2021 – OTA – 152
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **S. WILLENS AND** **R. WILLENS**	) OTA Case No. 18010910)))))

OPINION

Representing the Parties:

For Appellants: Randall Bickham, Manager

For Respondent: Ann Mazur, Specialist

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, S. Willens and R. Willens (appellants) appeal an action by Franchise Tax Board (FTB) denying appellants' claims for refund of $114,173.00 (plus interest of $31,005.50), and $425,290.00 (plus interest of $70,021.45), for the 1999 and 2000 taxable years, respectively.[1]

Appellants waived the right to an oral hearing; therefore, this matter is decided based on the written record.

ISSUES

1. Did FTB properly impose accuracy-related penalties for the 1999 and 2000 taxable years?
2. Have appellants established that they are entitled to abatement of the accuracy-related penalties?

[1] The amounts acknowledged by the Board of Equalization (BOE) in its letter dated December 14, 2014 ($343,758 and $955,177, for taxable years 1999 and 2000, respectively) included interest paid on the entire liabilities. Only the accuracy-related penalties and interest accrued thereon are at issue in this appeal.

FACTUAL FINDINGS

1. Appellant-husband was the founder, president, and chief executive officer (CEO) of Livingston Enterprises, Inc., a leading provider of remote access networking solutions. In 1997, Lucent Technologies (Lucent) acquired the corporation in exchange for Lucent stock in a $650 million merger. Appellant was a knowledgeable and sophisticated businessperson.
2. In April 1999, on the advice of appellants' tax preparer at myCFO, appellants engaged KPMG to structure a charitable remainder unitrust under the Taxpayer Relief Act of 1997 (CRT).[2]
3. KPMG marketed the CRT strategy to appellants and other customers, sold it to appellants for $822,500, and implemented the plan and is thus considered a "promoter."
4. In May 1999, appellants created a charitable remainder unitrust that was drafted for them by the law firm of Groom & Cave, which also assisted appellants in forming SRWST Limited Partnership (partnership). Appellants exchanged 1,614,206 shares of Lucent stock in exchange for a 99.9 percent ownership in the partnership.[3]
5. On July 11, 1999, after a transfer from the CRT to the partnership (of 88.17 percent of the Lucent stock value), appellants received the first of two distributions from the partnership. On their 1999 tax return, filed on October 15, 2000, appellants reported just over 1.6 percent of that distribution as taxable and reported a total tax liability of $308,144.
6. On October 18, 1999, the Internal Revenue Service (IRS) proposed Treasury Regulation (Treas. Reg.) section 1.643(a)-8 (CRT regulation), applicable to distributions made by a CRT.[4] The regulation was designed to combat the use of CRTs to convert appreciated assets into cash while avoiding tax on the gain from the sale or other disposition of the assets.
7. On January 31, 2000, appellants received a second distribution from the partnership.

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[2] Public Law 105-34, 111 Stat. 788 (1997); Int.Rev. Code, § 664.

[3] A limited liability company (LLC) contributed $100,100 in cash in exchange for the remaining .1 percent ownership interest in the partnership. Nothing in our record indicates the relationship, if any, between appellants and the LLC.

[4] References to Treas. Regs. are to the version that applied when appellants filed their tax returns.

8. The abusive transaction described in the CRT regulation was designated a "Recognized Abusive and Listed Transaction" on February 28, 2000.[5]
9. On March 23, 2000, KPMG issued a tax opinion on appellants' CRT transaction and the corresponding tax treatment of the CRT transactions. The report concluded that it was more likely than not that appellants would prevail if the IRS challenged the transaction. KPMG considered the CRT regulation and concluded that the proposed CRT regulation deserves to be given little weight or deference. KPMG also stated that if the CRT regulation became final, the conclusions in the report "may no longer be applicable to distributions made from the [CRT transaction] after October 18, 1999."[6] The report did not discuss the fact that transactions described in the CRT regulation had been named abusive (listed) transactions by the IRS.
10. The CRT regulation became final and effective on January 5, 2001, and applicable to all distributions made by a CRT after October 18, 1999.
11. On October 5, 2001, appellants obtained a second tax opinion, from Olson Lemons LLC (Olson Lemons), to address whether appellants could continue to rely on the KPMG opinion after the CRT regulation became final. The opinion concluded that the CRT regulation would be invalidated by a court if challenged.
12. On their 2000 tax return, filed October 12, 2001, appellants reported slightly less than 1.5 percent of the 2000 distribution as taxable and reported a total tax liability of $71,141.[7]
13. In 2003, the California Legislature passed legislation that became known as the Voluntary Compliance Initiative (VCI),[8] which allowed taxpayers who underreported income on their original tax returns through the use of abusive tax avoidance transactions,

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[5] IRS Notice 2000-15, 2000-1 C.B. 826, 2000-12 I.R.B. 826, effective February 28, 2000 (https://www.irs.gov/pub/irs-drop/n-00-15.pdf).

[6] KPMG letter dated March 23, 2000, page 92.

[7] KPMG letter dated March 23, 2000, pages 89-92.

[8] See R&TC section 19752, et seq. In 2011, California engaged in a second piece of legislation that was known as Voluntary Compliance Initiative 2, or "VCI 2." The 2011 legislation renamed the 2004 VCI as "Voluntary Compliance Initiative One." We refer to the earlier legislation, which is at issue in this appeal, as "VCI." California's VCI statute differs from the federal disclosure initiative found in IRS Announcement 2002-2. Disclosure of a tax shelter to the IRS entitles taxpayers to a waiver of the penalty for a substantial understatement of tax. California's VCI provides two options, one of which (the one selected by appellants) does not provide for automatic waiver of the accuracy-related penalty.

to disclose the transactions between January 1, 2004, and April 15, 2004, thereby avoiding potential penalties and criminal prosecution.

14. On April 8, 2004, appellants filed amended California income tax returns for 1999 and 2000 pursuant to the VCI.[9] With their amended returns, appellants submitted a VCI agreement form, which, as relevant here, resulted in a waiver of all penalties except the accuracy- related penalty.[10] Appellants reported additional tax of $2,157,135 and $3,170,923 for 1999 and 2000, respectively. Appellants submitted payments which satisfied the full amounts of additional tax and accrued interest. FTB reduced the overpayment amounts by the accuracy-related penalty plus interest and refunded the balance.

15. Appellants also participated in an IRS disclosure initiative and disclosed both the 1999 and 2000 CRT transactions, which resulted in a closing agreement with respect to both taxable years on August 3, 2009.[11] As relevant here, no accuracy-related penalty was assessed in the closing agreement.

16. After reaching a closing agreement with the IRS, appellants filed claims for refund in the form of a second set of amended California returns on March 15, 2010, which reported the federal adjustments as indicated in the closing agreement. The returns claimed overpayments of tax in the amounts of $1,543,201 and $1,044,470 for 1999 and 2000, respectively.

17. FTB allowed appellants' claims for refund but imposed a 20 percent accuracy-related penalty for each tax year. FTB issued Notices of Overassessment, Credit, or Refund reflecting those actions.

18. In April 2014, appellants filed claims for refund of the accuracy-related penalties and applicable interest. Appellants then filed an appeal[12] that was accepted as a "Deemed

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[9] The first set of amended returns stated that they were "protective returns." Appellants contend that these returns were filed in order to meet the short window for disclosing under the VCI program. Appellants argue that they intended to wait until they had a final IRS determination. Appellants later filed a second set of amended returns that reflected the changes made by the IRS in their closing agreement.

[10] R&TC section 19752(b) elected on FTB Form 622.

[11] Although the closing agreement encompassed transactions in 1999, 2000, 2001, and 2002, only the 1999 and 2000 taxable years are at issue here.

[12] The appeal was filed with the BOE. Pursuant to Assembly Bill 102, the Taxpayer Transparency and Fairness Act of 2017, the duty of processing administrative appeals for franchise and income taxes was transferred from the BOE to the newly created Office of Tax Appeals.

Denial of Claim for Refund by the Franchise Tax Board," based on FTB's lack of action in response to appellants' claims for refund.[13]

DISCUSSION

Issue 1: Did FTB properly impose accuracy-related penalties for the 1999 and 2000 taxable years?

R&TC section 19164, which generally incorporates the provisions of Internal Revenue Code (IRC) section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations; or (2) any substantial understatement of income tax. (IRC, § 6662(b).)[14] In determining whether there is a substantial understatement, the taxpayer excludes any portion of the understatement for which: (1) there is substantial authority for the treatment of the position; or (2) the position was adequately disclosed in the tax return (or in a statement attached to the return) and there is a reasonable basis for the treatment of the item. (IRC, § 6662(d)(2)(B).)

In 2003, the California Legislature enacted the VCI at issue here, which allowed taxpayers to file amended returns, disclose potentially abusive tax shelter transactions, pay the resulting tax and interest, and avoid the application of most penalties. (R&TC, § 19751 et seq.) Taxpayers could file amended VCI returns during the period from January 1, 2004, through April 15, 2004, inclusive. (R&TC, § 19751(b).)

Taxpayers who participated in VCI could elect one of two options. Under the first option, the taxpayer would give up the right to "file a claim for refund for the amounts paid in connection with" the abusive transactions in exchange for FTB waiving all penalties attributable to the abusive transactions and granting immunity from criminal prosecution. (R&TC, § 19752(a).) Under the second option, the taxpayer would retain the right to file a claim for refund in exchange for FTB waiving all penalties attributable to the abusive transactions except the accuracy-related penalty under R&TC section 19164 and grant immunity from criminal

[13] Under R&TC section 19331, if FTB fails to act on a claim for refund within six months after the claim is filed, the taxpayer may consider the claim disallowed and may appeal the "deemed denial."

[14] For an individual, there is a "substantial understatement of income tax" when the amount of the understatement for a tax year exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. (IRC, § 6662(d)(1).) Neither party disputes that the understatement was substantial.

prosecution. (R&TC, § 19752(b).) Additionally, R&TC section 19752(b)(5) provides that the taxpayer shall be subject to the accuracy-related penalty. The penalty may be assessed either:

> (i) When FTB acts on the claim for refund.
>
> (ii) When a federal determination becomes final for the same issue, in which case the penalty shall be assessed (and may not be abated) if the penalty was assessed at the federal level.

(*Ibid.*)

Appellants assert that FTB must follow the federal determination, which in appellants' case did not impose an accuracy-related penalty. Appellants offer several arguments why they believe FTB must follow the federal determination: (1) FTB has a long-established policy to follow a final federal determination and assess or not assess the penalty depending on the federal determination.[15] (2) Under R&TC section 19164, an accuracy-related penalty must be imposed, or not imposed, pursuant to IRC section 6662, and thus absent any statutory exception, FTB must follow the federal waiver of the penalty pursuant to appellants' participation in the IRS voluntary disclosure initiative provided for in Announcement 2002-2, and as reflected in their closing agreement. (3) FTB imposed the accuracy-related penalty pursuant to R&TC section 19752(b)(5)(A)(ii) (which states that the penalty, if imposed at the federal level, may not be abated). (4) R&TC section 19752(b)(5)(B) (relating to qualified amended returns (QARs)) provides the only exception to what they consider to be FTB's mandate to follow a final federal determination.

FTB does not dispute that its published guidance states that it will "generally" follow a federal determination. FTB asserts that its official published guidance is found in FTB Form 622, which states that FTB "will generally follow the federal determination" with respect to the accuracy-related penalty; but makes it clear that FTB will determine whether the penalty applies. The screenshot appellants submitted also states that with respect to the accuracy-related penalty, FTB "generally follows the federal determination." We find that both parties' evidence supports FTB's contention that it may but is not required to follow a federal determination that it believes to be erroneous. (*Appeal of Der Wienerschnitzel* (79-SBE-063) 1979 WL 4104.) FTB need not follow a federal determination where there is a compelling reason for departure from

[15] In support of this argument appellants submitted a screen shot of FTB's website which is no longer available.

the federal determination. (*Appeal of Sierra Pacific Industries* (94-SBE-002) 1994 WL 14076.) We find a compelling reason for departure from the final federal determination in appellants' matter due to the difference between the applicable voluntary compliance programs; the federal program relieves the accuracy-related penalties in all cases, but the California VCI does not.[16]

Appellants have provided no authority for their argument that because R&TC section 19164 generally incorporates IRC section 6662, only a statutory exception would excuse FTB from following a final federal determination. Appellants claim that because IRC section 6662 does not include an exception (to following the federal determination) that is based on participation in the voluntary compliance program in IRS Notice 2002-2, FTB must follow the IRS determination. Appellants' argument misstates the applicable penalty structure. FTB is not required to abate the accuracy-related penalty when a taxpayer elects option 2 of the VCI. R&TC section 19164 states that if the penalty is imposed, it shall be determined in accordance with IRC Section 6662, except as otherwise provided. Neither statute provides that FTB must follow an IRS determination when determining whether to impose the accuracy-related penalty. We find that no specific exception is needed for FTB to impose an accuracy-related penalty when the IRS does not.

Appellants also claim that R&TC section 19752(b)(5)(A)(ii) applies since FTB's action was taken after they reached a final closing agreement with the IRS. That subdivision says that if the IRS imposes the accuracy-related penalty, FTB shall also impose the penalty and may not abate it. (See R&TC, § 19752(b)(5)(A)(ii).) Appellants assert the reverse must also be true; if the IRS did not impose the accuracy-related penalty, then FTB may not impose it either. FTB, in turn, asserts that it took action on appellants' claims for refund pursuant to R&TC section 19752(b)(5)(A)(i) (on appellants' claims for refund) instead of under R&TC section 19752(b)(5)(A)(ii) (when a federal determination becomes final). FTB asserts that this makes a difference in whether the accuracy-related penalty may be imposed.

[16] The IRS (and FTB) allowed exclusion of 70 percent of the 1999 distribution and 12 percent of the 2000 distribution. Appellants argued that this compromise showed that they persuaded the IRS that there was substantial authority and reasonable cause for the position taken on the returns. The closing agreement does not specify the basis for the compromise, nor does it address an accuracy-related penalty. However, as noted above, IRS Announcement 2002-2 protected disclosing taxpayers from the imposition of the accuracy-related penalty at the federal level, but California did not conform to Announcement 2002-2 and did not provide a similar protection against the imposition of the accuracy-related penalty. Appellants have not provided a copy of the disclosure made to the IRS in accordance with Announcement 2002-2.

We do not find it relevant whether the penalty was imposed when FTB acted on appellants' claim for refund or whether it was imposed after the federal determination became final. R&TC section 19752(b)(5)(A) does not expressly indicate what FTB should do when the federal determination relieves the accuracy-related penalty. In the absence of such expression, if the penalty is not applied at the federal level, FTB could apply or not apply the penalty either when the federal determination became final or when FTB acted on appellants' claim for refund.

Lastly, we disagree with appellants' argument that R&TC section 19752(b)(5)(B) provides the only exception to FTB following the federal determination. Appellants' returns are not QARs as defined in Treas. Reg. section 1.6664-2(c)(3). Moreover, in our reading of R&TC section 19752(b)(5)(B), we find no reference to either an alleged rule that FTB must always follow a final federal determination or an exception thereto, as asserted by appellants.

The structure of the VCI statute at issue clearly gives appellants two options: the first does not allow for a claim for refund or appeal, but also does not allow imposition of the accuracy-related penalty; and the second allows a claim for refund and appeal, but requires FTB to "waive or abate all penalties, except the accuracy related penalty under [R&TC] section 19164."[17] (R&TC, § 19752(b)(1).) Appellants should be held to the bargain they struck with FTB when they selected option 2. (See *Shimmon, et al. v. Franchise Tax Board* (2010) 189 Cal.App 4th 688 (*Shimmon*), 693, rehg. den. Nov. 18, 2010.)[18] Appellants attempt to distinguish *Shimmon* on the basis that appellants, in the portion of the case that was certified for publication, selected VCI option 1 and wanted to claim refunds. The case is not distinguishable on a basis relevant to our analysis. The court's holding was simply that once an option was elected, a party is held to the option voluntarily chosen by them. FTB was not authorized by the California Legislature to mix and match the beneficial parts of each option but must abide by the one selected by the taxpayer.

[17] We reject arguments that we should look to statutory construction and legislative intent, because we find that the statute is unambiguous, and the plain language is clear. (See *Kisor v. Wilkie* (2019) 139 S.Ct. 2400.)

[18] Both parties refer to this case as *Du, et al. v. Franchise Tax Board*. The parties in *Appeal of Du* (2007 WL 5659403) participated in the *Shimmon* case along with other parties.

Issue 2: Have appellants established that they are entitled to abatement of the accuracy-related penalties?

As discussed above, FTB properly imposed the accuracy-related penalties based on the substantial underpayment of income tax for both the 1999 and 2000 taxable years. (See IRC, § 6662(b).) However, the penalty may be abated or reduced under certain circumstances.

Federal law (to which California conforms) provides the bases upon which a taxpayer may be relieved of accuracy-related penalties. (See R&TC, § 19164.) Generally, taxpayers may establish that they relied on substantial authority for the return position as provided in IRC section 6662(d)(2)(B)(i). In the case of a tax shelter, as here, appellants must also establish that they reasonably believed that the tax treatment of the transaction at issue was more likely than not proper when the return was filed in addition to establishing that they relied on substantial authority for the tax treatment. (Treas. Reg. § 1.6662-4(g)(4).) IRC section 6664(c)(1) provides a separate basis for reduction or abatement of accuracy-related penalties if appellants show there was a reasonable cause for the understatement and that they acted in good faith with respect to the understatement. Appellants contend that they are entitled to relief on both bases.

Substantial Authority and Reasonable Belief

Treas. Reg. section 1.6662-4(g)(1)(i) applies to noncorporate taxpayers who underreport tax shelter items on their returns. (Treas. Reg. § 1.6662-4(g)(2).) A tax shelter is generally defined as a partnership, corporation, trust, or other entity, an investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is to avoid or evade federal income tax. (Treas. Reg. § 1.6662-4(g)(2).) Appellants acknowledge that the CRT transactions at issue are “potentially” attributable to a tax shelter. Moreover, appellants, by opting to disclose the CRT transactions under the VCI, implicitly agree that the CRT transactions were abusive tax avoidance transactions. (R&TC, § 19751(b) [applying the VCI program to tax liabilities attributable to the use of abusive tax avoidance transactions].) However, appellants argue that even if the CRT did constitute a tax shelter, they had substantial authority for the tax treatment of the CRT transactions and they reasonably believed at the time they filed their tax returns that the tax treatment of the CRT transactions was more likely than not the proper treatment.

The substantial authority standard is defined in Treas. Reg. section 1.6662-4(d) is an objective standard involving an analysis of the law and the application of the law to relevant facts. The substantial authority standard is less stringent than the "more likely than not" standard, but more stringent than the "reasonable basis" standard used for analyzing whether an underpayment is due to negligence or disregard of rules or regulations. (Treas. Reg. § 1.6662-4(d)(2).) Substantial authority for the tax treatment of an item exists only if the weight of authorities supporting the treatment is substantial in relation to the weight of authorities supporting a contrary treatment. (Treas. Reg. § 1.6662-4(d)(3)(i).) Because it is an objective standard, the taxpayer's belief that there is substantial authority for the tax treatment of an item is not relevant in determining whether there is substantial authority for that treatment. (*Ibid.*)

The weight of an authority is evaluated considering the relevance, persuasiveness, and type of document providing the authority. (Treas. Reg. § 1.6662-4(d)(3)(ii).) Except under certain circumstances not relevant here, an exclusive list is provided for the purpose of determining whether there is substantial authority for the tax treatment of an item. (Treas. Reg. § 1.6662-4(d)(3)(iii).) Opinions rendered by tax professionals are not listed authority. (*Ibid*.) However, authorities underlying such opinions may give rise to substantial authority for the tax treatment of an item. (*Ibid*.) In fact, "a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision." (Treas. Reg. § 1.6662-4(d)(3)(ii).) An authority does not continue to be an authority to the extent it is overruled or modified, implicitly or explicitly, by a body with the power to overrule or modify the earlier authority. (*Ibid*.) Substantial authority for the tax treatment of an item is determined at the time the return containing the item is filed, or on the last day of the taxable year to which the return relates. (Treas. Reg. § 1.6662-4(d)(3)(iv)(C).)

FTB disputes that appellants had substantial authority for their position with respect to the CRT transactions and tax treatment. FTB asserts that the relevant CRT regulation was proposed a year before appellants filed their 1999 return and two years before appellants filed their 2000 return, and therefore there was "relevant and persuasive authority" prior to the dates appellants filed their returns. Furthermore, FTB points out that the CRT transaction described in the CRT regulation (substantially similar to the type used by appellants) was published as a listed transaction on February 28, 2000, which was nearly eight months prior to when appellants filed their 1999 tax return. The proposed regulation was finalized on January 5, 2001 and applied to transactions that occurred after October 18, 1999, which would include appellants' CRT distribution in taxable year 2000. (Treas. Reg. § 1.643(a)-8.)

Appellants rely on two opinions they obtained, both after the CRT regulation was promulgated. Both opinions discussed authorities supporting appellants' position, as well as the proposed CRT regulation,[19] and both concluded that more likely than not appellants' tax treatment of the CRT transactions would be upheld if the IRS were to challenge it. Notably, neither the KPMG or Olson Lemons opinion letters addressed IRS Notice 2000-15, which listed the CRT transaction at issue and identified it as a tax avoidance transaction.[20] Authorities underlying the opinions may give rise to substantial authority for the tax treatment of an item. (Treas. Reg. § 1.6662-4(d)(3)(iii).) Within the 92-page KPMG opinion letter, we can see that each step of the process from creation of the CRT through the CRT transaction distributions, was analyzed and supported with citations to the IRC, Treas. Regs., Revenue Rulings, Private Letter Rulings, and case law. KPMG's opinion letter, however, relying on case law, gives little or no weight to the proposed regulation and contends that until it became a final regulation the proposed regulation carried no more weight than a position in a brief. (See *General Dynamics Corp. v. Commissioner* (1997) 108 T.C. 107, 120; *Zinniel v. Commissioner* (1987) 89 T.C. 357, 369, quoting *F.W. Woolworth Co. v. Commissioner* (1970) 54 T.C. 1233, 1265-1266 ; *Laglia v. Commissioner* (1987) 88 T.C. 894, 897.) The cases cited by appellants, however, do not support their position. None of the cases cited dealt with the weight to be given to a proposed regulation when analyzing whether a taxpayer relied on substantial authority pursuant to Treas. Reg. section 1.6662-4.

The weight of the authority does not support appellants' tax treatment of the CRT transactions for either taxable year 1999 or taxable year 2000. Treas. Reg. section 1.662-4(d)(3)(iii) lists "proposed, temporary, and final regulations" as well as "Internal Revenue Services . . . notices . . ." as types of authority that may be considered when determining whether there is substantial authority for the treatment of tax items. "The weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority." (Treas. Reg. 1.662-4(d)(3)(ii).)

Appellants were made aware of the proposed CRT regulation well before they filed their tax returns; at least by March 23, 2000, when KPMG issued its opinion letter. Appellants claim

[19] The CRT regulation was final when appellants obtained the second opinion from Olson Lemons.

[20] The KPMG opinion letter was issued approximately one month after the IRS identified the CRT transaction as an abusive tax transaction.

that the CRT regulation was not proposed until after the distribution in 1999, and IRS Notice 2000-15 did not list the CRT transaction as abusive until after both the 1999 and 2000 CRT distributions were made. However, the tax treatment of those transactions is what is relevant, and we look to when appellants applied the tax treatment when they filed their returns. (See Treas. Reg. § 1.6662-4(g)(1)(i)(A), (B).) The proposed CRT regulation was directly on point with respect to the CRT distributions undertaken by appellants.

Although the KPMG and Olson Lemons opinion letters both discounted the proposed regulation, it was not reasonable to do so. Additionally, it was unreasonable for the opinions to ignore the IRS Notice 2000-15 that was issued prior to issuance of both opinions. A proposed regulation that is directly on point, along with an IRS notice that is also directly on point, weighs heavily against the tax treatment applied by appellants. Moreover, the proposed CRT regulation became final prior to the issuance of the Olson Lemons opinion letter and prior to the filing of appellant's 2000 tax return on October 12, 2001. A final regulation must command our respect. (*Commissioner v. Portland Cement Co. of Utah* (1981) 450 U.S. 156, 169; *Laglia v. Commissioner*, *supra*, 88 T.C. at p. 897.)

The weight of the most relevant authorities does not support appellants' tax treatment of the 1999 or the 2000 CRT distributions. Therefore, appellants have not established substantial authority as a basis to abate the accuracy-related penalty. Because we find that appellants did not have substantial authority for their treatment of the CRT distributions, we need not consider whether they had a reasonable belief the tax treatment was proper at the time they filed the returns.

Reasonable Cause and Good Faith Exception

The accuracy-related penalty may be abated where a taxpayer establishes that with respect to the understatement, the taxpayer had reasonable cause for, and acted in good faith with respect to the understatement. (Treas. Reg. § 1.6664-4(a).) Such a determination is made after taking into account all of the pertinent facts and circumstances. (Treas. Reg. § 1.6664-4(b).) Taxpayers may show reasonable cause for an understatement if they reasonably relied in good faith on the opinion of a professional tax advisor. (Treas. Reg. § 1.6664-4(c).) All the requirements of Treas. Reg. section 1.6664-4(c)(1) relating to reliance on an opinion or advice must be satisfied. (Treas. Reg. § 1.6662-4(2)(g)(4)(ii).) The advice must be based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances, including the taxpayer's purpose for entering into and structuring a transaction. (Treas. Reg. § 1.6664-4(c)(1)(i).) The advice must not be based on a representation or assumption which the taxpayer knows or has reason to know is unlikely to be true. (Treas. Reg. § 1.6664-4(c)(1)(ii).) A taxpayer may not rely on an opinion that a regulation is invalid. (Treas. Reg. § 1.6664-4(c)(1)(iii).) "Advice" is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly, and does not have to be in any particular form. (Treas. Reg. § 1.6664-4(c)(2).) Moreover, a taxpayer "cannot negate the accuracy-related penalty through reliance on the 'promoter' of a transaction or on other advisers who have a conflict of interest." (*Bell v. Commissioner*, T.C. Summ. Op. 2017-63; see also *Hansen v. Commissioner* (9th Cir. 2006) 471 F.3d 1021, 1031 [adopting the principle that a promoter's opinion cannot be relied upon as independent legal advice].)

Appellants contend that they satisfied the reasonable cause and good faith standards for their position with respect to the tax treatment of the CRT distributions based on their reliance on the KPMG and Olson Lemons tax opinions. However, because KPMG marketed the CRT strategy, sold it to appellants for $822,500, implemented the plan, and provided an opinion letter on the likelihood of its success if challenged by the IRS or FTB, KPMG is considered a "promoter," and an inherent conflict of interest exists with respect to the KPMG opinion.

The record does not show how much appellants paid Olson Lemons for their opinion on the CRT transaction and the corresponding tax treatment of the CRT distributions, or if they were involved in the transaction in any other way. However, we need not determine whether Olson Lemons could be considered a "promoter." Even if not, appellants' reliance on the Olson Lemons opinion does not appear to be reasonable or in good faith. The date of that opinion is October 5, 2001, making it impossible for appellants to have relied on it with respect to the July 1999 or January 2000 distributions, or the position taken on appellants' 1999 tax return. Additionally, the opinion "addresses only the general effect of the promulgation of the Final Regulations on your ability to report CRT distributions consistent with the KPMG opinion. We neither confirm nor adopt the conclusions set forth in the KPMG Opinion and are not responsible for them." The Olson Lemons opinion also takes the position that it believes that it is more likely than not that the "final regulations would be declared invalid by a reviewing court." In accordance with Treas. Reg. section 1.6662-3(c)(2), appellants cannot rely on that portion of the opinion to establish that they acted with reasonable cause and good faith. Moreover, the fact that appellants failed to disclose a reportable, listed transaction for each of the taxable years at issue is strong evidence that appellants did not act in good faith with respect to the CRT transactions. (See Treas. Reg. § 1.6664-4(d).)

Additionally, pursuant to Treas. Reg. section 1.6664-4(c)(1), a taxpayer's education, sophistication, and business experience is relevant when determining if their reliance on a professional tax opinion was reasonable and in good faith. According to the record, appellant-husband was the president and CEO of a leading provider of remote access networking solutions, which was acquired by Lucent Technologies, in a merger involving approximately $650 million worth of Lucent stock. Appellant-husband has significant business experience and a high level of sophistication in business dealings. As the court said in *Kerman v. Commissioner,* "[b]eing promised something for nothing – tax benefits without economic cost – should give a reasonable person pause." (*Kerman v. Commissioner* (6th Cir. 2013) 713 F.3d 849, 870.) With respect to the CRT distributions, appellants only paid tax on between 1.4 and 1.7 percent of the distributions. Such a large tax benefit without corresponding economic cost would have given a reasonably sophisticated businessperson pause as to the propriety of the transactions as they related to taxes.

We find that under all the facts and circumstances, appellants did not act reasonably and in good faith in reporting the CRT transactions for taxable years 1999 and 2000.

HOLDINGS

1. Appellants have not shown error in FTB's imposition of the accuracy-related penalties for the 1999 and 2000 taxable years.
2. Appellants have not established a basis to abate the accuracy-related penalty for the 1999 and 2000 taxable years.

DISPOSITION

FTB's action in denying appellants' claim for refund is sustained.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Michael F. Geary
Administrative Law Judge

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John O. Johnson
Administrative Law Judge

Date Issued: 3/17/2021