OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19034478
R. REED	)
	)
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Jeffery M. Loff, CPA

For Respondent: David Kowalczyk, Tax Counsel

J. LAMBERT, Administrative Law Judge: On November 5, 2019, the Office of Tax Appeals (OTA) issued an opinion in which it reversed respondent Franchise Tax Board's (FTB) action in denying R. Reed's (appellant) claim for refund of $3,773.50 for the 2016 tax year because appellant had established reasonable cause for untimely filing his tax return. FTB filed a timely petition for rehearing (PFR). We conclude that the grounds set forth therein do not establish a basis for granting a rehearing.

As relevant here, a rehearing may be granted where one of the following grounds exists, and the substantial rights of the filing party (here, FTB) are materially affected: there is an irregularity in the proceedings which occurred prior to issuance of our opinion and prevented the fair consideration of the appeal; the opinion is contrary to law; or there is an error in law.[1] (Cal. Code Regs., tit. 18, § 30604.)

[1] California Code of Regulations, title 18, section (Regulation) 30604 is essentially based upon the provisions of California Code of Civil Procedure (CCP) section 657. (See *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654 [the State Board of Equalization (SBE) looks to CCP section 657 in determining the SBE's grounds for rehearing]; *Appeal of Do,* 2018-OTA-002P [OTA adopts the SBE's grounds for rehearing].) Therefore, the language of CCP section 657 and case law pertaining to the statute are persuasive authority in interpreting this regulation.

Irregularity in the Proceedings

FTB argues there was an irregularity in the proceedings because OTA did not provide it with the opportunity to have its arguments fairly considered. Specifically, FTB contends that, after briefing concluded, OTA denied its request for additional briefing to distinguish OTA's recently published precedential decision, *Appeal of Moren*, 2019-OTA-176P (*Moren*). FTB asserts that OTA subsequently relied on *Moren* in its original opinion here, stating: "Reasonable cause may be found when a taxpayer is unable to acquire the information necessary to make a reasonably accurate estimate of a tax liability after prudent efforts to acquire such information."

An irregularity in the proceedings has been defined as "any departure by the court from the due and orderly method of disposition of an action by which the substantial rights of a party have been materially affected." (See *Appeal of Graham and Smith,* 2018-OTA-154P, citing *Gay v. Torrance* (1904) 145 Cal. 144, 149.) Included in the classification of irregularities is an "overt act of the trial court . . . or adverse party, violative of the right to a fair and impartial trial." (*Russell v. Dopp* (1995) 36 Cal.App.4th 765, 779.) Examples of irregularities include the absence of a judge from the courtroom during a portion of the trial, and a judge threatening to prejudge testimony unless a witness is withdrawn.[2] (*O'Callaghan v. Bode* (1890) 84 Cal. 489, 495; *Pratt v. Pratt* (1903) 141 Cal. 247, 252.)

Pursuant to Regulation 30304(b), "[g]rounds for a request for additional briefing may include new facts, arguments, evidence, or any other matter essential to the resolution of the appeal. If an additional brief is submitted outside of the applicable briefing schedule, OTA will determine whether there is good cause to accept the submission." Here, OTA determined FTB did not show good cause for additional briefing, which is within its legal authority, pursuant to Regulation 30304(b).[3]

[2] An irregularity in the proceedings must be established by more than just an objection made during the proceedings; it is "intended to refer to matters which [a party] cannot fully present by exceptions taken during the progress of the trial." (*Gibbons v. Los Angeles Biltmore Hotel Co*. (1963) 217 Cal.App.2d 782, 791.) As discussed below, in an appeal before OTA, the grounds for a rehearing pursuant to Regulation 30604 can exist both where an oral hearing is held and where an appeal is submitted for decision based upon on the written record without an oral hearing.

[3] While FTB does not specifically argue there was an "error in law" with regard to the denial of its additional briefing request, we also determine that such denial does not constitute an "error in law," pursuant to Regulation 30604(e). As discussed, OTA was within its legal authority in denying the additional briefing request and FTB has not presented any legal authorities indicating that OTA made an error in its ruling as a matter of law.

In its PFR, FTB provides no new evidence, but instead makes the same or similar arguments offered during original briefing. Presumably, these are the same arguments it would have offered had we granted its additional briefing request. We denied FTB's additional briefing request because the question of whether appellant had shown reasonable cause was a question of fact and, accordingly, we determined it was not necessary for FTB to provide further legal briefing on this issue. "[W]hat elements must be present to constitute 'reasonable cause' is a question of law." (*Haywood Lumber & Mining Co. v. Commissioner* (1950) 178 F.2d 769, 772); however, "whether the elements which constitute 'reasonable cause' are present is a question of fact." (*Ibid*.) Further, as discussed below, FTB does not offer any argument in its PFR that would have materially affected the outcome of this appeal. Therefore, FTB has not shown there was an irregularity in the proceedings that prevented the fair consideration of the appeal.

Error in Law

FTB also argues that there was an "error in law" because OTA did not properly apply *Moren* in determining whether appellant exercised ordinary business care and prudence. As stated in CCP section 657 in the judicial context, an error in law "occurring at the trial and excepted to by the party making the application" is grounds for a new trial.[4] We note that, in an appeal before OTA, the grounds for a rehearing under Regulation 30604, including an "error in law," may exist both where an oral hearing is held and where an appeal is submitted for decision based upon on the written record without an oral hearing. An "error in law" includes situations where, for example, OTA made an erroneous evidentiary or procedural ruling.[5] (See, e.g., *Donlen v. Ford Motor Co*. (2013) 217 Cal.App.4th 138; *Ramirez v. USAA Casualty Ins. Co.* (1991) 234 Cal.App.3d 391.) Here, FTB is not arguing that there was an "error in law" during

[4] If, after an objection is overruled, and a party takes an "exception," the functions of an exception are: (1) to make the ruling a matter of record so that it may be re-examined by the court on a motion for a new trial or be reviewed by an appellate court; (2) to apprise the trial court that its ruling is challenged, and thereby enable it to reconsider its ruling and correct the error if it be such. (*Grossblatt v. Wright* (1951) 108 Cal.App.2d 475, 480.) However, CCP section 647 effectively abolished the requirement of exceptions in California. Pursuant to CCP section 647, "[i]f the party, at the time when the order, ruling, action or decision is sought or made, or within a reasonable time thereafter, makes known his position thereon, by objection or otherwise, all other orders, rulings, actions or decisions are deemed to have been excepted to." Therefore, it is sufficient that a party objects on the record or otherwise makes his or her position known, for purposes of establishing an "error in law" pursuant to CCP section 657.

[5] "As ordinarily understood, an error of law is committed when [OTA], either upon motion of one of the parties or upon its own motion, makes some erroneous order or ruling on some question of law which is properly before it and within its jurisdiction to make." (*Pratt v. Pratt, supra,* 141 Cal. at p. 251.)

the course of the proceedings, such as an order or procedural ruling that is erroneous as a matter of law. FTB is, in fact, arguing that the opinion is "contrary to law," pursuant to Regulation 30604(d). Accordingly, we address that issue.

Contrary to Law

The question of whether the opinion is contrary to law is not one which involves a weighing of the evidence, but instead requires a finding that the opinion is "unsupported by any substantial evidence"; that is, the record would justify a directed verdict against the prevailing party. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906.) This requires a review of the opinion in a manner most favorable to the prevailing party (here, appellant), and an indulging of all legitimate and reasonable inferences to uphold the opinion to the extent possible. (*Id*. at p. 907.) The question before us on a PFR does not involve examining the quality or nature of the reasoning behind OTA's opinion, but whether that opinion is valid according to the law. (*Appeal of NASSCO Holdings, Inc*. (2010-SBE-001) 2010 WL 5626976.)

Turning to this issue, we note that FTB is incorrect in asserting that OTA "relied" on *Moren* in its opinion, such that OTA would not have ruled otherwise without *Moren*. OTA made a factual determination that appellant exercised ordinary business care and prudence, and, as discussed in *Moren*, it is well established that we may examine a taxpayer's efforts to timely file his or her return.[6] In addition, the cases cited by FTB in its PFR establish that taxpayers may show reasonable cause if it is impossible to obtain information necessary to file the return, and that we may examine efforts to acquire such information in making that determination.[7] (See *Appeal of Tons* (79-SBE-027) 1979 WL 4068 [taxpayers did not establish they were "denied access" to "essential records"]; *Nirosta Corp. v. Commissioner* (1947) 8 T.C. 987, 990 [discussing taxpayer's "failure to exert some effort to obtain information"].) Therefore, OTA correctly applied the reasonable cause standard described in the cited cases and *Moren*.

[6] See, e.g., *Appeal of Bieneman* (82-SBE-148) 1982 WL 11825 [taxpayer alleged "diligent efforts to obtain the partnership information," but provided no evidence of the extent or nature of his efforts].

[7] In other words, while a lack of necessary information may be insufficient in and of itself to show reasonable cause for the failure to timely file (see *Appeal of Orr* (68-SBE-010) 1968 WL 1640), reasonable cause may nevertheless be established after an examination of all the facts and circumstances, including a taxpayer's efforts to obtain such information. (See, e.g., *Hornberger v. Commissioner*, T.C. Memo. 2000-42 ["we conclude that petitioner was unable to obtain the necessary trust records"], affd. (4th Cir. 2001) 4 Fed.Appx. 174; *Connor v. Commissioner*, T.C. Memo. 1982–302 ["[petitioner] was honestly ignorant of . . . large income, found her inquiries angrily rebuffed"].)

FTB also asserts that investors in pass-through entities can exercise their legal right to access the entity's financial documents, which can be used to ascertain whether they have a filing requirement. (See Corp. Code, §§ 15904.07, 15903.04, 17704.10, 17701.13.) FTB cites to *Appeal of Campbell* (85-SBE-112) 1985 WL 15882 (*Campbell*), where the SBE determined the taxpayers had access to the information necessary to estimate their tax because one of the taxpayers was a 50 percent owner in the partnership. FTB asserts that, as 10 percent owner of Kinaole Capital Partners LLC (KCP) in 2017, appellant could have accessed KCP's financial records or requested copies of the documents used to prepare its 2016 tax return. However, appellant sold his interest in KCP on December 31, 2016, and held no ownership interest in 2017, when FTB alleges he had the legal right as a partner to access financial records. Therefore, *Campbell* is readily distinguishable from the instant appeal. Accordingly, we conclude that OTA applied the correct law in its opinion.

Next, we examine whether the opinion is supported by substantial evidence. While FTB contends that appellant should have had access to or received KCP's financial statements as early as March 2017, the evidence indicates the financial statements were not completed until as late as September 2017. An email from KCP to appellant dated September 29, 2017, states that "KCP financials done at the end of this month." The evidence also demonstrates that such information continued to be withheld from appellant in the months that followed.[8] FTB argues that, given the extensive business activities in California, including a $35 million deal in 2016 to bring solar panels to California, appellant should have been aware of KCP's income-generating assets in California. However, such knowledge is not necessarily determinative as to whether appellant could have ascertained whether he had a filing requirement or performed a rough estimate of his California source income.[9] Appellant was notified by KCP on October 20, 2017, that it could not determine whether he had a gain or loss, after he requested such information. Therefore, the evidence indicates that, despite reasonable efforts, appellant could not even obtain

[8] As discussed in the original opinion, there are numerous emails establishing appellant's requests for such financial information: (1) October 10, 2017: "Anything new to report? Time is short."; (2) October 19, 2017: "What's the story"; (3) November 16, 2017: "What in the world is the holdup"; and (4) December 14, 2017: "Did someone get hit by a bus? Haven't seen anything yet."

[9] KCP had a series of losses in prior years, as appellant's share of KCP's losses was $11,963 in 2014, while assuming partnership liabilities of $102,767, and $94,899 in 2015.

a rough estimate of his income. Accordingly, OTA's opinion was supported by substantial evidence and was not contrary to law.[10]

Based on the foregoing, we find that FTB has not shown grounds exist for a new hearing as required by the authorities referenced above, and FTB's PFR is hereby denied.

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Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

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Nguyen Dang
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Nguyen Dang
Administrative Law Judge

DocuSigned by:
Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 6/3/2020

[10] FTB also asserts that it did not receive requested information from appellant and argues that OTA's opinion is contrary to law because a failure to produce evidence that is within the taxpayer's control could give rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayer's case. (*Appeal of Bindley*, 2019-OTA-179P.) However, appellant provided substantial evidence in meeting his burden of proof, regardless of such a presumption. Furthermore, we find such a presumption more applicable to circumstances where a taxpayer provides only self-serving statements not accompanied by corroborating evidence. (See *Appeal of Cookston* (83-SBE-048) 1983 WL 15434, citing *Giddio v. Commissioner* (1970) 54 T.C. 1530, 1535.) We note that, otherwise, we have considered all of FTB's contentions and arguments and to the extent not discussed herein, we find them to be insufficient grounds to warrant a new hearing.