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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE OF,)
MARSHALL REDDICK,) OTA NO. 18012102
APPELLANT.)
_____)

Transcript of Proceedings, taken at
6150 Van Nuys Blvd., Van Nuys, California, 91401,
commencing at 10:09 a.m. and concluding
at 12:37 p.m. on Friday, January 25, 2019,
reported by Ernalyne M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: Hon. KENNY GAST

Panel Members: Hon. SARA HOSEY
Hon. JEFFREY MARGOLIS

For the Appellant: Marshall Reddick, Taxpayer
Joseph E. Mudd, Attorney

For the Respondent: State of California
Franchise Tax Board
By: CHRIS HASKINS
MICHAEL CORNEZ

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I N D E X

OPENING STATEMENT

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DEPARTMENT'S

WITNESSES:

DIRECT

CROSS

REDIRECT

RECROSS

(None offered)

APPELLANT'S

WITNESSES:

DIRECT

CROSS

REDIRECT

RECROSS

Marshall Reddick 20 45

E X H I B I T S

(All of Appellant's Exhibits were received at page 7.)

(All of Franchise Tax Board's Exhibits were received at pages 7 and 52.)

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Van Nuys, California; Friday, January 25, 2019

10:09 a.m.

ADMINISTRATIVE LAW JUDGE GAST: Let's go on the record.

All right. This is the appeal of Marshall Reddick, OTA Case No. 18012102. It is Friday, January 25th, 2019. The time is approximately 10:09 a.m. We're in Van Nuys, California. I am the lead administrative law judge. And with me to today, to my right is Judge Sara Hosey, and to my left is Judge Jeffery Margolis. We are the panel hearing and deciding this case.

At this point I'd like to ask the parties to please state your names and titles for the record, please.

MR. MUDD: Joseph Mudd. I am the attorney for Marshall Reddick, Real Estate, Inc., and Marshall Reddick.

ADMINISTRATIVE LAW JUDGE GAST: Thank you.

MR. HASKINS: Christopher Haskins, representing the Franchise Tax Board in this appeal, and my co-counsel is Michael Cornez.

ADMINISTRATIVE LAW JUDGE GAST: Thank you. So we have three issues for today, and I'm going to state those three issues. The first one is kind of long, so I apologize.

1 First one is whether appellant has satisfied his
2 burden of proving that FTB erroneously reallocated taxable
3 income from Ocean Living, Inc., an S corporation, to
4 Appellant because an employee stock ownership plan
5 strategy was a sham and lacked both a nontax business
6 purpose and economic substance for the 2003 through 2006
7 tax years.

8 The second issues is whether FTB properly imposed
9 the noneconomic substance transaction penalty for the 2003
10 through 2006 tax years.

11 And the third issue is whether FTB properly
12 imposed the interest-based penalty for the 2005 and 2006
13 tax years.

14 All right. With that I'm going to admit all of
15 the exhibits in the electronic file that OTA sent the
16 parties. It's the 2,549 pages. And that file contains
17 all the parties' documentary evidence submissions for this
18 appeal, including those submitted to the Board of
19 Equalization for the prior appeal that we are now hearing
20 today.

21 So because the parties have no objections to that
22 document, all those exhibits --

23 MR. HASKINS: Question for the panel.

24 ADMINISTRATIVE LAW JUDGE GAST: Yeah.

25 MR. HASKINS: Within the 2,500-plus pages of the

1 exhibit, there's the summary decision -- the prior summary
2 decision from the Board of Equalization. I would -- since
3 you didn't mention it, I don't know if you had intended
4 that come in. It is in the --

5 ADMINISTRATIVE LAW JUDGE GAST: Yeah. It's one
6 of the exhibits attached to FTB's. So that'll come in.

7 MR. HASKINS: Okay.

8 ADMINISTRATIVE LAW JUDGE GAST: All the exhibits.

9 MR. HASKINS: Then I have no objection.

10 MR. MUDD: No objection.

11 ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you.
12 So all the exhibits, therefore, will come in. So they are
13 now admitted into the record as evidence. And I'm also
14 going to admit the MPA's that both parties submitted for
15 the 2003 through 2006 tax years. So that's going to be
16 admitted into the record as evidence.

17 (Appellant's Exhibit were received
18 in evidence by the Administrative Law Judge.)

19 (Respondent's Exhibits were received
20 in evidence by the Administrative Law Judge.)

21 ADMINISTRATIVE LAW JUDGE GAST: Okay. So why
22 don't we move on to the parties' presentations. Just to
23 remind the parties, taxpayer and FTB will both have five
24 minutes for an opening statement.

25 And then Mr. Reddick you will have 30 minutes for

1 testimony. I'll have to swear you in before you do that.
2 FTB can cross-examine for 30 minutes, and then both the
3 taxpayer and FTB will have about 10 minutes for closing.
4 And taxpayer, you can have 5 minutes for follow up if you
5 so choose.

6 Okay. Any questions?

7 MR. HASKINS: No, sir.

8 ADMINISTRATIVE LAW JUDGE GAST: Okay. Mr. Mudd,
9 whenever you're ready.

10

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OPENING STATEMENT

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MR. MUDD: Thank you. Just briefly, what
Mr. Reddick's testimony is going to show here is that
Mr. Reddick was the owner of Marshall Reddick Real Estate,
Inc., which was basically an education company that taught
people how to invest in income producing real estate, and
then worked with them to make those purchases and to run
their income.

Marshall Reddick personally bought properties and
all of the units that Marshall Reddick Real Estate, Inc.,
identified along with his customers, so his customers
could see that he was willing to invest in those. Prior
to the time that real estate collapsed, Marshall Reddick
personally owned over 300 rental properties that showed up
in 900-some page personal income tax return for all the

1 depreciation and expenses on each of those 300 properties.

2 Marshal Reddick Real Estate had been very
3 successful. And Marshall Reddick was a very giving and
4 caring person. He took care of all of his employees. He
5 hired a lot of down and outers. He hired college students
6 and paid for their college as long as they got A's and
7 B's. And he ran a company that was very successful.

8 Their income was based on commission sharing that
9 they got with the people or with the real estate brokers,
10 who actually represented properties that they bought.
11 Most often it was new properties and new subdivisions that
12 they identified, then they hold the seminar. They drive
13 the people who came to the seminar out to see the
14 properties, and talked to the brokers. And the people
15 would buy properties themselves along with Mr. Reddick and
16 a certain identified subdivision.

17 In '03 and '04 the company was successful, and it
18 appeared that it was going to be more successful. And
19 Marshall Reddick was looking for a way to give his
20 employees additional benefits by way of a pension and
21 ownership of his company. And he sought referrals and was
22 referred to an individual who came in and studied his
23 books and records and said the best thing for him to do
24 was purchase an ESOP.

25 It would have tax benefits for him as well as tax

1 benefits for -- for the employees. And the employees
2 would end up with a big pension, and he would end up with
3 a deductible expense.

4 Since he was an S-Corp, he could not sponsor an
5 ESOP in which he was already the sole shareholder of the
6 company where he would be the primary beneficiary. So the
7 individual suggested -- not only suggested, but prepared
8 all the documents to form a new S-Corp that would be owned
9 strictly by the employees of Marshall Reddick Real Estate,
10 which would provide services for Marshall Reddick Real
11 Estate by way of administrative and management services
12 that normally were provided by employees of Marshall
13 Reddick.

14 So these people became employees and owners of
15 Ocean Living, Inc., the ESOP. Ocean Living, Inc., would
16 pay them. Marshall Reddick Real Estate was to donate
17 money or contribute money to Ocean Living, which was an
18 ESOP. And he would get the deduction and Ocean Living
19 would become a pension program for his employees.

20 He good didn't -- he relied on these experts who
21 he was told were experts. And he relied on the experts
22 that he had in his company, who also really became the
23 supervisors and owners of OLI, and they set him up in the
24 company. In 2003 -- the company was formed in 2003, but
25 didn't qualify or adopted an ESOP plan until 2004, I

1 believe.

2 In 2003 Marshall Reddick paid Ocean Living, Inc.,
3 \$1,000,000 for management fees, borrowed \$990,000 of that
4 back, and I suspect that's where -- that's the issue we're
5 seeing. The biggest issue we're seeing is that it has no
6 business purpose. That money was borrowed back at
7 5.6 percent interest, and it was to be repaid by Marshall
8 Reddick Real Estate.

9 The plan was completed and adopted in 2004. It
10 was audited by the IRS in 2008 and approved with no change
11 letter. They audited a 2004 tax run for Ocean Living,
12 Inc. ESOP and made some suggested changes to OLI. In one
13 of them was that Marshall Reddick was an officer of the
14 ESOP. He should not do that, number one.

15 Number two, Marshall Reddick had received some
16 salary from the ESOP, and he was not allowed to do that,
17 at which point he stopped. He resigned immediately as
18 officer and stopped receiving any salaries from OLI.
19 Those were the suggestions. The IRS approval letter is
20 among the documents, specifically page --

21 ADMINISTRATIVE LAW JUDGE MARGOLIS: We're aware
22 of the page.

23 MR. MUDD: You're aware of the page. Okay.

24 Then Mr. Reddick then continued to contribute
25 money to the ESOP in 2004, '05, and '06. He continued to

1 run successfully. Marshall Reddick Real Estate made
2 \$23,000,000 gross in 2006, and \$25,000,000 gross receipts
3 in 2005. He expected that would continue. There would be
4 no problem repaying the debt. The principals of OLI
5 believed that the investment in Marshall Reddick Real
6 Estate was a worthwhile investment because of the success
7 Marshall Reddick Real Estate had over all the years.

8 In 2007, though, the real estate collapsed. The
9 bottom fell out from under it. By to 2008 it was clear
10 that most of the mortgage real estate properties owned by
11 Marshall Reddick individually were upside down. Some were
12 paid in full, and some, we believe, had some equity
13 interest.

14 It was in 2008 that the executives in OLI came to
15 Marshall Reddick and said, look, you know, we need this
16 loan repaid. We realize things are tough. We can't keep
17 going without it, and we need the loan repaid. So they
18 sat down and identified properties and Marshall Reddick
19 transferred the properties to Ocean Living, several of
20 which were actually free and clear.

21 As it turned out, Marshall Reddick lost every one
22 of the 300 properties that he owned to foreclosure or to
23 debt repayment, other than the ones he transferred to OLI.
24 He lost his own house. He lost the business. And so this
25 was not something that OLI suffered the loss. Marshall

1 Reddick Real Estate and Marshall Reddick suffered a total
2 loss of everything to the point that he now rents a house
3 and lives on a pension.

4 He lives on pension that he -- that he earned
5 while as a Cal State Los Angeles professor for over 20
6 years.

7 MR. REDDICK: 30 years.

8 MR. MUDD: 30 years. I'm sorry. One of the
9 other things that OLI invested in, at the recommendation
10 of -- of -- I'll say the person who was promoting it was
11 probably a bit of a shyster -- was large life insurance
12 policies on Mr. Reddick, and on the principals that -- the
13 executives that actually worked for Marshall Reddick Real
14 Estate. They were deemed to be the important people.

15 It was explained that these policies were paid
16 for by OLI with money that was transferred by Marshall
17 Reddick to OLI. It was explained that these were valid
18 investments for several reasons. Number one, if Marshall
19 Reddick died, OLI would have an asset that would continue
20 to allow it to pay out all of his pensions.

21 Number two, if OLI preferred and if it was
22 viable, it would be able to use the proceeds of the
23 policies to purchase Marshall Reddick Real Estate should
24 he die, but didn't have to.

25 And number three, those insurance policies would

1 develop cash value and it would reach -- the company would
2 reach a point, but it would not have to pay the premiums
3 anymore because the cash value of the policies would pay
4 the premiums.

5 By 2009, \$500,000 had been borrowed against the
6 life insurance policies, and OLI cashed out the policies,
7 paid the balance of the loan, and apparently got some cash
8 back. OLI continued until sometime in 2009. We don't
9 know for sure when it collapsed because Marshall Reddick
10 and Marshall Reddick Real Estate were out of the picture.
11 But it did have some money in it to pay some of the people
12 who qualified some small pensions.

13 I don't know what has happened to it since then.
14 I assume it ran out of money just because the cost of
15 administration for the ESOP is so high on an annual basis.

16 ADMINISTRATIVE LAW JUDGE MARGOLIS: Mr. Mudd,
17 when did you say this happened?

18 MR. MUDD: I believe it was around 2009 that OLI
19 collapsed because it had spent all of its money on
20 administration. However, it paid pensions to some people
21 as late as 2011. So it must have had some money to pay
22 some small amounts of pensions. My understanding is the
23 cost of administration of an ESOP is many thousand dollars
24 annually, and it had to pay that to keep on going as well.

25 Mr. Reddick will testify that it was his

1 intention from the beginning that OLI would provide a
2 great pension for all of his employees. He was set. He
3 owned millions of dollar's worth of property. He was
4 earning millions of dollars every year. He was paying
5 very, very high taxes until 2006 when his rentals lost a
6 great deal of money. And he wanted to share it with his
7 employees.

8 With his testimony, you'll find out that's just
9 the kind of person he is. With the people he took in that
10 needed jobs, he took them in. At some point in his
11 career, he had as many as 100 employees, maybe more. At
12 the time OLI was formed, I think there was 40 shareholders
13 who were part of OLI, and it wasn't Mr. Reddick.

14 Now, the IRS has condemned certain actions with
15 ESOP's for S corporations. And the reason it has done
16 that is because it was an abuse. The new corporation ESOP
17 would be started with Mr. Reddick, for instance, as the
18 sole shareholder. And so everything he contributes to the
19 ESOP is just his until some employees get some. But he's
20 getting a big deduction to put money into his own pension
21 fund. It wasn't the case.

22 He didn't own stock in OLI, only his employees
23 did. And it was managed by his -- by a professional
24 manager who was managing it, and it was overseen by his
25 executives who were owners and members. One was an

1 attorney, and there were other executive members.

2 Had the real estate market not collapsed, the
3 debts would have been repaid. The pension would have been
4 worth lots of money. Mr. Reddick would have had lots of
5 money. And as he intended, his employees would have been
6 fine. We had the worse real estate collapse probably in
7 history of real estate that occurred in 2007 and '08
8 causing losses and evaluations. I can say he lost all of
9 his properties, every one of them, other than what he
10 transferred to OLI. Like I said, he transferred to OLI
11 properties that were free and clear.

12 We ask that you find this indeed was not a tax
13 motivated transaction. It was a legitimate business
14 transaction. And I think you will agree when you hear
15 testimony from Mr. Reddick.

16 ADMINISTRATIVE LAW JUDGE GAST: Thank you. FTB.

17

18 OPENING STATEMENT

19 MR. HASKINS: Thank you.

20 In 2003 Appellant, a financially successful real
21 estate investor, purchased a plan from ASTER Financial
22 that had no economic substance or business purpose in
23 order to improperly avoid taxes. Appellant himself called
24 the plan patently illegal in a lawsuit he filed in 2008
25 against the promoters of the plan.

1 Because FTB determined that audit and affirmed
2 protest that the plan had no economic substance or
3 business purpose, FTB disregarded the transactions that
4 were called for in the plan. I'll try and briefly
5 describe the plan for you.

6 According to the plan, Appellant would and did
7 set up a new corporation in this case, Ocean Living
8 Incorporated or OLI, selected S status for it for taxation
9 purposes. Appellant was the CEO of OLI. Appellant also
10 set up an employee stock ownership plan an ESOP trust for
11 the express purpose of purchasing all the shares of OLI.

12 Appellant was the trustee of the ESOP trust.
13 ESOP's are generally tax exempt. California conforms
14 under Revenue and Tax Code Section 17501 ET sec and 17531
15 ET sec to Internal Revenue Code 401, which controls
16 employee benefit plans and 0501.

17 If an ESOP owns all the shares of an
18 S corporation, the income of the S corporation is
19 generally tax exempt. California does assess a 1.5 tax
20 against the earnings of all S corps regardless. And that
21 was done, and as far as I can tell was paid.
22 Additionally, the ESOP trust is generally tax exempt also.
23 Thus under the plan, all the earnings of OLI would
24 purportedly be tax exempt.

25 Next according to the plan, Marshall Reddick

1 Reality Incorporated, Reddick Reality hereafter,
2 Appellant's wholly owned S corporation would hire the
3 newly formed S corporation, OLI, to manage it. And
4 according to Appellant's 2008 complaint, quote, "Pay large
5 tax deductible management fees, thereby, shielding the
6 amounts paid as management fees from taxation."

7 OLI reported net income of \$13,028,001 for the
8 tax years at issue. Appellant using the plan accessed
9 this tax exempt income in two ways. First, Appellant
10 directed OLI to loan its tax exempt income to Appellant's
11 other company, Reddick Reality, approximately \$5,400,000
12 in the tax years at issue.

13 Appellant simply gave the OLI tax exempt money to
14 Reddick Reality, allegedly, for investment purposes.
15 Allegedly there -- this was pursuant to loans. However,
16 no loan documents have been submitted into evidence, and
17 we have no real evidence that loans ever existed.

18 Reddick Reality wouldn't report this loan as
19 income since it was in a form of a loan. Plus Appellant
20 had unfettered use of the unfettered -- I'm sorry -- the
21 untaxed income originating from the earnings of Reddick
22 Reality and funneled through OLI back to Reddick Reality.

23 Appellant allegedly paid the loans back by
24 transferring property into OLI. However, he has never
25 substantiated the property values he assigned to those

1 properties, or if he even owned some of the properties he
2 allegedly transferred.

3 The second part of the plan was that OLI would
4 buy expensive whole life insurance policies on Appellant's
5 life and the lives of other key employees with untaxed
6 earnings. Then Appellant and these key employees as the
7 named insured persons, would borrow against these policies
8 never paying back the loans or paying tax on the income
9 that paid for these loans, and allow the loans to be
10 repaid, if at all, with the proceeds of the insurance
11 policy if someone should pass on away.

12 The premiums for the insurance policies totaled
13 approximately \$7,768,910, and had a face value of
14 \$77,730,000-plus dollars. Contrary to Appellant's
15 assertion in his briefing correspondence from his
16 representatives, Appellant borrowed against these life
17 insurance policies. Some of the amounts are documented in
18 the record. FTB has not been provided with all of the
19 amounts of the loans.

20 Appellant's money was never out of his control as
21 he was the sole shareholder of Reddick Reality, the CEO of
22 OLI, and the trustee of the ESOP trust that owned OLI
23 throughout the tax years at issue. Through the use of a
24 plan that had no economic substance or business purpose,
25 Appellant sheltered more than \$13,000,000 from California

1 income tax.

2 Thank you.

3 ADMINISTRATIVE LAW JUDGE GAST: Thank you.

4 Okay. So we can move on to Mr. Reddick's
5 testimony whenever you're ready, Mr. Mudd. I'll need to
6 swear in Mr. Reddick first.

7 All right. Mr. Reddick can you please stand and
8 raise your right hand.

9

10 MARSHALL REDDICK,
11 produced as a witness by and on behalf of himself, and
12 having been first duly sworn by the Administrative Law
13 Judge, was examined and testified as follows:

14

15 THE WITNESS: I do.

16 ADMINISTRATIVE LAW JUDGE GAST: Thank you. You
17 may be seated.

18

19 DIRECT EXAMINATION

20 BY MR. MUDD:

21 Q Mr. Reddick, can you please tell the judges your
22 background and about Marshall Reddick Real Estate?

23 A Sure. I'd be happy too. And thank you for
24 allowing us to be here. Can you hear me okay?

25 ADMINISTRATIVE LAW JUDGE GAST: Yes.

1 THE WITNESS: I was a college professor from 1970
2 to the year 2000. I was -- I started the entrepreneurship
3 program and was handling the marketing department. I've
4 always -- I went into teaching so I could help people, and
5 I've always followed through with wanting to try to serve.
6 During the time that I was a college professor, I started
7 doing real estate seminars on how to buy real estate
8 through the university and community colleges on the
9 weekends for adults.

10 Over the years the adults wanted some help in
11 order to be able to find and buy really good real estate.
12 So I started a little fledgling real estate company. I
13 had a broker's license -- a broker's real estate license
14 in California since 1977. And so I started to help them
15 to find property first in Long Beach and then throughout
16 Los Angeles and then in Colorado, where I'm from
17 originally, and in Arizona and Las Vegas and so on. And
18 they seem to appreciate that.

19 I would help them find properties. I'd find a
20 realtor there to help them and property manager so that
21 they could buy property out of state inexpensively, and
22 have it properly managed and so on. And so I retired
23 after 30 years in the year 2000. And there was a
24 recession going on and lot of my friends in church needed
25 work. A lot of my friends needed work and so I decided

1 to, rather than retire, expand the fledgling business into
2 a regular real estate company.

3 And so it worked out very successfully. I was
4 able to hire people that sometimes were not hireable. I
5 had a blind lady that I hired that was from my church. I
6 had two dyslexic people hired, people from my church and
7 so on. And when I started the company, I wanted to make
8 sure I had a company that everybody wanted to come to, and
9 I wanted it to be very special. Not like a lot of other
10 companies where people don't look forward to going to work
11 and so on.

12 And so I did everything I could think of to make
13 it desirable to work at Marshall Reddick Realty. Some of
14 the things that I did was I provided free massages twice a
15 week from two, one male and one female, massage therapist.
16 I offered loans -- I'm sorry, not loans. I offered free
17 education that anybody could go to college. And we ended
18 up, I think, helping 22 very young people as interns that
19 normally probably would not have gone to college to go to
20 college.

21 They received money. They worked as helping us
22 with our logistics and seminars, and I paid for all or a
23 lot of their college education; 100 percent if they got
24 A's, 75 percent if they got B's, 50 percent if they got
25 C's and nothing if they got D's. And one even received a

1 master's degree doing that.

2 I really believe in nutrition so we had yoga
3 sessions at my expense -- and during working hours. We
4 had two garages that I turned into a fitness center. I
5 bought a beautiful absolutely gorgeous building for them
6 in Irvine. I have pictures, if anybody is interested in
7 seeing pictures. I don't know if you want to see them or
8 not, of the staff and the workings and son.

9 When people had birthdays, once a month we would
10 have kind of a party, and I'd bring in food and so forth.
11 So we had free orange juice, free seminars on nutrition
12 and so on. So my whole background was to really help the
13 people that start -- belong to the company. I did not
14 start or expand Marshall Reddick Reality with the intent
15 of making money. I didn't need to.

16 I had a retirement program. I was very satisfied
17 with that, but I really, really did want to provide a
18 state of the art company where people loved to work, and
19 then hire people that would really, really needed work.
20 And so I hired a lot of people that were in their 60s,
21 that were unemployable, that many -- their husbands have
22 died or they were divorced and had never worked or haven't
23 worked for a long time and were really struggling. So I
24 hired them.

25 So I just want to let you know that my motivation

1 the whole time was to try to serve the people that I
2 really cared for. We were like a big family. Everybody
3 loved one another. All different nationalities as you can
4 see on the picture, if you want to see this. And that was
5 my motivation.

6 Q Mr. Reddick, in 2003, which this is all about,
7 you formed -- you aided in forming an ESOP through Ocean
8 Living, Inc.; correct?

9 A Correct.

10 Q Can you tell us how that came about?

11 A Sure. I had a very good friend, Ken Bradburn,
12 that had met Dr. Chuck Dagger who, I guess, turned out to
13 really be an insurance salesman, but he promoted himself
14 as a financial planner. And I'd never had a financial
15 planner. I thought it would be a good idea.

16 So I met with him, and he asked me a lot of
17 questions on what my goals were for the company and for
18 myself and so on. And I told him my dream of being able
19 to have a company in which everybody benefited. I failed
20 to mention that we had a really, really good health
21 program. I think we paid 90 percent. I wanted a
22 retirement program.

23 And I really wanted to turn the business over to
24 the employees because I wasn't married. I have no close
25 relatives. And so I really wanted to -- when this company

1 became very successful, turn it over to the employees.
2 That was my goal. And so he suggested an ESOP. And he
3 mentioned several companies, and I have, I think, a list
4 of all the companies that are ESOP's and they're pretty
5 impressive.

6 Southwest Airlines is not an ESOP, but it's
7 company owned. I think 20 percent of the employees own
8 Southwest Airlines. I was always impressed with
9 Southwest. They always have happy people and so forth.
10 And so that was how it was promoted to me. I wasn't after
11 a tax shelter quite frankly. He said there were shelter
12 benefits.

13 I said great, but the main reason I did the ESOP
14 was to be able to help the employees. It sounded ideal,
15 but we could come up with a requirement program, and we
16 could -- I could eventually give the company to my
17 employees, which I love very much. So that was my
18 motivation.

19 Q And Ocean Living, Inc., was formed. Do you
20 recall that?

21 A Yes. Ocean living was, as I understood. I knew
22 nothing about an ESOP. I relied on others to do this.
23 And I trusted them that they knew what they were doing.
24 So they suggested I set up Ocean Living.

25 Q And who were the owners of Ocean Living?

1 A Ocean Living were the employees.

2 Q So former employees or current employees of
3 Marshall Reddick Realty?

4 A Yes, current employees. Yes.

5 Q Now, after Ocean Living was formed in 2004, and
6 actually formed and approved by the Internal Revenue
7 Service, you continued to make large contributions to
8 Ocean Living?

9 A Yes. I gave them enough money to be able to pay
10 the employees and then some.

11 Q Did you give them enough money to be able to
12 purchase the life insurance policies?

13 A Yes.

14 Q And do you know who are the owners of those
15 policies were supposed to be?

16 A Ocean Living. I think I owned, like, 5 percent.
17 They said that was the requirement of the insurance, that
18 I had to own something of it because it was on me.

19 Q And do you know if you actually borrowed any cash
20 value out of this policy? You personally?

21 A I think I borrowed \$500,000.

22 Q Did you borrow it or did Ocean Living borrow it?

23 A Well, Ocean Living, yeah, borrowed it and gave it
24 to me. Yes.

25 Q And Ocean Living -- is that part of the money

1 that Ocean Living loaned back to you every year after you
2 made the contribution?

3 A Yes.

4 Q Now, during the time that Ocean Living was
5 formed, you contributed money to Ocean Living. Do you
6 know approximately how much money was loaned to you during
7 that period of -- loaned to Marshall Reddick Real Estate
8 during that period?

9 A No, I'm not -- I'm not certain.

10 Q I'm going to refer to -- go straight to
11 documents. Go straight to page 002155 in the exhibits.
12 And does that appear to be a page --

13 ADMINISTRATIVE LAW JUDGE GAST: Is that
14 Schedule L?

15 MR. MUDD: Schedule L from the Marshall Reddick
16 Real Estate, Inc.

17 ADMINISTRATIVE LAW JUDGE GAST: Which tax year?

18 MR. MUDD: 2006. We got it for '03, '04, '05,
19 and '06.

20 ADMINISTRATIVE LAW JUDGE GAST: Okay, thank you.

21 BY MR. MUDD:

22 Q In 2006, according to Schedule L of Marshall
23 Reddick Real Estate, the amount of money that was loaned
24 to you -- and this schedule is in the return itself -- was
25 \$5,404,853; is that correct?

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A Yes.

THE COURT REPORTER: I'm sorry to interrupt, but can you repeat that number again?

ADMINISTRATIVE LAW JUDGE GAST: The stenographer asked you to repeat what you said.

MR. MUDD: I would be happy to give everyone a copy of that schedule.

ADMINISTRATIVE LAW JUDGE MARGOLIS: Can you please bring the microphone closer to you so the stenographer can hear you.

MR. MUDD: Okay.

BY MR. MUDD:

Q So the Schedule L for 2006 showed at the end of the year total loan to Marshall Reddick Real Estate \$5,404,853.

A Okay. I think that I borrowed money every year, and the intention was to be able to grow the business. We were doing very, very well. I had a very interesting business model. If I can --

Q Hang on. I want to talk about the loan first.

A Okay. That'll be fine.

Q So that was in 2006. Was that the total of all the money that had been loaned to Marshall Reddick Real Estate?

A I don't know.

1 Q Well, let's take a look then at Exhibit 002115,
2 and that's an attachment to the Federal Return for 2003,
3 Schedule L. Do you see that?

4 A Yes.

5 Q And that shows for 2003 and any loans to Ocean
6 Living, Inc., of \$990,000; is that right?

7 A Hm-hm.

8 Q Is that all the money that Marshall Reddick Real
9 Estate borrowed from Ocean Living in 2003?

10 A Yes.

11 Q And Exhibit 002128, do you see that?

12 A Hm-hm.

13 Q That is a schedule from 2004. It says '04 in the
14 left hand corner. And you see on Statement 6 that there's
15 a loan payable to Ocean Living, Inc. At the beginning of
16 the year it was \$990,000. At the end of the year, it was
17 \$3,600,000.

18 A Yes.

19 Q So is it true that Ocean Living, Inc., loaned
20 Marshall Reddick Real Estate additional money in 2004 that
21 totaled \$3,600,000?

22 A Yes.

23 Q And look at Exhibit 002139. Do you see that?

24 A Hm-hm.

25 Q And that's a Schedule L, Statement 7. It refers

1 to Statement 7, but it shows the beginning of loan balance
2 of \$3,600,000; is that correct? And at the end of the
3 year, \$4,178,160?

4 A Yes. Yes.

5 Q So in the year 2005 Marshall Reddick Real Estate
6 borrowed enough money to bring that total from \$3,600,000
7 up to \$4,178,000?

8 A Yes.

9 Q We already looked at -- at Exhibit No. 002155 and
10 that's at the end of 2006, which the total was \$5,444,253?

11 A Yes.

12 Q And that's the total of all the money that
13 Marshal Reddick Real Estate had borrowed from Ocean
14 Living?

15 A Yes.

16 Q And have reported it all as long as it's on a tax
17 return?

18 A Yes.

19 Q Did you make a determination on how much money --
20 was it you who made the determination of how much would be
21 loaned to Marshall Reddick Real Estate?

22 A No.

23 Q Who made that determination?

24 A The executives.

25 Q And who were those people?

1 A John Louche was the in-house attorney. And then
2 Fred Desworth was our chief financial officer, and I
3 believe -- I believe that Ed Saninski was the manager by
4 then.

5 Q Other than that money that was loaned back to
6 Marshall Reddick Real Estate at that period of time, did
7 you get out of the contributions you made to OLI, did you
8 get anything else back?

9 A No.

10 Q Now, one of the things that OLI spent money on
11 was to purchase life insurance policies on you and some of
12 the other executives?

13 A Right.

14 Q Was that your idea?

15 A No.

16 Q Whose idea was that?

17 A It was their idea.

18 Q And --

19 ADMINISTRATIVE LAW JUDGE MARGOLIS: Who is
20 "they?"

21 THE WITNESS: The executives.

22 BY MR. MUDD:

23 Q And it was your understanding that -- who would
24 get the proceeds of the life insurance policy if you die?

25 A They would.

1 Q Now, after ESOP was formed in 2004, sometime of
2 that, did you receive notice of an audit from the IRS?

3 A Yes, I did.

4 Q And you had to supply a lot of documents to the
5 IRS?

6 A Absolutely. It went on for three years.

7 Q And those documents are part of the exhibits in
8 this set, page 1697 to about 1701. So the audit was
9 completed in 2008; is that correct?

10 A Right.

11 Q And what was the result of that audit?

12 A I don't know what they called it, but we were
13 given a free bill of health as far as I was concerned,
14 except for a few things they wanted us to do. One of them
15 was that I had been signing the tax return, so I wasn't
16 supposed to do that anymore. I can't remember what the
17 other thing was. I can't remember.

18 Q Did you -- after that notice, did you resign your
19 position of CEO of OLI?

20 A Yes. Yes, I did.

21 Q And the IRS indicated you needed to do that?

22 A Yes.

23 ADMINISTRATIVE LAW JUDGE MARGOLIS: Excuse me for
24 a second. I'm looking at the documents you just referred
25 to, 1698, is the letter from the IRS. And it refers to an

1 attachment which notes the items that needed to be -- that
2 required your attention. But that's not part of -- you
3 didn't attach that to the letters?

4 MR. MUDD: We weren't able to. We requested it
5 from OLI. All their documents are -- many of them are in
6 Connecticut in the hands of the administrator and
7 attorney, and this is the best that we were able to do.

8 We did also attach the complete information
9 document request that shows all the documents that the IRS
10 had requested for the purpose of completing this in time.
11 Those were the only documents we were able to recover, and
12 also the only documents we were able to recover from the
13 IRS.

14 BY MR. MUDD:

15 Q Now, isn't it true that OLI was now paying many,
16 if not, most of your employees?

17 A Yes.

18 Q And the Marshall Reddick Real Estate employees?

19 A Yes.

20 Q And so when the State of California disallowed
21 the ESOP, it also caused you not to get a deduction that
22 you otherwise would have paid yourself; isn't that true?

23 A Yes.

24 Q In -- after 2006, tell us what happened to
25 Marshall Reddick Real Estate?

1 A Okay. 2005 to 2006 were our best years. We were
2 doing very, very well. And then the end of the 2006 the
3 recession started to take place, and I thought that I
4 would be able to get through the recession. I had gone
5 through three of them. They usually only lasted about a
6 year and a half. And so my belief was that I could
7 basically be able to keep the company going.

8 I remember reading about employers during the
9 last recession, that they kept their people regardless the
10 fact they wouldn't have income. But they were able to do
11 so and get through the recession so they could come out
12 the other side and be successful. I wanted to be able to
13 be such a person.

14 So even though income was really, really down, I
15 gave them the properties to help meet their expenses, and
16 I really stand behind my field in real estate. We did
17 real estate in every area that I was given properties in.
18 I think I showed in that handout that I either showed
19 comps of values of property.

20 Or I showed through different procedures the
21 values, actual comps or -- some of the systems I used
22 estimated, you know, from older comps or newer comps or
23 how fast the property values were going up or down or what
24 the values were. So I stand behind those property values.
25 So I gave them the properties. I later gave them some

1 more properties when they ran out of money.

2 Q Let's hold back.

3 A Okay. Okay.

4 Q You're being --

5 A Okay. I'm sorry.

6 Q What happened to Marshall Reddick Real Estate in
7 the beginning of 2007?

8 A Okay. Well, we went from incredible sales. I
9 remember one of our best months, I believe in '06, we sold
10 1,200 properties and closed on 900 properties. And I
11 think it was December of '07, I believe, where we only
12 sold 12 properties. That's how fast it dropped.

13 There were no loans available for people even if
14 they wanted to buy. Property values were going down
15 dramatically. And from '07 I have an article here from
16 '07 and the next three years. It went down an average of
17 42 percent. I bought 25 brand new homes in 2006 for
18 \$250,000 in Florida, and three years later I short sold
19 them for \$75,000. That's how much a brand new home in
20 Florida dropped in a really good area.

21 ADMINISTRATIVE LAW JUDGE MARGOLIS: When you say
22 you do this, do you mean you personally?

23 THE WITNESS: I personally did it.

24 ADMINISTRATIVE LAW JUDGE MARGOLIS: Not Marshall
25 Reddick Real Estate?

1 THE WITNESS: No. I personally did it.

2 BY MR. MUDD:

3 Q How did this effect Marshall Reddick Real Estate
4 as a business?

5 A Well, the business model absolutely collapsed.
6 The Realtors that we were working within 150 cities
7 couldn't pay their commissions. We call them finder fees,
8 to me. Our brokers ended up owing huge amounts. If they
9 had been able to pay, I would have been able to survive
10 the recession, but they were losing their homes.

11 Everyone that owned real estate was doing
12 horribly. And property values were dropping dramatically.
13 You couldn't get loans. There was concern that the
14 financial market was going to collapse. All the talk was,
15 you know, that many people were concerned of if our
16 economy would survive.

17 Q Isn't it true then, that you were unable to
18 conduct seminars after 2007?

19 A Right. There was no demand for seminars, and
20 that was the source of most of our people.

21 Q Isn't it true that it was difficult for anybody
22 to get a loan?

23 A You couldn't -- you couldn't get a loan. It was
24 impossible to get a loan.

25 Q And did Marshall Reddick Real Estate have debt?

1 A Oh, absolutely. We had huge expenses. I had an
2 office building. I had, you know, salaries to pay
3 through -- through the ESOP and so forth. Yeah, it was --
4 yeah, the expenses didn't stop.

5 Q And in February of 2009, what happened with
6 Marshall Reddick Real Estate?

7 A Okay. In '09 we declared Chapter 7.

8 Q No.

9 A Chapter 11. I'm sorry. Chapter 11, bankruptcy.
10 As I -- and then we tried to survive. I say we, I mean
11 ESOP tried to survive. In 2013 we finally had to --

12 Q ESOP didn't file bankruptcy here?

13 A No. No. It was --

14 Q -- Real Estate at the time --

15 THE COURT REPORTER: Please, I really need you
16 both to speak one at a time and not speak over each other.
17 BY MR. MUDD:

18 Q And did Marshall Reddick Real Estate file
19 bankruptcy because it wanted to survive?

20 A Yes. Right. And that was February of 2009. And
21 I tried to make it. I tried to pay creditors, but we just
22 couldn't do it. So we finally filed Chapter 7 in 2013.

23 Q And prior to filing bankruptcy, you transferred
24 some property to OLI; is that correct?

25 A Yes.

1 Q And what was the purpose of that transfer? Just
2 tell me the purpose of the purpose?

3 A Okay.

4 Q Don't tell me anything else.

5 A The purpose of the transfer was to pay back the
6 loans that I had taken and to help OLI survive.

7 Q Was that your idea to pay back the loans or was
8 it somebody else's?

9 A No. That was theirs.

10 Q That was theirs, and by that you mean --

11 A The OLI executives.

12 Q And did they ask you to pay back the loan?

13 A Yes.

14 Q And you didn't have cash to pay back the loans?

15 A I did not. I did not.

16 Q So what did you do?

17 A So I gave them 27, I thought at the time, really
18 good properties.

19 Q And did they review those properties with you?

20 A They did, and they -- they thought they were good
21 properties too at that particular time. They -- they were
22 doing fine. Now, I -- I did this over a year's time.
23 This was probably in '07 when things all still looked
24 pretty good. And it took six months to record the
25 properties, and they took time to, you know, took time to

1 do the paperwork and so forth.

2 ADMINISTRATIVE LAW JUDGE MARGOLIS: Excuse me,
3 Mr. Reddick. Were these properties that you gave, these
4 you owned personally?

5 THE WITNESS: Yes.

6 ADMINISTRATIVE LAW JUDGE GAST: These properties
7 MRRI gave?

8 THE WITNESS: Yeah. A real estate company cannot
9 buy properties. I had to buy them individually.

10 ADMINISTRATIVE LAW JUDGE GAST: Okay. So did you
11 contribute them to MRRI or --

12 THE WITNESS: No.

13 ADMINISTRATIVE LAW JUDGE GAST: -- you just gave
14 them straight to --

15 THE WITNESS: I gave them to ESOP.

16 BY MR. MUDD:

17 Q And the purpose to giving them to ESOP was cover
18 Marshall Reddick Real Estate's loans; is that right?

19 A Yes.

20 Q But you didn't formally give it to the Marshall
21 Reddick Real Estate, but to OLI?

22 A I don't know how that happened, but that's what
23 happened. It got to OLI.

24 Q And did OLI agree with you that is sufficient to
25 repay the loan?

1 A They did, and I support it. I thought it was
2 too.

3 Q I'm going to show you page 2216 of the exhibit
4 book, and ask you if that is a list of the properties that
5 you transferred to OLI?

6 A It is, yes.

7 Q Were some of those properties free and clear?

8 A Yes.

9 Q How many of them? Do you know?

10 A No, I don't. It did allow OLI to survive another
11 two years. I also gave them personally \$100 of my
12 retirement fund. I retire -- cashed out some funds.

13 Q Excuse me. You said \$100?

14 A One \$100,000. I gave them seven more properties
15 that they had in their name. And then from then on I -- I
16 cashed out every property that I could either refinance
17 and take money out, or I sold them and gave OLI the money
18 to keep going. I did everything I could to keep OLI
19 solvents hoping we'd get through the recession.

20 It's the saddest thing in my life to have let
21 people go. Just imagine standing in front of 25 people
22 and telling them that you have to let them go. It's
23 awful. It's just terrible. I had to do that three times.
24 It's the worse time of my life.

25 Q Did OLI come back to you and tell you what

1 happened with each of the parties?

2 A No.

3 Q So anything that they did -- did some of them go
4 into foreclosure?

5 A I have no idea. Property values dropped, like I
6 said, an average of 42 percent in three years.

7 Q And is it true that all the remaining properties
8 that you owned, other than those that were transferred to
9 OLI, were lost?

10 A Yes.

11 Q Did you lose your home?

12 A Yes.

13 Q Is Marshall Reddick Real Estate been able to go
14 back into business after the bankruptcy?

15 A Two young men that worked for me bought the
16 company. They really believed in it, and so they have
17 continued it. It's a very different business model. It's
18 just totally different. And they are wildly successful.
19 I think they have about ten employees, but they kept the
20 company going, which I'm very grateful for. They were two
21 of the interns that I got through school.

22 Q Did you -- you signed the OLI annual tax returns;
23 is that right?

24 A Yeah. No. I got terrible advice. I -- I had --

25 Q Just answer the question.

1 A Oh, okay. Yes, I did.

2 Q And you signed as CEO?

3 A I did.

4 Q Did you review the returns?

5 A No.

6 Q Who told you to sign them?

7 A If -- most of you are familiar. When tax time
8 comes, the tax thing you're supposed to sign comes to you,
9 right, the day it's due. And so I think my secretary
10 brought this and said this needs to be signed and turned
11 in. And so I signed it not having an inkling of an idea
12 that it shouldn't be. Because there was an administrator
13 but the administrator didn't know that she should sign it
14 either.

15 It's very complex. If you had 10 attorneys and
16 10 accountants and you all asked them the same question on
17 an ESOP, they would all come up with a different -- I had
18 three attorneys during this time. And I had three really
19 excellent tax accountants, and none of them were aware of
20 this. None of them were.

21 ADMINISTRATIVE LAW JUDGE GAST: Mr. Mudd, I want
22 to just remind you, you have exceeded your 30 minutes.

23 MR. MUDD: I'm finished.

24 ADMINISTRATIVE LAW JUDGE GAST: Okay.

25 ///

1 BY MR. MUDD:

2 Q Oh, I know. I have one question. On page 2057
3 of the exhibits, is that an example of the application for
4 the life insurance you filled out to buy the life
5 insurance policy?

6 A Yes. Yes.

7 Q And that's on policy that ends in 3140?

8 A Yes.

9 Q And on the second page, page 02058, it shows on
10 the first paragraphs that -- that paragraph, who the
11 owners of the policy would be, does it not?

12 A Yes.

13 Q And it says that 95 percent -- was it your
14 understanding that showed 95 percent to be owned by OLI?

15 A Yes.

16 Q Because they were the employer of all the OLI
17 employees?

18 A Right.

19 ADMINISTRATIVE LAW JUDGE MARGOLIS: Excuse me.
20 It also says that it'll be owned in proportion to be --
21 who made the premium payments?

22 THE WITNESS: Correct.

23 ADMINISTRATIVE LAW JUDGE MARGOLIS: Did
24 Mr. Reddick individually -- did you make the premium
25 payments of 5 percent or was it all made by OLI?

1 THE WITNESS: I don't know.

2 MR. MUDD: I mean, he contributed the money to
3 OLI, and OLI made all the payments. And it's been our
4 assertion that OLI was the sole owner of the policies as a
5 result of the payments that were made. And the
6 application, it was listed that OLI would own 95 percent,
7 apparently, because that's what he was told by the
8 insurance agent.

9 THE WITNESS: I think that was the requirement of
10 the insurance company.

11 BY MR. MUDD:

12 Q And you were told that?

13 A Yeah, that's what I was told.

14 MR. MUDD: I don't have any further questions.

15 ADMINISTRATIVE LAW JUDGE GAST: Thank you.

16 MR. HASKINS: Judges, based on some of the
17 testimony that was given and the testimony and notes I
18 have made, I need a few minutes in between. May I have a
19 ten-minute break to collect up some more exhibits I need
20 and talk with co-counsel?

21 ADMINISTRATIVE LAW JUDGE GAST: I don't have a
22 problem with that. Let's go on a recess for ten minutes.

23 (There is a pause in the proceedings.)

24 ADMINISTRATIVE LAW JUDGE GAST: Let's go back on
25 the record.

1 FTB you're up.

2 MR. HASKINS: Thank you. First, Mr. Mudd, can I
3 have that packet you were speaking of that has the
4 Schedule L on it?

5 MR. MUDD: The loan?

6 MR. HASKINS: No, Schedule L. You had a packet or
7 something?

8 MR. MUDD: Oh. Sure. Of course. The rest of
9 the tax returns would be surrounding that schedule in the
10 book. I just pulled out those pages.

11 MR. HASKINS: Hm-hm. All right. All right.

12

13 CROSS-EXAMINATION

14 BY MR. HASKINS:

15 Q Now, where to begin? Mr. Reddick, in your direct
16 examination you said that you created the ESOP according
17 to the plan set up by ASTER Financial?

18 A Yes, that's true.

19 Q Okay. And did you read that plan before you
20 enacted it?

21 A I don't think so.

22 Q Do you normally not read contracts?

23 A I think most people don't.

24 Q Do you read real estate contracts?

25 A No.

1 Q You just sign them?

2 A Yes.

3 Q And you've been in real estate how many years?

4 A Since 1977. It's very common. They're very --

5 Q Now, when you -- you mentioned or actually your
6 representative mentioned, that you took a loan of \$990,000
7 from OLI in 2013; is that correct? I'm sorry. In 2003,
8 is that correct that you took that loan?

9 A Yes.

10 Q And that was a loan that was referred to in the
11 packet that Mr. Mudd had?

12 A Yes.

13 Q Okay.

14 ADMINISTRATIVE LAW JUDGE MARGOLIS: Are you
15 referring to the book, the loan to MRRI or to Mr. Reddick
16 individually?

17 MR. HASKINS: I thought the packet --

18 MR. MUDD: I'll object to the question. It says
19 that Mr. Reddick wasn't to the loan. I think the
20 testimony was Marshall Reddick Real Estate.

21 MR. HASKINS: Actually, it doesn't say either.

22 MR. MUDD: Well, it's on Marshall Reddick Real
23 Estate tax return.

24 MR. HASKINS: Okay.

25 ///

1 BY MR. HASKINS:

2 Q Mr. Reddick, you were the 100 percent shareholder
3 of Marshall Reddick Reality?

4 A Yes.

5 Q So it was your company?

6 A Yes.

7 Q And it was an S-Corp?

8 A Yes.

9 Q And everything flowed through to you?

10 A Yes.

11 Q Okay. So my question is, if we look at page 2114
12 on the Bates Stamped -- I wish I had a mouse. I'm looking
13 at federal attachments to the 2003 return for Marshall
14 Reddick Reality. Mr. Mudd simply didn't include this
15 page. It is page 2114. His discussion started at 2115.
16 On --

17 ADMINISTRATIVE LAW JUDGE GAST: I'm sorry. You
18 said he didn't include it in the record or in his
19 testimony?

20 MR. HASKINS: In his presentation. He didn't
21 include this page.

22 ADMINISTRATIVE LAW JUDGE GAST: Okay.

23 MR. HASKINS: So yes, I'm referring to something
24 that's in the record.

25 ADMINISTRATIVE LAW JUDGE GAST: Okay.

1 BY MR. HASKINS:

2 Q It appears from this form that Marshall Reddick
3 Reality paid OLI \$1,000,000 in management fees in 2003.
4 Do you recollect that?

5 A If it says that, I'm sure it's true.

6 Q So okay.

7 A This was a long time ago.

8 Q No, I know. And then you borrowed \$990,000 from
9 them in that same year?

10 A Yes.

11 Q Actually MRRI did?

12 A Yes.

13 Q Now, you said that in your testimony that you
14 were the CEO to begin with but then resigned from the
15 position of CEO. When or what year did you do that -- of
16 what entity did you do that?

17 A 2008.

18 Q From OLI or MRRI?

19 A From OLI.

20 Q OLI. Okay.

21 ADMINISTRATIVE LAW JUDGE GAST: I'm sorry. You
22 resigned from OLI as a CEO in 2008?

23 THE WITNESS: Yes.

24 ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you.

25 ///

1 BY MR. HASKINS:

2 Q I'd like to direct the Court's attention to -- or
3 the panel's attention to Bates Stamped pages 161 through
4 170, 170 in particular?

5 MR. MUDD: 161 to 170?

6 MR. HASKINS: Yeah, 170. May I approach the
7 witness?

8 ADMINISTRATIVE LAW JUDGE GAST: For what purpose?

9 MR. HASKINS: To show him part of that exhibit.

10 ADMINISTRATIVE LAW JUDGE GAST: Sure.

11 MR. HASKINS: I don't believe he has it, and I
12 didn't know it was going to come up so I don't have extra
13 copies.

14 ADMINISTRATIVE LAW JUDGE GAST: Yes, that's fine.
15 Thank you.

16 BY MR. HASKINS:

17 Q Mr. Reddick, do you recognize the signature on
18 that page?

19 A Yes.

20 Q Is that your signature?

21 A Yes.

22 Q Do you see paragraph 12 on that page?

23 A Yes.

24 Q And what's that date?

25 A 2009.

1 Q So this was a -- do you remember what this is?

2 A No.

3 Q Okay. You said you had an agreement or maybe you
4 didn't. Didn't you have an agreement between MRRI and OLI
5 or OLI to manage Reddick Reality?

6 A I'm sure there was such an agreement. I'm not
7 sure we could find them.

8 Q For the tax years at issue? We've been supplied
9 this one that is dated in the year 2009. I call the
10 panel's attention to the fact that this 2009 document list
11 Marshall Reddick as the CEO of -- I'm sorry.

12 MR. MUDD: What's the page number again?

13 ADMINISTRATIVE LAW JUDGE GAST: Of MRRI?

14 MR. MUDD: What's the page number again?

15 ADMINISTRATIVE LAW JUDGE GAST: 170.

16 MR. HASKINS: 170. All right. We'll move on.

17 BY MR. HASKINS:

18 Q Now, you do agree that you borrowed against the
19 life insurance policies that had been bought by OLI in
20 your name?

21 A The Marshall Reddick Reality, I believe,
22 borrowed.

23 Q Marshall Reddick Reality?

24 A Oh, I'm sorry. OLI -- no. OLI borrowed -- I'm
25 sorry. OLI borrowed against it.

1 Q And your testimony is you weren't an officer of
2 the corporation at that time?

3 A No.

4 Q So you couldn't sign for it?

5 A No.

6 Q Okay.

7 MR. HASKINS: May I approach the witness?

8 ADMINISTRATIVE LAW JUDGE GAST: Yes.

9 MR. HASKINS: Thank you. For the panel, this is
10 now the exhibit that I spoke of earlier. I have labeled
11 it Appeal Exhibit A1 through 12.

12 ADMINISTRATIVE LAW JUDGE GAST: These are the
13 exhibits that Mr. Mudd -- did you have a chance to take a
14 look at them?

15 MR. MUDD: Yeah, I did. I know these were
16 floating around beforehand. I'm not sure I've seen them
17 all, but I'm not going to object to them.

18 ADMINISTRATIVE LAW JUDGE GAST: Okay.

19 MR. HASKINS: Okay. And --

20 ADMINISTRATIVE LAW JUDGE GAST: Actually, before
21 you proceed, just to be safe here. I'm going to admit
22 these exhibits into the record as evidence since there's
23 no objections. These are Exhibits A1 one through A12?

24 MR. HASKINS: Yes. Should be.

25 ADMINISTRATIVE LAW JUDGE GAST: Okay. All right

1 they're admitted into the record as evidence.

2 (Respondent's Exhibits A1-A12 were received
3 in evidence by the Administrative Law Judge.)

4 MR. HASKINS: Thank you.

5 BY MR. HASKINS:

6 Q May I direct your attention to this document?

7 What's that -- what's this document called?

8 A Request for Policy Value.

9 Q Okay. And who is it signed by?

10 A Me.

11 Q And what does that say right there?

12 A Policy Owner Signature.

13 Q Ask who's signature is there?

14 A That's my signature.

15 Q And what's that date?

16 A 1/19/06.

17 Q One second. Okay. Mr. Reddick, are you familiar
18 with Laurie Brown?

19 A The name is familiar. I don't recall who she is.

20 Q So you don't recall if she was an employee of
21 OLI?

22 A I don't recall.

23 Q Did you actually pick up the checks that were the
24 payment for the loans taken against the life insurance
25 policies?

1 A Did I personally?

2 Q Yeah.

3 A No, not that I know of.

4 MR. HASKINS: I'm going to let that go on the
5 advice of co-counsel.

6 ADMINISTRATIVE LAW JUDGE GAST: Okay.

7 BY MR. HASKINS:

8 Q Mr. Reddick, you had -- you have testified and
9 have maintained throughout that the purpose of this
10 structure, this plan in your mind was you wanted to turn
11 the company over to your employees?

12 A That's true.

13 Q Did you express that to ASTER Financial?

14 A Absolutely.

15 Q Did they inform you that you could, in fact, form
16 an ESOP for Reddick Reality?

17 A Well, yeah. They're the ones that did it.

18 Q Now, I think you testified they said that there
19 might be issues with that?

20 A AZRA (sic)?

21 Q No. Yeah. AZRA might?

22 A No, not at all.

23 Q They didn't tell you anything about there would
24 be issues if you were an owner of MRRI, and it had an
25 ESOP?

1 A No. They -- they set it up. I thought they knew
2 perfectly well what my objective was.

3 Q And MRRI took deductions for 401K administrative
4 fees in 2003 and '04. You already had a retirement plan
5 for your employees, didn't you?

6 A I -- I don't know. If it was, it wasn't as good
7 as I hoped it would be.

8 Q And why didn't you just give ownership of MRRI to
9 your employees and remain as president or an adviser?

10 A Well, AZRA assured me this was the best route to
11 take, and it seemed to be a good one.

12 ADMINISTRATIVE LAW JUDGE MARGOLIS: Counsel, do
13 you have the page cites where you claim that MRRI deducted
14 fees for retirement plans? Do you have that? Do you have
15 documents on that?

16 MR. HASKINS: That would likely be in the same
17 range as Bates 2114. Pages prior to that and subsequent
18 to that are the attachments that were on MRRI's 2003
19 return, which I believe was actually requested by the
20 Board subsequent to hearing and delivered to the Board and
21 to us.

22 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. Thank
23 you. I see a \$4,700 deduction for administrative fees on
24 page 2144.

25 MR. HASKINS: Thank you.

1 BY MR. HASKINS:

2 Q You, Mr. Reddick, you've testified that you
3 received loans -- or let me correct -- MRRI received loans
4 from OLI in the amount of \$5,400,000. That's across the
5 years in issue, 2003 to 2006, or all in one lump sum?

6 A I'm not sure.

7 Q Did those loans have exorbitant interest rate
8 attached to them?

9 A I think I was paying -- I think it was 6 percent,
10 something like that.

11 Q Okay.

12 ADMINISTRATIVE LAW JUDGE GAST: I'm sorry.
13 Mr. Reddick, you personally, individually, were paying
14 6 percent on the loans or MRRI was?

15 THE WITNESS: MRRI.

16 ADMINISTRATIVE LAW JUDGE GAST: Okay.

17 ADMINISTRATIVE LAW JUDGE MARGOLIS: Was it
18 actually paid? Was it owed, or was the interest actually
19 paid back by MRRI to OLI?

20 THE WITNESS: When we got into problems and we
21 couldn't make the premiums, that it was cashed out and
22 that was paid back with cash.

23 MR. MUDD: No.

24 THE WITNESS: No?

25 ///

1 BY MR. MUDD:

2 Q The question was did you pay the interest on the
3 loans? Did MRRI pay interest on the loans that it got
4 from OLI?

5 A Oh, I don't know. I don't think they did. I
6 think I was to pay that.

7 MR. HASKINS: May I?

8 ADMINISTRATIVE LAW JUDGE GAST: Yes.

9 BY MR. HASKINS:

10 Q Mr. Reddick, you testified that you gave
11 properties that you valued at \$11,000,000-plus in order to
12 pay back the loan --

13 A Right.

14 Q -- from OLI to MRRI?

15 A Yes.

16 Q You gave them \$11,000,000 for a \$5,400,000 loan?

17 A I wanted to make sure there was enough money to
18 cover the running of the company. I was trying to keep
19 the company going any way that I could.

20 Q Why did MRRI pay \$1,000,000 to OLI in management
21 fees in 2003 if the ESOP and OLI -- well, if OLI had been
22 formed in late December and the ESOP was not in effect
23 until 2004?

24 A I thought it -- I thought it had started, quite
25 frankly. I didn't realize that it was not until '04 that

1 it was formally.

2 Q Did you file an amended return correcting that?

3 A I don't think so.

4 MR. HASKINS: For the panel's information, we
5 have no amended returns for that year.

6 ADMINISTRATIVE LAW JUDGE GAST: Okay.

7 MR. HASKINS: My co-counsel would ask a few
8 questions with your permission?

9 ADMINISTRATIVE LAW JUDGE GAST: That's fine.

10 MR. HASKINS: Thank you.

11 BY MR. CORNEZ:

12 Q Mr. Reddick, the loans -- the \$5,400,000 loan was
13 from OLI to MRRI?

14 A Yes.

15 Q Did you personally guarantee that loan?

16 A No.

17 Q Nevertheless, you transferred property to repay
18 the loan?

19 A Yes.

20 Q And I'm a little confused about which years. I
21 think you did that in more than one year, but in total it
22 was \$11,000,000?

23 A Yes.

24 Q Did you report taxable income on the repayment of
25 that loan of \$11,000,000?

1 A I don't know.

2 MR. MUDD: Did he or did OLI?

3 BY MR. CORNEZ:

4 Q Did Mr. Reddick report taxable income on the
5 repayment of the loans of the \$5,400,000 loan when you
6 repaid it by transferring property? Did you report
7 taxable income?

8 ADMINISTRATIVE LAW JUDGE GAST: When you say
9 report taxable income, you mean cancellation of
10 indebtedness?

11 MR. CORNEZ: Well, it would either be
12 cancellation of an indebtedness income or an exchange
13 of -- but, yes. By paying back the loan that you didn't
14 report taxable income when you received it. You have
15 taxable when you pay it back, or you paid it back after
16 tax dollars. One or the other, but there should have been
17 income reported.

18 ADMINISTRATIVE LAW JUDGE MARGOLIS: I'm sorry.
19 I'm not sure what you're saying.

20 MR. CORNEZ: Well, he cancelled his debt by
21 giving them property, so that would be a taxable event.

22 ADMINISTRATIVE LAW JUDGE MARGOLIS: But he may
23 not have had positive income.

24 MR. CORNEZ: Correct. That's all the questions I
25 have.

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ADMINISTRATIVE LAW JUDGE GAST: Okay.

Mr. Haskins, are you -- do you need more time?

MR. HASKINS: I am checking on that right now.

ADMINISTRATIVE LAW JUDGE GAST: Okay.

MR. HASKINS: Again, I apologize. But with 2,500 pages of discovery, it's a little tough. The FTB is done with its cross-examination.

ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you.

At this point I'm going to open it up to the panel for questions. All right. I'll go first.

Mr. Reddick or Mr. Mudd, whichever one wants to answer, the ESOP has an effective plan date of January 1st, 2004?

MR. MUDD: Correct.

ADMINISTRATIVE LAW JUDGE GAST: So but on the 2003 return for OLI, it's shown as the sole shareholder. Is there a provision in the law that allows that retroactive ownership?

MR. MUDD: Excuse me. Who is the sole shareholder?

ADMINISTRATIVE LAW JUDGE GAST: The ESOP.

MR. MUDD: Oh, okay.

ADMINISTRATIVE LAW JUDGE GAST: I can point to you to the --

MR. MUDD: Well, they wouldn't have gotten the

1 stock before they were formed. So the reality is, for
2 2003, the money that was contributed probably should not
3 have been deductible, but put back by the notice. So
4 that's probably correct.

5 ADMINISTRATIVE LAW JUDGE GAST: So what's correct
6 then?

7 MR. MUDD: \$989,000 that the Franchise Tax Board
8 assessed on -- against Mr. -- or against MRRI for 2003
9 probably is correct because that money would have been
10 contributed before the formal -- that \$1,000,000 would
11 have been contributed before the formal creation of the
12 ESOP. So transferring that money to OLI at that point in
13 time, probably was not a deductible expense.

14 ADMINISTRATIVE LAW JUDGE GAST: Okay.

15 MR. MUDD: So that the notice for 2003 is
16 probably correct. Mr. Reddick got \$990,000 back. The
17 adjustment is \$989,000. That is probably correct. We
18 can't argue that. However, I'm not sure the statute was
19 extended or what happened to keep the 2003 referral.

20 ADMINISTRATIVE LAW JUDGE GAST: Okay. With
21 respect to the transfer of employees from MRRI to OLI, was
22 that all of MRRI's employees or a portion of them?

23 MR. MUDD: It was a portion of them that actually
24 began working for OLI. And Mr. Reddick doesn't recall
25 which portion it was, whether it was the executives or

1 whether it was the rank and file secretaries or everyone
2 else. He doesn't recall.

3 But he says there were paychecks made by Marshall
4 Reddick Real Estate, and paychecks made by OLI. But he
5 doesn't recall how it was divided. It was just whatever
6 they told him to do.

7 ADMINISTRATIVE LAW JUDGE GAST: Okay. And were
8 all the employees of OLI from 2003 to 2006 participants in
9 the ESOP?

10 MR. MUDD: That was his understanding, but
11 100 percent of Marshall Reddick Real Estate employees
12 receive stock in OLI.

13 ADMINISTRATIVE LAW JUDGE GAST: Okay. And then
14 with respect to Mr. Reddick's relationship with OLI, you
15 said that he was the CEO for all the years under review,
16 but then he relinquished that position in 2008?

17 MR. MUDD: The IRS told him that he needed to
18 relinquish that position.

19 ADMINISTRATIVE LAW JUDGE GAST: Okay. And during
20 that time period, did he sign checks on behalf of OLI?
21 Did he have any kind of authority or control over the
22 company?

23 MR. MUDD: Did you run any day-to-day operations
24 of OLI?

25 THE WITNESS: No.

1 MR. MUDD: Did you sign any checks?

2 THE WITNESS: No.

3 ADMINISTRATIVE LAW JUDGE GAST: And then the loan
4 documents -- you might have addressed this, and if I
5 missed it I apologize. What happened to those
6 memorializing the loans?

7 MR. MUDD: I haven't been able to locate them. I
8 have requested them, but the loans -- the actual loans of
9 the \$5,400,000 are the loans made each year.

10 MR. HASKINS: I can answer that.

11 MR. MUDD: Okay. Do you have them?

12 MR. HASKINS: No.

13 MR. MUDD: I wasn't able to locate them.

14 MR. HASKINS: They don't exist anymore. In an
15 early -- early into this audit, the loan documents were
16 requested and FTB was informed that they had perished in a
17 fire at MRRI, at Mr. Reddick's accountant's office.

18 THE WITNESS: We did have a big fire, and he was
19 responsible for all this.

20 MR. HASKINS: That would be in 2471, Bates
21 No. 2471. I believe it's paragraph 5 or 9 on that page.

22 ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you.
23 And with respect to the lawsuit against AZRA Financial, do
24 you know what happened to that?

25 MR. MUDD: I don't have any idea.

1 THE WITNESS: Well, this was, I think, the
2 Chapter 11 was going on then, and the insurance company
3 paid half a million dollars, that I didn't get that. It
4 went to the Chapter 11. We were going to sue Chuck
5 Decker, but it was determined that it would be
6 non-collectible, that he didn't have assets.

7 ADMINISTRATIVE LAW JUDGE MARGOLIS: So OLI got
8 the \$500,000 from the lawsuit?

9 THE WITNESS: No. I think it was in Chapter 11.
10 So it we want to the people that we were trying to pay
11 back.

12 ADMINISTRATIVE LAW JUDGE GAST: Oh, so MRRI was
13 in Chapter 11.

14 THE WITNESS: Yeah. Right.

15 ADMINISTRATIVE LAW JUDGE MARGOLIS: So MRRI --
16 something like that. I got you.

17 ADMINISTRATIVE LAW JUDGE GAST: I'm trying to see
18 if I have more questions. I do have a question for the
19 FTB in terms of what you're arguing exactly? Are you
20 disputing that the ESOP, OLI, or MRRI were sham entities
21 or just the transactions that occurred between the
22 entities were shams?

23 In other words, was the ESOP validly created
24 under the law? Are you disputing that? Or are you
25 arguing that the transactions between them, the loans, the

1 life insurance policy premiums were shams?

2 MR. HASKINS: In as a quick summary as I can, we
3 are not arguing that MRRRI was not a valid S corp. We're
4 not arguing that OLI was an S corp. It may have been set
5 up as part of a fraudulent plan, but we're not debating
6 whether or not OLI was or was not registered with the
7 Secretary of State.

8 We are also not arguing that the ESOP apparently
9 was constructed properly as ESOP's should be under the
10 federal law. And I think that was the thrust of the
11 discussion of the IRS audit. And when you read those
12 documents, what you find is what they were looking at was
13 purely the structure of the ESOP.

14 It's what you do with these structures that can
15 be abusive. That is our argument. We're not arguing if
16 there's any list of transactions here. We're simply
17 arguing that the actions taken lacked economic substance
18 for a California business purpose.

19 ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you.
20 That's it for my questions. Judge Margolis?

21 ADMINISTRATIVE LAW JUDGE MARGOLIS: When were the
22 employees of Marshall Reddick Reality transferred over to
23 OLI?

24 THE WITNESS: When was what?

25 ADMINISTRATIVE LAW JUDGE GAST: When did you

1 actually transfer the employees over to OLI?

2 THE WITNESS: I don't know. I'm sorry. I just
3 don't know.

4 MR. MUDD: Would it have been shortly after OLI
5 was formed when it became an ESOP, or would it have been
6 some other time?

7 THE WITNESS: Well, I think it was as soon as we
8 could do it. So I -- I just don't know. It looked like
9 we had some actual transactions before the actual
10 stocks --

11 MR. MUDD: Well, the ESOP -- his testimony and
12 exhibits, say the ESOP was formed in February 2004.

13 THE WITNESS: That seems late.

14 MR. MUDD: Well, if that was when it was formed,
15 when do you believe the employees were transferred?

16 ADMINISTRATIVE LAW JUDGE GAST: You had meetings
17 with the employees and explained to them about the whole
18 plan?

19 THE WITNESS: Yes.

20 ADMINISTRATIVE LAW JUDGE GAST: Okay. You also
21 made a \$10,000 loan so they could water the stock of OLI
22 initially; is that correct?

23 THE WITNESS: Correct.

24 ADMINISTRATIVE LAW JUDGE GAST: Do you know if
25 that loan was ever paid off?

1 MR. MUDD: Can I suggest, I don't think he knows.
2 If you look at the contribution of \$1,000,000, \$990,000
3 was paid back. So I'm guessing that the difference of
4 \$10,000 had something to do with that loan, although, I
5 don't know. And he doesn't know either.

6 MR. HASKINS: May I make a quick observation?

7 ADMINISTRATIVE LAW JUDGE MARGOLIS: Yes.

8 MR. HASKINS: The \$990,000, quote, unquote,
9 "loan," we have no documentation that that actually
10 existed.

11 ADMINISTRATIVE LAW JUDGE GAST: Let me understand
12 that. You said the loan documents disappeared in a fire.

13 MR. HASKINS: That was for the \$5,400,000 that
14 was loaned from OLI to Reddick Reality. If they are
15 saying there's yet another loan document for \$990,000, we
16 also do not have that.

17 MR. MUDD: Well, look at page 2115. Schedule L
18 shows that 2003 at the end of the year the balance of the
19 loan to be paid to Ocean Living by Marshall Reddick Real
20 Estate was \$990,000.

21 MR. HASKINS: I'm aware of what it says on the
22 return. I'm disputing --

23 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. Yeah.
24 We can move on from that. Question for the FTB, maybe
25 it's also for the taxpayer. How much do you contend was

1 actually loaned back in some form or other from OLI to
2 Marshall Reddick Reality?

3 MR. HASKINS: Judge, if you're speaking about
4 both the \$5,400,000 loan and the insurance loans --

5 ADMINISTRATIVE LAW JUDGE GAST: Yes.

6 MR. HASKINS: -- it's our contention that all of
7 the premiums paid for the insurance policies were returned
8 to Mr. Reddick, MRRI, or key employees. And the
9 \$5,400,000 loan, it's not in dispute from Mr. Reddick so
10 \$5,400,000 and \$7,700,000 comes to \$13,000,000.

11 ADMINISTRATIVE LAW JUDGE MARGOLIS: So wait. The
12 \$7,700,000, that's the amount of insurance premiums?

13 MR. HASKINS: Yes.

14 ADMINISTRATIVE LAW JUDGE MARGOLIS: But those
15 weren't paid to Marshall Reddick Reality. Those were paid
16 to the insurance company; right?

17 MR. HASKINS: From OLI with untaxed money in the
18 name of Mr. Reddick and in the name of key individuals.
19 There's a \$48,000,000 policy for Mr. Reddick, a
20 \$23,000,000 policy and a \$6,000,000 policy, two of which
21 we have evidence were borrowed against.

22 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. And
23 how much were the borrowings against the premiums for
24 which they paid \$7,700,000? How much were the borrowings?

25 MR. HASKINS: The information that I have, and it

1 comes from Appellant -- I'm sorry. Appeal Exhibit A-12,
2 part of that exhibit I gave. It's an e-mail from Patrick
3 Fronte of Ocean Living, saying that -- and it's dated in
4 2010.

5 It's saying that, "We drew out a total of
6 \$595,851 in loans." It then says, "We cashed out the
7 remaining surrender values." But those loans are crossed
8 out because we specifically only asked for the two loans
9 that we know about, and it's part of a subpoena duces
10 tecum.

11 ADMINISTRATIVE LAW JUDGE MARGOLIS: So you don't
12 know the amount of surrendered value of the cash back?

13 THE WITNESS: I can give you the surrender values
14 at the time the loans were made for the \$23,000,000 loan
15 and the \$6,000,000. I do not know --

16 MR. CORNEZ: Policy.

17 MR. HASKINS: Policy. Sorry. The policy loan.
18 I don't have any documents on the \$48,000,000 loan.

19 ADMINISTRATIVE LAW JUDGE MARGOLIS: And you just
20 got the information straight off these documents?

21 MR. HASKINS: Yes. The page you want to look at
22 is A5, and it would be in the upper section to the right.
23 And there's a line for loan balance.

24 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. Do you
25 know when -- from these documents, Mr. Haskins, do you

1 know when Marshall Reddick Reality stopped paying premiums
2 on these insurance policies?

3 MR. HASKINS: Yes. For that particular loan, it
4 looks like the last premium was paid February 28, 2006,
5 just shortly after the loan was taken. And on the
6 \$6,000,000 loan, it looks like the last date of payment
7 was 3/22/2006, again, shortly after loan was taken.

8 ADMINISTRATIVE LAW JUDGE MARGOLIS: You mean when
9 the policy was taken?

10 MR. HASKINS: No. The policy loan was taken.
11 The policy had been put in effect in 2003, but there's a
12 one-year moratorium on borrowing against it. Plus it had
13 to build up some cash value. And so the surrender value
14 in 2006 when the loan was taken, appears to be about
15 \$120,000 and a \$102,000 loan was taken, according to page
16 A6.

17 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. Let me
18 move on for a second. I can look at these later and work
19 out the numbers. Can you respond to the Mr. Mudd's
20 concern that he's not being allowed to even deduct the
21 payments -- that MRRI and him, because it passes through
22 to you individually. That the amounts that actually went
23 to the employees that were working for OLI, that he's not
24 getting deductions for those amounts; is that correct?

25 MR. HASKINS: No, that's not correct. OLI

1 deducted those employee wages on their return. So did
2 Marshall Reddick Reality on its return deducted wages.
3 Both corporations deducted wages for employees. Those
4 deductions were given. We're not debating those
5 deductions. He was given all the deductions that were
6 allowed at that time. So no one has denied him that
7 deduction.

8 MR. MUDD: May I say something?

9 ADMINISTRATIVE LAW JUDGE GAST: Go ahead.

10 MR. MUDD: The deduction wasn't disallowed on the
11 return, but the transactions are allegedly a sham, and all
12 of the money that was paid over to OLI was being
13 disallowed, which means he wasn't -- Marshall Reddick Real
14 Estate -- OLI took the deductions for those wages. It
15 made no difference.

16 They're saying the transaction was a sham, and
17 that the money OLI paid to -- or the money that Marshall
18 Reddick Real Estate paid to OLI, paid those wages was lost
19 because everything he gave to OLI was lost.

20 ADMINISTRATIVE LAW JUDGE MARGOLIS: I'm not sure.
21 Maybe you can clarify this. The way I understood with
22 what the Franchise Tax Board is doing here is that they
23 allowed the deductions to OLI, and they're just moving
24 back to Marshall Reddick Reality the net income; is that
25 correct?

1 MR. HASKINS: Exactly.

2 ADMINISTRATIVE LAW JUDGE MARGOLIS: So I think
3 what they're saying is that you're already getting the
4 benefits of the amounts that went to the employees of OLI.
5 I just want to make sure that's clear. There's no dispute
6 about that. Because I think by taking -- by only
7 reallocating the debt income, you're already getting the
8 benefits of the amounts that were paid to the employees.

9 MR. MUDD: I think that the deductions that were
10 disallowed on the notice at least, if I'm not mistaken, in
11 '05 exceeds the amount that was contributed to OLI.

12 ADMINISTRATIVE LAW JUDGE MARGOLIS: Is that
13 correct, Mr. Haskins?

14 MR. MUDD: I can look that up.

15 MR. CORNEZ: We would have to look at the tax
16 returns for OLI and MRRI to clarify this. But I think
17 their understanding all along was, as Judge Margolis
18 stated, we only allocated to Mr. Reddick the net taxable
19 income of OLI, which was after deductions. But we would
20 have to look at returns to clarify.

21 MR. HASKINS: That was also discussed in one of
22 the reply briefs that we filed, specifically that very
23 question why they were not being denied a deduction. We
24 specifically said it's the K-1 income that you would have
25 earned after net income was made that we're putting back.

1 ADMINISTRATIVE LAW JUDGE MARGOLIS: That's my
2 impression from reading and talking, so that's basically
3 all the -- what they're saying is that they're taking the
4 income of OLI and saying that well, we treated -- it was
5 treated as nontaxable because it went to the ESOP.
6 They're saying that it was -- it should be treated as a
7 sham. So the amount of income after allowing all the
8 deductions goes back to MRRI.

9 So I think that you've already got the benefits
10 of those deductions. We'll check, but that's -- that's
11 what I think from looking at the documents. So there may
12 be a bit of a misunderstanding here.

13 Why did MRRI need all these loans, Mr. Reddick?

14 THE WITNESS: From the ESOP?

15 ADMINISTRATIVE LAW JUDGE GAST: Well, they didn't
16 borrow from the ESOP directly. They borrowed from OLI.
17 Why did MRRI need loans from OLI?

18 THE WITNESS: To grow the business.

19 ADMINISTRATIVE LAW JUDGE MARGOLIS: And when the
20 loans came back to MRRI, did MRRI loan money to you?

21 THE WITNESS: No. No. It was to grow the
22 business. We had tremendous growth. We doubled in
23 employees during this time. We had incredible expenses.
24 We were doing seminars all over Southern California,
25 Northern California. We had an office building to pay

1 for, and a conference center to pay for. We had
2 incredible expense that allowed us to grow. It benefited
3 the ESOP. It benefited the employees. We were able to
4 hire more people.

5 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay.

6 THE WITNESS: It didn't come to me personally.

7 ADMINISTRATIVE LAW JUDGE MARGOLIS: And you said
8 employee of OLI as well, from my understanding. You
9 received a salary from MRRI and OLI?

10 THE WITNESS: Yeah. I wasn't supposed to. I had
11 no idea, and I don't know why my accountants didn't catch
12 that. I just don't get it, but I didn't know better.

13 ADMINISTRATIVE LAW JUDGE MARGOLIS: What did you
14 do for OLI that you received a salary?

15 THE WITNESS: What?

16 ADMINISTRATIVE LAW JUDGE MARGOLIS: What did you
17 do for OLI that you received a salary for? What was
18 your --

19 THE WITNESS: Well, I was running the company. I
20 don't know. I mean, I was doing everything. I was
21 growing the business. I was providing all the income.

22 ADMINISTRATIVE LAW JUDGE MARGOLIS: Who was the
23 trustee of the ESOP? Were you the trustee of the ESOP?

24 THE WITNESS: I -- I don't know.

25 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay.

1 THE WITNESS: James was its administrator of the
2 ESOP.

3 ADMINISTRATIVE LAW JUDGE MARGOLIS: I don't think
4 I have any questions.

5 ADMINISTRATIVE LAW JUDGE GAST: Okay.
6 Judge Hosey, do you have any questions?

7 ADMINISTRATIVE LAW JUDGE HOSEY: I think you have
8 covered everything at this point. Thank you.

9 ADMINISTRATIVE LAW JUDGE GAST: Okay. I think
10 that brings us to the closing arguments.

11 Mr. Mudd, whenever you're ready.

12

13 CLOSING STATEMENT

14 MR. MUDD: I think you scheduled 10 minutes. I
15 don't know that I'll need 10 minutes.

16 A couple of things that I would like to point
17 out. You were shown page A6 on the documents that were
18 provided today. It showed Marshall Reddick signed this as
19 policy owner on a loan application for policy ending in
20 0032. If you can look at the next page, page A7, this is
21 dated 12/22/05. Marshall Reddick ensured Ocean Living,
22 Inc., is listed as the owner. So if he signed this, it's
23 obviously wrong because their own records show
24 differently.

25 THE WITNESS: I might mention that's my stamp

1 too. So anybody could have been stamped it. But --

2 MR. MUDD: Well -- and also I'd like to point out
3 that on page A12 --

4 THE WITNESS: I, you know, I didn't sign that.
5 If I had signed it, it would have been in my signature.
6 So it was stamped by somebody else who didn't know better.

7 MR. MUDD: Page A12 talks about the fact that the
8 cash values of the loans were apparently used to repay the
9 balance of the loans of the policies. And if you look at
10 page A10, it also shows a loan balance on the \$102,000
11 loan, the loan balance is \$112,000. The surrender value
12 was taken and \$2,816 was left over. The same on the
13 \$43,000 loan on page A11.

14 It shows that surrendered for lapse of payment,
15 but the cash value was used to pay off, leaving a
16 surrender value of \$144,000. I think it's clear in there,
17 I'm not sure the testimony was -- or the questioning of it
18 was clear.

19 Number one, as I said, the ESOP didn't exist in
20 '03. \$1,000 payment, the deduction he took -- the
21 \$1,000,000 deduction that he took would not have been
22 deductible as a payment of the ESOP. There's no way
23 around that. The balance of the money that Mr. -- that
24 Marshall Reddick Real Estate benefited from these items
25 was strictly the loan values for '04, '05, and '06 was

1 amounted to roughly \$5,000,000 -- or \$4,400,000 went back
2 to take the \$1,000,000 for 2004 and 2003.

3 Even if he hadn't paid the loans, that's the full
4 value of any benefit he got as a result of all these
5 things. All the rest of the money went to OLI, and OLI
6 used it for payment of wages or whatever. Apparently, he
7 had a pretty significant income, and OLI as an ESOP was
8 entitled to their income.

9 And even in 2008 when the IRS approved it, they
10 suggested some changes had to be made, but they approved
11 the plan. I think the reality is that Mr. -- Marshall
12 Reddick Realty through Marshall Reddick fully intended to
13 have a program for the benefit of employees. The money in
14 OLI and its profit was supposed to be for the employees.

15 They may have used a part of it for payment of
16 life insurance, but not a bad -- at least they were
17 informed that wasn't a bad investment for the ESOP because
18 it would protect the ESOP in the event of the death of
19 Marshall Reddick. And then he would always be there to
20 make payments or contributions to the ESOP and be there to
21 repay the loan.

22 We don't have any idea, although, the State did
23 have some indications that some of the properties that
24 Mr. Reddick provided to OLI were ultimately foreclosed on.
25 It may be true, but there were properties that were free

1 and clear, and they obviously got their money on those
2 properties. The listing -- and they weren't objected to,
3 but the list of the ones that were free and clear are
4 listed in the document that we sent yesterday.

5 It's not a large number of them, and are not high
6 value and they may have sold them for a whole lot less,
7 but it shows they were free and clear. Secondly, I
8 suspect, but I'm not sure, that the State is suggesting
9 that there was an adjustment of more than 25 percent to
10 keep the statute open for '03 and '04. Otherwise '03 and
11 '04 statute would have expired because the returns were
12 timely filed. Late, but the notebook was sent out in
13 September of '10.

14 '03 would have -- the extended date was August or
15 October of '04. Before it was October of '05. Both of
16 the statutes would have otherwise expired in '09. I don't
17 think we would have been here at all had the real estate
18 market not crashed and all the loans are repaid and money
19 was given to OLI. All OLI employees would have had big
20 retirement checks coming to them at this point.

21 I think the only reason that it all turned out
22 bad was because the real estate market collapsed. And not
23 only did OLI lose everything they might have gotten in the
24 future from Marshall Reddick -- Marshall Reddick himself
25 and Marshall Reddick Real Estate lost everything as well.

1 I ask that you find that the ESOP was valid, and
2 I think we just heard them say that, and that the
3 transactions made sense, and the only reason they didn't
4 is because everything failed.

5 ADMINISTRATIVE LAW JUDGE GAST: Thank you.
6 Mr. Haskins.

7 MR. HASKINS: Thank you. A few quick answers and
8 then I'll go into my closing. For the panel's
9 clarification, page A6 of the packet that I distributed in
10 page A7, refer to two different loans. And that's pretty
11 obvious when you read the entire page. One of them says
12 the owner is Marshall Reddick.

13 The other one says the owner is Ocean Living.
14 One is for \$23,000,000, and the other is for \$6,000,000.
15 They're not the same loan. There is no discrepancy there.
16 Now, if I may.

17

18 CLOSING STATEMENT

19 MR. HASKINS: In closing -- and so that because
20 they're all on the record I don't need to say this, but
21 all of the filings from FTB have pointed to the Economic
22 Substance Doctrine. It's a doctrine of long history.
23 It's a doctrine that attempts to interpret what actually
24 happened versus what the form of the transaction was.

25 In form, these transactions may appear correct,

1 but in substance, that's not what happened. The Economic
2 Substance Doctrine has been articulated by courts for
3 almost 100 years now. It's a well-developed law. It has
4 the following:

5 In determining whether a transaction lacks
6 economic substance, courts and administrative board, such
7 as the BOE and this panel, have generally focused on the
8 following principals: Whether taxpayer has demonstrated a
9 business purpose for engaging in a transaction other than
10 tax avoidance; and two, whether the taxpayer has shown
11 that the transaction had economic substance beyond the
12 creation of tax benefits.

13 It is the taxpayer's burden of proving that the
14 transaction had economic substance, and that was not done
15 here. And whether the taxpayer meets the economic
16 substance test is a factual finding for the Board. Here
17 in the 9th Circuit, and thus controlling for us, a
18 two-prong test is applied.

19 The prongs are not discrete. It's a -- you use
20 both prongs to come to a decision as to what actually
21 happened. And that's Casebeer v Commissioner 1990,
22 909 F.2d 1360. So the test is applied here to determine
23 whether the transactions between Reddick Reality, OLI, and
24 the ESOP had any practical economic effects other than tax
25 benefits, by examining whether the Appellant has shown a

1 subjective business purpose for entering into the
2 transactions, and that those transactions had objective
3 economic substance.

4 With regard to this subjective business purpose
5 of the transactions, the evidence shows that the primary
6 purpose of these transactions was to create tax benefits.
7 The allegations Appellant and Reddick Reality alleged in
8 the lawsuit filed against the promoter of the ESOP
9 strategy, support a finding that Appellant intended from
10 the beginning that the primary purpose of the transactions
11 was to shift taxable income to a nontaxable entity, and
12 then move that income back into his pocket for his own
13 use.

14 The formation of OLI, the purported execution of
15 the management agreement, the adoption of the ESOP, and
16 the sale of the OLI stock to the ESOP were all done in
17 closed proximity in late December 2003. In *Melnik v*
18 *Commissioner Tax Court Memo 2006-25*, such close timing was
19 a factor against finding a valid business purpose.

20 As for Appellant's assertion that the business
21 purpose was to provide a retirement plan for the employees
22 of Reddick Reality, the creation of a management company
23 and the associated ESOP had no effect on that purpose.
24 Appellant has not shown why Reddick Reality could not have
25 created a pension plan, and as mentioned they already had

1 one.

2 In addition, Appellant has not demonstrated why
3 he needed to create a separate management company in the
4 first place. The management company provided the same
5 services with the same employees that were previously
6 provided when they were employed by Reddick Reality.

7 The lack of a business purpose is also supported
8 by the fact that in 2003 Reddick Reality paid management
9 fees of \$1,000,000 to OLI, even though OLI was in
10 existence for less than a month. Appellant has not shown
11 how Reddick Reality derived any economic benefit from
12 paying OLI a total of \$15,983,975 in the years at issue.
13 That was the total before tax deductions that we allowed.

14 There's no evidence that the management
15 arrangement between Reddick Reality and OLI had a
16 subjective business purpose other than to shift income
17 from Reddick Reality to the tax-exempt ESOP adopted by
18 OLI. With respect to the objective economic substance
19 prong, the evidence shows that the management fees paid to
20 OLI were rerouted back to Appellant through the payment of
21 large insurance premiums. And then Appellant got that
22 benefit by borrowing against those insurance policies.

23 Thus, the transactions did not change Appellant's
24 economic position in a meaningful way, other than the
25 income tax benefits or affects. Because Appellant

1 received the economic benefit of the manager fees through
2 loans against the insurance policies.

3 Furthermore, Appellant -- yes. Furthermore,
4 Appellant received the economic benefits of the loans from
5 OLI directly to Reddick Reality to fund Reddick Reality's
6 operating expenses. For the employees, the employees
7 received very little as they merely received partially
8 allocated shares in a company which was apparently worth
9 only \$10,000 at the time. The ESOP was created and had
10 very little cash or assets.

11 If the panel refers to pages 1612 and 1626 during
12 your deliberations, you will note that on a payroll -- a
13 25 percent payroll in 2004, \$293,831 was the benchmark for
14 releasing shares to the ESOP, i.e. money actually going
15 from OLI to the ESOP. That's the benefit that would go to
16 the employees. The employees did not get any money. It
17 sat in OLI. It had to be transferred to the ESOP.

18 In this case the value of the shares released in
19 2004 was \$1,000. In 2005 on a payroll of \$3,161,062 and a
20 measuring stick of 25 percent of that payroll was
21 \$793,266. And yet OLI decided to allocate no shares.
22 None of the value earned in 2005 was contributed to the
23 ESOP for the benefit of the employees.

24 ADMINISTRATIVE LAW JUDGE MARGOLIS: Counsel, why
25 was there a need to allocate shares? I'm not sure if I

1 understood. I thought the ESOP owned 100 percent of the
2 shares.

3 MR. HASKINS: In order for any participant in an
4 ESOP to derive value from it, they have to be allocated
5 shares. If the shares simply sit in the underlying
6 company or in the ESOP trust, the employee benefits
7 nothing. There has to be a formula, and it's set in law,
8 that determines what your measuring stick can be.

9 But the choice to allocate any shares to any one
10 individual employee is left to the trustee of the ESOP.
11 And in this case, Appellant decided in one year that a
12 \$1,000 would go to the 40 different employees. And in
13 2005, no money would go to the employees. It simply sat
14 in the ESOP trust or in OLI.

15 We know that it was loaned back to Appellant, and
16 other funds were used to buy exorbitant whole life
17 insurance policies, against which he borrowed tax free.
18 And in reference to the loans, although recognizing
19 Appellant's experience, Appellant has not provided
20 incredible substantiated evidence to support his assertion
21 that the value of the properties paid back anything to
22 OLI.

23 In the notice -- I'm sorry. In the decision by
24 BOE, they pointed out the fact that some of these
25 properties weren't owned by OLI or Mr. Reddick. Some of

1 these properties were eventually foreclosed on, and
2 Mr. Reddick received a 1099 in years well beyond these tax
3 years, and beyond 2008 when he allegedly transferred them
4 to OLI in payment of this loan, for which we have no
5 documentation.

6 In sum, the evidence in the record suggest that
7 the substance in effect of the ESOP strategy, the loans,
8 and the insurance policy premium loans was solely to
9 provide tax benefits to Appellant. Keeping in mind that
10 there was a plan put in place, and this plan was enacted
11 by Mr. Reddick. He and we find that that plan was an
12 abusive tax avoidance transaction lacking any economic
13 substance.

14 As for the NEST penalty, Revenue and Tax Code
15 Section 19774, imposes a penalty for noneconomic substance
16 transactions understatements for any taxable year in an
17 amount equal to 40 percent of the understatement. That
18 term, "noneconomic substance transaction understatement,"
19 is defined in 17 -- revenue and tax code section 19774 as
20 the disallowance of any loss, deduction, or credit, or
21 addition to income attributable to a determination that
22 the disallowance for addition is attributable to a
23 transaction or arrangement that lacks economic substance.
24 A transaction shall be treated as lacking economic
25 substance if the taxpayer does not have a valid nontax

1 California business purpose for entering into the
2 transaction.

3 As discussed above, the transaction lacked
4 economic substance and Appellant did not have a valid
5 nontax California business purpose for entering into the
6 transaction, thus the NEST penalty is applicable. And we
7 ask that this panel sustain it.

8 For the interest-based penalty for the years it's
9 applicable, the applicable statute was amended in 2005 to
10 add another, for lack of a better word, qualifying event
11 that can occur that will allow FTB to assess the penalty.
12 The penalty is 100 percent of the interest that has
13 accrued from when we send the notice.

14 ADMINISTRATIVE LAW JUDGE GAST: Mr. Haskins, I
15 think you exceeded the ten minutes. Do you have a lot
16 more to go?

17 MR. HASKINS: No. No. I'm within half a minute.

18 ADMINISTRATIVE LAW JUDGE GAST: All right.

19 MR. HASKINS: In this case, there was a gross
20 misstatement within the meaning of Revenue and Tax Code
21 Section 19777. Because Appellant reported federal
22 adjusted gross income -- this is Appellant's individual
23 tax return -- gross income of \$4,854,567 and negative
24 \$2,289,821 on his 2005 and '06 California individual tax
25 returns respectively.

1 Reddick Reality deducted management fees of
2 \$6,476,161 in 2005 and positive -- or deducted \$3,491,393
3 in 2006. These amounts are well over the 25 percent of
4 the gross income required to be reported on Appellant's
5 return. On this bases, the interest-base penalty applies.

6 FTB request that the NPA's issued for tax years
7 2003 to 2006 be sustained except for the interest-based
8 penalty for tax years 2003 and '04. Thank you.

9 ADMINISTRATIVE LAW JUDGE GAST: Thank you.
10 Judge Margolis has a question for the FTB.

11 ADMINISTRATIVE LAW JUDGE MARGOLIS: First of all,
12 during your -- during, I think it was actually your
13 opening, you said that a notice that a deficiency was
14 determined against MRRI. Is there any evidence on that?
15 Has the FTB done that? I mean, because these adjustments
16 only flow through to Mr. Reddick.

17 I mean, one way they come to Mr. Reddick is if it
18 is by virtue of ownership of Marshall Reddick, Inc., an
19 S corp. And I believe you said something about a notice
20 being issued to that S corp.

21 MR. HASKINS: No. There was no issue. There was
22 no notice issued to Marshall Reddick Reality because OLI
23 was examined, and it was determined that it was an abusive
24 tax avoidance transaction. Thus the money was in effect
25 returned to MRRI and flowed through to its only

1 shareholder, Mr. Reddick. So the notices went to
2 Mr. Reddick as the only shareholder of Reddick Reality.

3 ADMINISTRATIVE LAW JUDGE MARGOLIS: So there was
4 a one-half percent tax at the S corporation level. So
5 that didn't --

6 ADMINISTRATIVE LAW JUDGE GAST: I think they said
7 applied -- that OLI paid tax at 1.5 percent.

8 ADMINISTRATIVE LAW JUDGE MARGOLIS: Did MRRI get
9 a notice?

10 MR. HASKINS: Yeah, we should have.

11 MR. CORNEZ: We did not assess it.

12 MR. HASKINS: I am informed that we did not
13 assess MRRI any additional income.

14 ADMINISTRATIVE LAW JUDGE MARGOLIS: Okay. And
15 I'm not sure if I understand the basis on what you claim
16 is on the statute of limitations. It's open because there
17 was a 25 percent omission on his return. That's what you
18 said in your closing.

19 MR. HASKINS: The 25 percent related to the
20 interest-based penalty.

21 ADMINISTRATIVE LAW JUDGE MARGOLIS: Oh, okay.

22 MR. HASKINS: For the statute of limitations it
23 simply says that if we determine and it is sustained that
24 there was the use of an abusive tax avoidance transaction.
25 We may go back longer than the normal four years. And

1 that was all spelled out in the original audit
2 determination and in the protest determination. You have
3 a copy of the protest determination letter amongst the
4 2,500 pages.

5 ADMINISTRATIVE LAW JUDGE MARGOLIS: Thank you
6 very much.

7 ADMINISTRATIVE LAW JUDGE GAST: Mr. Mudd, you can
8 have a five-minute rebuttal if you'd like.

9 MR. MUDD: I have a couple of items that
10 Judge Margolis raised. Number one, the deductions in
11 these cases were all taken by MRRI. It would appear that
12 proper adjustment would have been to MRRI, which
13 ultimately would have flowed in through to the taxpayer.
14 But the amount of those adjustments to MRRI are certainly
15 less than 25 percent of its gross income. In 2005 MRRI
16 had an income of \$25,000,000. In 2006 that income was
17 \$23,000,000, number one.

18 Number two, I'd like to point out that on the
19 Exhibits A1 through A12 that were presented today, on A12
20 the very last letter, it's a letter written on behalf of
21 Ocean Living, Inc., that basically starts out saying to
22 the person at the insurance company, "You previously
23 helped me out regarding some life insurance policy loans
24 we had. Thus, I hope you can help again." This is
25 written on behalf of Ocean Living.

1 I don't think there's any indication that any
2 loans were made directly to Marshall Reddick, other than
3 the fact he signed the application on behalf of Ocean
4 Living, not on behalf of himself.

5 ADMINISTRATIVE LAW JUDGE MARGOLIS: I think
6 that's clear. He puts his tax ID number rather than his
7 social security on the bottom of those forms.

8 MR. MUDD: It's a very confusing case. ESOP's
9 are generally entered into by businesses because there are
10 tax advantages in ESOP's. And an ESOP with a C corp, the
11 portion of the stock that's applied for the ESOP, and the
12 shareholders sign notices or other documents to buy the
13 stock from the shareholder. And the money that's
14 contributed by the company that owns the stock is actually
15 deductible by the company when they pay to the ESOP for
16 the purposes of buying back its own shares.

17 The page that explains that is one of the pages
18 in the document here. I don't have it in front of me, but
19 it is one of them. It explains how an ESOP generally
20 works. And then the owner of the stock, in this case had
21 MRRI been a C corp and he had allocated a portion of the
22 stocks, say 20 to 30 percent to an ESOP, the value of that
23 stock would have been set up in an ESOP, and the ESOP
24 would buy the stock from Mr. Reddick, MRRI would actually
25 give the money to the ESOP, and then the ESOP would use

1 that money to buy the stock back, and then it would go
2 back to Mr. Reddick. And he's able to defer taxation of
3 that money until some future time.

4 So there are huge tax benefits to a company to
5 use an ESOP. I think it's clear there were definitely tax
6 benefits the way the ESOP was set up, but it's not
7 prohibited by anything else. And Mr. Reddick, the CEO of
8 the ESOP, I think, definitely had an intent to give money
9 to the employees, and that is economic substance. I think
10 that's clear that was what his intent was.

11 Did somebody mess it up? Did somebody do it
12 wrong? Or were things done wrong? Were insurance
13 policies not to be purchased? I don't think that effects
14 the economic substance of the fact that Mr. Reddick's
15 intention was to create something for the employees.

16 Could he have done another pension plan?
17 Perhaps, but he certainly could not have contributed as
18 much he did to the ESOP. He had a pension plan in 2003.
19 There's obviously a payment from his 401K, but it's very
20 limited. The employees are very limited what they can do
21 through a 401K. There's a matching up to a certain limit
22 too. It's not all that much for an employee who's not
23 highly paid.

24 I'm sorry. The ESOP returns are part of this
25 exhibit. I don't think I saw it.

1 ADMINISTRATIVE LAW JUDGE MARGOLIS: There are
2 partial copies.

3 ADMINISTRATIVE LAW JUDGE GAST: Yeah, I think
4 there's partial copies in the file.

5 MR. MUDD: But I didn't see anything in any of
6 these documents to support the fact, to my knowledge,
7 support the fact that there is economic substance and the
8 only purpose of all this was the tax purpose. If the real
9 estate, as I said before, if the real estate market had
10 not failed, I don't think we'd be here today.

11 ADMINISTRATIVE LAW JUDGE GAST: Okay. Mr. Mudd,
12 is that it?

13 MR. MUDD: That's it.

14 ADMINISTRATIVE LAW JUDGE GAST: Okay. Thank you
15 very much. So any more questions from the panel?

16 ADMINISTRATIVE LAW JUDGE HOSEY: No.

17 ADMINISTRATIVE LAW JUDGE GAST: Okay. So this
18 concludes the hearing. The Judges will meet and decide
19 the case based on the documents and the testimony
20 presented, and we will aim to send a written opinion
21 within 100 day of today.

22 With that, the case is now submitted. And the
23 record is closed. Thank you.

24 (Proceedings adjourned at 12:37 p.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 16th day of February, 2019.

ERNALYN M. ALONZO
HEARING REPORTER