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2019 – OTA – 090
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011313
JAWFEN CHEN	) Date Issued: April 11, 2019

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:	Eva Y. Tsai, CPA
For Respondent:	David Hunter, Tax Counsel IV
For Office of Tax Appeals:	William J. Stafford, Tax Counsel III

S. HOSEY, Administrative Law Judge: On August 20, 2018, we issued an opinion sustaining the proposed assessment of respondent Franchise Tax Board (FTB) in the amount of $3,282,288 in additional tax and an accuracy-related penalty of $656,457.60, plus applicable interest, for the 2011 tax year. Appellant filed a timely petition for rehearing dated September 19, 2018. Upon consideration of the petition for rehearing, we conclude that the grounds set forth therein do not constitute good cause for a new hearing, as required by the *Appeal of Wilson Development, Inc.*, 94-SBE-007, Oct. 5, 1994,[1] and adopted in the Office of Tax Appeals Rules for Tax Appeals (OTA Rules for Tax Appeals), Cal. Code Regs., tit. 18, div. 4.1, section 30604.

In *Appeal of Wilson Development, Inc.*, *supra*, the Board of Equalization determined that good cause for a new hearing may be shown where one of the following grounds exists, and the rights of the complaining party are materially affected: 1) irregularity in the proceedings by which the party was prevented from having a fair consideration of its case; 2) accident or surprise, which ordinary prudence could not have guarded against; 3) newly discovered evidence, material for the party making the petition for rehearing, which the party could not, with

[1] Board of Equalization (BOE) opinions are generally available for viewing on the BOE's website: <www.boe.ca.gov>.

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reasonable diligence, have discovered and produced prior to the decision of the appeal; 4) insufficiency of the evidence to justify the decision, or the decision is against law; or 5) error in law.[2]

FTB asserted in the underlying appeal proceedings that the "merger" of Ardent Corporation (Ardent) and Cisco Systems, Inc. (Cisco) constituted a "tax-free exchange" under Section 351.[3] At the time, appellant did not dispute FTB's characterization of the transaction. In her petition for rehearing, however, appellant explained that the transaction between Ardent and Cisco was not an exchange under Section 351.

After reviewing the matter, FTB now agrees with appellant's statement, and asserts that the transaction between Ardent and Cisco instead constituted a merger under the provisions of Section 368(a)(1)(A).[4] FTB contends, however, that the underlying proposed assessment of additional tax remains unchanged because her ex-husband's tax basis in his Ardent shares was, after adjusting for the number of shares issued, carried over to his Cisco shares, regardless of whether the applicable transaction was a so-called "tax-free exchange" under Section 351 or a "plan of reorganization" under Section 368(a)(1)(A).

As an additional issue in her petition for rehearing, appellant contends that her ex-husband's initial tax basis in the Cisco stock was $74.875 per share, not $6.6262 per share as determined by FTB and as we found in our prior opinion. Appellant derives the alleged basis of $74.875 per share by referencing a Form S-3 Registration Statement filed by Cisco in relation to the applicable merger, which states that the average price quoted on the Nasdaq Stock Market for Cisco common stock on August 13, 1997, was $74.875 per share. In short, appellant is using the average price of Cisco common stock on August 13, 1997, as her ex-husband's initial tax basis in his Cisco shares. The August 13, 1997 stock price does not take into account the Ardent-Cisco merger and the subsequent four stock splits.

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[2] See also OTA Rules for Tax Appeals, section 30604.

[3] All Section references are to the Internal Revenue Code, unless otherwise indicated. Section 351 is generally incorporated into California law at Revenue and Taxation Code (R&TC) section 17321. Section 351(a) provides: "No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation."

[4] For the first time on appeal, FTB provides a complete copy of the Agreement and Plan of Reorganization between Ardent and Cisco, which states that the parties entered into the agreement as of June 23, 1997, and that the parties intended to merge the companies into a single company and to qualify the merger as a reorganization under the provisions of Section 368(a)(1)(A).

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Although appellant does not state the grounds upon which she is petitioning for a rehearing, it appears as though she is arguing that the decision is against law. In *Renfer v. Skaggs* (1950) 96 Cal.App.2d 380, 382-383, the court of appeal explained that insufficiency of evidence to justify the decision is a separate and distinct cause from "against the law"; "[t]hey are objections of an entirely different order." As explained in *Sanchez-Corea v. Bank ofAmerica* (1985) 38 Cal.3d 892, 906, "[t]he jury's verdict was 'against law' only if it was 'unsupported by any substantial evidence, i.e., [if] the entire evidence [was] such as would justify a directed verdict against the part[ies] in whose favor the verdict [was] returned.' [Citations.]" This requires a review of the decision to "indulge in all legitimate and reasonable inferences" to uphold the decision. (*Id.* at p. 907.) The relevant question is not over the quality or nature of the reasoning behind the decision, but whether the decision can or cannot be valid according to the law. (*Appeal of Nassco Holdings, Inc*., 2010-SBE-001, Nov. 17, 2010.)

Here, appellant has not presented any evidence demonstrating that FTB's calculation of her ex-husband's tax basis in his shares of Ardent stock as being $1.00 per share was against law. Appellant's clarification in her petition for rehearing that the transaction at hand was not an exchange under Section 351 as FTB had represented in the prior proceedings does not alter our previous finding that her ex-husband's tax basis of $1.00 per share in his Ardent stock carried over to his Cisco stock, resulting in an initial tax basis of $6.6262 per share of Cisco stock when adjusted for the number of Cisco shares issued. Appellant has not shown that our decision was unsupported by any substantial evidence or that the decision was invalid according to the law. As we stated in our opinion, appellant received the Cisco shares with the same tax basis as her ex-husband in accordance with Section 1041(a) and (b). We also stated that after adjusting for three additional stock splits, appellant had a tax basis in her Cisco stock of just $0.7363 per share, which resulted in a capital gain of $31,933,449 when the shares were later sold for $32,868,973. Appellant has not demonstrated that our determination of appellant's stock basis in her Cisco shares (and the resulting capital on the sale thereof) based on the evidence provided was against law.

As for the accuracy-related penalty, appellant's petition for rehearing merely reiterates arguments made during the underlying appeal proceedings. Appellant adds, however, that she is "willing to submit" a declaration as soon as possible, demonstrating her knowledge of the facts regarding the merger. However, appellant never provided a declaration (or any new evidence)

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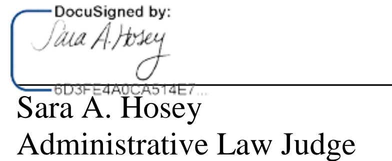
with her petition for rehearing or showed that the decision is against law in any way. Accordingly, we have no basis for reconsideration on the penalty.

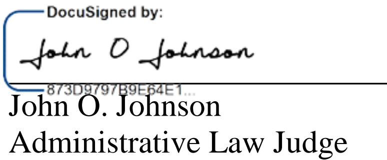
Our opinion dated August 20, 2018, was based on appellant's failure to show error in the proposed assessment of additional tax, penalty, and applicable interest. Appellant had the burden of proving error in FTB's proposed assessment, and she failed to meet that burden of proof. In summary, appellant has not demonstrated irregularity in OTA's proceedings, offered new evidence which she could not, with reasonable diligence, have discovered and produced prior to the decision of her appeal, or established that the evidence was insufficient to justify the opinion or it was against law. Furthermore, appellant has not demonstrated any error in law that had an impact on the underlying proposed assessment of additional tax, penalty, and applicable interest.

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

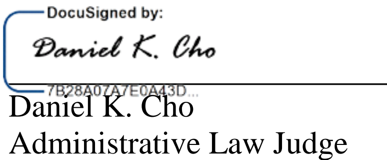


Sara A. Hosey
Administrative Law Judge

We concur:



John O. Johnson
Administrative Law Judge



Daniel K. Cho
Administrative Law Judge