penalty. Thus, the written record contained ample facts supporting the BOE's conclusion that appellant did not commit fraud. For these reasons, respondent has also failed to show how its substantial rights were materially affected and that it was prevented from having a fair consideration of its case.

Based on the foregoing, respondent has not satisfied the requirements for obtaining a rehearing.[9] Accordingly, respondent's request for a rehearing is denied.

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Kenneth Gast
Administrative Law Judge

We concur:

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Douglas Bramhall
Administrative Law Judge

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Jeffrey G. Angeja
Administrative Law Judge

[9] We, therefore, do not need to address respondent's petition for a rehearing on the interest abatement issue, which it conceded was dependent on the granting of a rehearing for the other three issues.