

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 19105411  
K. SURAPANENI, TRANSFEREE OF )  
MEDWRITE, INC. )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellant: Martin G. Laffer, CPA

For Respondent: Jason Riley, Tax Counsel IV

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, K. Surapaneni (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing that he is liable as transferee for taxes, penalties, fees, and interest due from Medwrite, Inc. (Medwrite) for tax years 2012, 2013, and 2014.

Appellant waived his right to an oral hearing; therefore, the matter is being decided based on the written record.

**ISSUE**

Whether appellant is liable as transferee for the taxes, penalties, fees, and interest due from Medwrite for tax years 2012, 2013, and 2014, on account of an alleged asset transfer from Medwrite to him in 2014.

**FACTUAL FINDINGS**

**Background**

1. Appellant caused Medwrite to be incorporated in Nevada on December 29, 2011. Throughout the tax years at issue (2012-2014), and apparently continuing through 2016, appellant was Medwrite’s sole shareholder, officer, and director. Medwrite was engaged in the business of providing transcription services to companies in the healthcare industry

until late 2014, when it sold the assets of that business. During the tax years at issue, Medwrite was headquartered in California.

### Sale of Medwrite's Medical Transcription Business Assets

2. Medwrite, appellant, and iMedX Inc. (iMedX), entered into an asset purchase agreement dated November 4, 2014, pursuant to which Medwrite sold to iMedX all of the assets owned by Medwrite that were used in its business (the primary exception being various receivables).
3. A schedule attached to the asset purchase agreement identified several items of intellectual property that were to be transferred to iMedX. Among those items was a single item that was owned by appellant personally, namely, a trademark (for a word mark) that had been registered with the U.S. Patent and Trademark Office on January 18, 2010. However, the U.S. Patent and Trademark Office's records indicate that the trademark was never transferred to iMedX, and that it was cancelled on March 2, 2018.
4. The asset purchase agreement, although dated November 4, 2014, stated that it had become effective four days earlier, on October 31, 2014. The agreement also stated that the October 31, 2014 date was the closing date for the asset sale.
5. In the agreement, Medwrite was identified as "Seller," appellant as "K. Surapaneni" or "Stockholder," and iMedX as "Purchaser."<sup>1</sup>
6. The purchase price stated in the agreement was \$7.5 million, 60 percent of which (\$4.5 million) was to be paid on the October 31, 2014 closing date, and 40 percent of which (\$3 million) was to be paid shortly after the conclusion of a one-year "measurement period" that commenced on the closing date. The \$4.5 million amount due on closing was referred to as the "cash consideration," and the \$3 million payment was referred to as the "contingent consideration." The contingent consideration was subject to potential reduction (but not below zero) if Medwrite's revenues during the measurement period were less than they were during the prior 12-month period. Medwrite also was entitled to

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<sup>1</sup> In addition to using the above references for the parties, the asset purchase agreement states that, "Each of the Seller and K. Surapaneni may be referred to herein as a 'Selling Party' and collectively, as the 'Selling Parties.'" (Underlining in original.)

additional compensation, referred to as an “earnout payment,” in the event that it earned “new account revenues” during the measurement period.

7. Pursuant to the agreement, all of the consideration paid by iMedX was to be transmitted by wire transfer to a bank account designated by Medwrite or, if no wire transfer recipient was designated, by overnighted check to Medwrite.
8. We find that on or shortly after October 31, 2014, iMedX paid Medwrite *at least* \$4,424,682 of the \$4.5 million of cash compensation called for under the asset purchase agreement.<sup>2</sup> The record does not indicate whether iMedX paid the \$3 million of contingent compensation that was due to be paid in November 2015. The record also does not indicate whether iMedX made an earnout payment.

### Medwrite’s California Tax Reporting

#### Medwrite’s 2012 Tax Year

9. Medwrite did not timely file a California Corporation Franchise or Income Tax Return (Form 100) with FTB for 2012. Instead, on or about March 20, 2016, Medwrite filed what purported to be a 2012 Amended Corporation Franchise or Income Tax Return (Form 100X). The return stated that it was being filed to claim a net operating loss (NOL) carryback deduction of \$915,163 from 2014 to 2012. On the “as originally reported” portion of the return, Medwrite stated that its original 2012 tax return (which was never filed) reported net income of \$3,488,016, a total tax liability of \$308,341, and an underpayment of estimated tax penalty (estimated tax penalty) of \$6,222. On the “as corrected” portion of the return, Medwrite reported corrected taxable net income of \$2,572,853, a corrected total tax liability of \$227,440, and an estimated tax penalty of \$4,590. Medwrite did not make any payments of the California tax or penalties reported to be due for 2012 through at least September 21, 2016.
10. On the balance sheet portion of Medwrite’s “amended” 2012 return, Medwrite reported having \$7,484,520 of assets (\$5,022,174 of which was cash) and \$206,540 of liabilities at year-end.

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<sup>2</sup> The basis for this determination is explained in the sections that follow.

Medwrite's 2013 Tax Year

11. Medwrite did not timely file its 2013 California Corporation Franchise or Income Tax Return.
12. Medwrite filed its 2013 California return on April 4, 2016, reporting California net income of \$2,763,270. It offset this amount by claiming a California net operating loss carryback deduction from 2015 of \$2,763,270. It reported owing total tax of \$17,816, comprised of the \$800 minimum franchise tax and \$17,016 of alternative minimum tax. Medwrite also self-assessed an estimated tax penalty of \$346. Medwrite did not make any payments of the California tax or penalties reported to be due for 2013 through at least September 21, 2016.
13. On the balance sheet attached to its 2013 California return, Medwrite reported having total assets at year-end of \$10,056,507 (\$764,314 of which was cash) and total liabilities of \$24,768.

Medwrite's 2014 Tax Year

14. Medwrite timely filed a 2014 California Corporation Franchise or Income Tax Return pursuant to extension on September 15, 2015. On this return, Medwrite reported California net income of \$4,917,919. The return reflected a total California tax liability of \$434,744 and self-assessed an estimated tax penalty of \$8,447, for a total amount due of \$443,191. Medwrite did not make any payments of the California tax or penalties reported to be due for 2014 through at least September 21, 2016.
15. Medwrite described the asset sale to iMedX as a sale of "R&D Software" on the Schedule D attached to its 2014 return, but that description was not accurate. Although the asset purchase agreement confirms that virtually all of the assets used in Medwrite's business were sold to iMedX, there is no indication that any "R&D software" was sold under the agreement. To the contrary, a schedule attached to the agreement entitled "Title to Purchased Assets" states as follows: "It is understood that the software/hardware assets utilized in the Business are not owned by Seller and will be subject to continued services under the Transition Services Agreement." It appears that the valuable assets that were sold under the agreement consisted of Medwrite's goodwill and its ongoing contracts with customers. The gross sales price reported on Medwrite's

2014 Schedule D was \$2,212,341, the basis reported was zero, and the gain reported was \$2,212,341. Appellant claims that the \$2,212,341 amount constituted half of the amount Medwrite received in 2014 from iMedX, and that the other half was reported as income on appellant's amended personal income tax return for 2014. We agree that the documentary evidence shows that the \$2,212,354 amount Medwrite reported on its 2014 return constituted approximately half of the \$4.5 million Medwrite received in 2014 under the asset purchase agreement, and that \$2,212,354 of the balance due under the agreement was paid to Medwrite but was reported as income on appellant's amended personal income tax return.<sup>3</sup>

16. Medwrite attached a statement to the return which stated:

The attached return reflects a substantial tax liability. The taxpayer is in the process of filing additional entity tax returns which will generate bad debts. It is expected that the new returns will be offsetting this tax liability in full.

17. Medwrite left blank the balance sheet portion of the return and attached a disclosure which stated:

The balance sheet for this entity is omitted because the opening balances do not appear correct. Several years of tax returns contain errors on the balance sheet because of problems with the accounting records, and we [i.e., Medwrite's tax preparer, who is also appellant's representative in this appeal] have been retained to reconcile various accounts and reconstruct the balance sheet. We expect to complete the reconciliations and reconstructions and file the past due returns within the next couple of months. At that time, we should be able to amend the attached return by adding a balance sheet. ...

18. On March 30, 2016, Medwrite filed an Amended California Corporation Franchise or Income Tax Return for 2014. On this amended return, Medwrite reduced its previously reported net income of \$4,917,919 by \$6,138,136, so as to claim a loss of \$1,220,217, \$915,163 of which it carried back to 2012. (The remainder was carried forward to 2015.) The explanation of changes portion of the return stated that the amended return was being filed to reflect: (i) management fees paid to the shareholder that were not reflected on the

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<sup>3</sup> Our determination that Medwrite and appellant each reported approximately half of the income from the sale to iMedX does not mean that we agree such reporting was proper.

- original return; (ii) certain transactions allegedly undertaken by a related entity for Medwrite's benefit; and (iii) the inclusion of balance sheet information.
19. The balance sheet portion of Medwrite's amended return reported total assets at year-end of \$8,867,840, \$4,953,949 of which was cash. It also reported total liabilities at year-end of \$60,516.
  20. On the amended return's Schedule D, Medwrite reported capital gain income of \$2,212,341 from the sale of "R&D software" (as it did on its original return).
  21. Medwrite's amended return reported a total California tax liability of \$800, an estimated tax liability penalty of \$22, and a revised balance due of \$822. Medwrite did not make any payments of the California tax or penalties reported to be due for 2013 through at least September 21, 2016.
  22. By letter dated October 13, 2017, FTB informed Medwrite that its amended return for 2014 was accepted as filed.

#### Other Financial Information Regarding Medwrite

23. On December 9, 2015, Medwrite's board of directors held its annual meeting. The minutes indicate that the board of directors (i.e., appellant) authorized and directed Medwrite to write off a debt of \$3,874,023 that was owed to it by KPMD, Inc. (another corporation wholly owned by appellant).
24. According to appellant, Medwrite had minimal business activity in 2016 and ceased its operations entirely by the end of 2017.
25. Appellant claims that Medwrite's books reflect that it held only \$4,257 of assets (computer and furniture) at year-end 2016 and 2017.

#### Appellant's California Income Tax Returns

##### Appellant's 2012 California Returns

26. Appellant and his spouse filed an original joint California Individual Income Tax Return (Form 540) for 2012 reporting negative taxable income and a zero tax liability.
27. In July of 2016, appellant and his spouse filed an amended joint California Amended Individual Income Tax Return (Form 540X) for 2012, reporting additional taxable income of \$1,109,328, a California total tax liability of \$96,520, and an estimated tax

penalty of \$2,167. The return contained the following statement explaining the reason for the amendment:

Our firm [i.e., appellant's tax preparer, who is also his representative in this appeal] was retained for the purpose of correcting errors and omissions to the originally filed tax returns. The taxpayer was concerned that the prior accountant failed to properly account for certain transactions. As a result, the taxpayer's book and records required numerous adjusting journal entries which now give rise to the amended return.

#### Appellant's 2014 California Returns

28. Appellant and his spouse filed an original joint California return for 2014 pursuant to extension on October 15, 2015. On that return, appellant did not report any gain from the asset purchase agreement with iMedX.
29. On August 11, 2016, appellant and his spouse filed an amended California income tax return for 2014.<sup>4</sup> On their amended return for 2014, they reported the "sale of [an] interest" for a gross sales price \$2,212,341, and that they had no basis in the "interest" that was sold, resulting in gain of \$2,212,341. Appellant contends that this income was reported because he was personally taxable on 50 percent of the income generated from the sale of assets to iMedX. The amended return included the following explanatory statement of the reason for filing the amended return:

The taxpayer was concerned that the prior accountant failed to properly account for certain transactions. As a result, the taxpayer's books and records required numerous adjusting journal entries which now give rise to the amended return.

#### FTB's Collection Efforts

30. Because Medwrite had failed to pay any of the liabilities reported on its originally filed or amended tax returns for 2012, 2013 and 2014, FTB undertook collection activity. FTB was largely unsuccessful in its collection efforts.
31. On September 21, 2016, FTB issued Medwrite a Corporation Final Notice Before Levy for tax years 2012, 2013, 2014, and 2015, listing balances due for those years of

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<sup>4</sup> The record does not reveal the precise date this return was filed.

\$434,583.38, \$24,367.32, \$533,503.56, and \$417.21, respectively. The total balance due was \$992,871.47.

32. Eventually, FTB determined that the liabilities were not collectible from Medwrite.

#### FTB's Demands for Information

33. On October 22, 2018, FTB issued demands to furnish information, one to Medwrite at an address in Nevada and the other to Medwrite, Attn: K. Surapaneni, at an address in Anaheim, California. The demands requested information concerning the relationships between Medwrite, appellant, and several entities with which Medwrite appeared to have been engaged in business.
34. By letter dated November 12, 2018, appellant (through his representative) responded to FTB's demands to furnish information. Appellant stated that the entities FTB was inquiring about were wholly owned by him. With respect to FTB's request for proof of payments between appellant, various identified entities, and Medwrite, appellant claimed that FTB's request was "somewhat ambiguous," that he was "not sure what [FTB] was looking for," and that complying with the request would be burdensome since "there are hundreds of transactions between entities, and identifying and scheduling these entries would be oppressively difficult." There is no evidence that, after receiving this response, FTB followed up to require a further response from either appellant or Medwrite.

#### FTB's Transferee Liability Notices of Proposed Assessment (NPAs)

35. On January 4, 2019, FTB issued appellant, as transferee of Medwrite, three NPAs, one each for Medwrite's 2012, 2013 and 2014 tax years.
36. The NPA for 2012 proposed a transferee liability totaling \$390,815.24, consisting of tax of \$308,341,<sup>5</sup> an estimated tax penalty of \$4,589.86, a late-filing penalty of \$77,085.25, and electronic funds transfer penalties of \$540.33 and \$258.80. The NPA indicated that FTB received payments of \$5,403.39 and \$2,588.07, which it would apply to reduce the balance due.

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<sup>5</sup> This is the amount of tax reflected on Medwrite's "amended" 2012 return as having been due per Medwrite's original return for 2012, although, as noted above, Medwrite never filed an original return for that year. In other words, FTB did not allow the carryback from 2014 that was claimed on Medwrite's "amended" 2012 return.



37. The NPA for 2013 proposed a transferee liability totaling \$22,616.17, consisting of a tax liability of \$17,816, an estimated tax penalty of \$346.17, and a late-filing penalty of \$4,454.
38. The NPA for 2014 proposed a transferee liability totaling \$9,487.14, consisting of tax of \$800, an estimated tax penalty of \$8,447.14, a late payment penalty of \$200, and a lien fee of \$40.<sup>6</sup>

#### Appellant's Protest from the NPAs

39. Appellant protested the NPAs. In response to the protest, FTB issued a letter dated July 22, 2019, requesting that appellant provide the following information and documents:
  - (a) Medwrite's board of directors' minutes approving the loans to appellant and the repayment schedule, amounts of repayments, and interest.
  - (b) Medwrite's board of directors' minutes approving disbursements of Medwrite's retained earnings.
  - (c) Information regarding the amount of all monetary compensation Medwrite paid to appellant, including "management fees, K-1's, commission, 1099's, wages, salary, etc."
  - (d) Identify any retained earnings still held by Medwrite.
  - (e) List all assets held by Medwrite during the period from 2012 until the present.
  - (f) Copies of all bank account information and statements under the control of Medwrite from January 1, 2016, until the present.
  - (g) The contract of sale for Medwrite's assets (i.e., the asset purchase agreement), identifying the terms of the sale, the amount of the sale, and the disbursements made in connection with the payment of the sale price, including the person(s) paid and the amounts paid.
  - (h) Copies of payroll ledger, general ledger, cash disbursement journals, and Form 1099 payments "in which [appellant] or Mededwrite [sic] Inc. had an interest in or under their control from January 1, 2016 to present."
  - (i) Any other information supporting appellant's position.

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<sup>6</sup> The estimated tax penalty is the amount Medwrite self-assessed on its originally filed 2014 return. The tax liability is the amount shown on Medwrite's amended 2014 return, which FTB accepted as filed.

40. In reply, appellant provided, inter alia, the following:
- (a) Medwrite’s board of directors’ minutes dated December 9, 2015. These minutes do not specifically discuss Medwrite’s loans or disbursements of retained earnings; they merely ratify and approve (in general terms) the actions of Medwrite’s officers (i.e., appellant) for the past year and re-elected appellant as Medwrite’s sole officer. They also state that KPMD (a corporation wholly owned by appellant) owed \$3,874,023 to Medwrite, that the debt had become uncollectible, and authorized and directed Medwrite to write off the debt.
  - (b) Medwrite’s board of directors’ minutes of an annual meeting held on December 12, 2016. These minutes do not specifically discuss Medwrite’s loans or disbursements of retained earnings; they merely ratify and approve (in general terms) the actions of Medwrite’s officers (i.e., appellant) for the past year and re-elect appellant as Medwrite’s sole officer. They also note that Medwrite had “expended approximately \$3,000,000 for a business project in Dubai and India,” state that “the Board of Directors [i.e., appellant] has determined that the business project in Dubai and India is not viable,” and authorize and direct Medwrite to “abandon the business project.”
  - (c) Appellant’s representative explained as follows regarding appellant’s compensation from Medwrite:

... Medwrite’s clerical staff issued payments for [appellant’s] personal expenses through Medwrite, and the original tax preparer treated those personal payments as business deductions. Also, payments between entities were treated as income and expense items, rather than as “due to/from” transactions. When our legacy firm (Laffer & Gottlieb) was retained by [appellant], every effort was made to correct the errors in the bookkeeping and tax returns, and amended returns were filed. We attempted to capture all of the payments directly to or on behalf of [appellant] and charge the amounts to him personally. These amounts were reflected on amended personal returns filed by [appellant]. The payments were re-categorized on the Medwrite records as “management fees” and self-employment taxes were paid on the personal federal returns.
  - (d) Appellant stated that Medwrite no longer had any retained earnings.

- (e) Appellant also provided a summary list of Medwrite’s assets for 2012-2017. It showed the following:
- i. At year-end 2012, Medwrite allegedly had cash of \$5,022,174, an amount due from DS Genomics of \$16,747, an amount due from Mediclean of \$1,587,076, an amount due from OCSC of \$419,091, an amount due from shareholder (appellant) of \$439,422,<sup>7</sup> furniture of \$3,026, and computer assets of \$1,231.
  - ii. At year-end 2013, Medwrite allegedly had cash of \$764,314, an amount due from KPMD of \$3,215,603, an amount due from Mediclean of \$4,740,164, an amount due from OCSC of \$424,953, an amount due from shareholder (appellant) of \$853,473,<sup>8</sup> furniture of \$3,026, and computer assets of \$1,231.
  - iii. At year-end 2014, Medwrite allegedly had cash of \$4,953,949, an amount due from KPMD of \$3,874,023, an amount due from Mediclean of \$10,000, an unidentified loan receivable of \$29,868, furniture of \$3,026, and computer assets of \$1,231.
  - iv. At year-end 2015, Medwrite allegedly had cash of \$3,695,768, furniture of \$3,026, and computer assets of \$1,231.
  - v. At year-end 2016 and 2017, Medwrite allegedly had furniture of \$3,026 and computer assets of \$1,231.
- (f) Medwrite stated that its bank accounts were closed in 2016.
- (g) Medwrite provided a copy of the asset purchase agreement with iMedX and stated that: “The sale was divided between [appellant] and Medwrite because [appellant] personally funded the development of the software, and it was his intellectual property.” Medwrite also stated that: “The proceeds from the sale ... was transferred ... to pay a third-party vendor for a contract for additional software development. The software was determined to be unfeasible, and was never finalized.” No supporting documentation was provided.

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<sup>7</sup> This obligation was eventually discharged by offset through the creation of a “management fee” due appellant.

<sup>8</sup> This obligation also was eventually discharged by offset through the creation of a “management fee” due appellant.

- (h) Medwrite did not provide any payroll or general ledgers. Medwrite stated that “[t]here was no payroll or activity to provide.”
  - (i) Medwrite also provided a 2012 profit and loss statement that was generated in 2016.
41. Ultimately, FTB issued Notices of Action (NOAs) denying the protest and affirming the NPAs. Each of the NOAs states that: (i) appellant’s representative indicated that Medwrite was out of business and lacked the ability to pay the tax liability; (ii) the 2014 amended return showed that Medwrite sold its assets of \$2,212,341; and (iii) “the mere fact of the sale reported from [Medwrite] to [appellant’s] personal return demonstrate[s] [appellant] received asset [sic] from [Medwrite].” Each of the NOAs also states that appellant had the “responsibility to ensure that [Medwrite’s] corporation liability is paid timely and in full.”

#### Appellant’s Allegations on Appeal

42. Appellant timely filed this appeal from the NOAs.
43. On appeal, appellant argues that he should not be held liable as a transferee of Medwrite’s tax liabilities. Appellant states that: “Any remaining cash in Medwrite after the 2014 software sale [i.e., the asset sale to iMedX] was used to pay for operations and finalization of the business.” Appellant also claims that Medwrite did not receive any notices of unpaid California tax until after it filed its 2012 return in March 2016 and, “[a]t that point in time[,] Medwrite had *de minimis* assets, and no cash.” Appellant claims that Medwrite did not transfer any cash or other assets to him when it ceased operations. Appellant also claims that he reported half of the proceeds from the asset sale to iMedX on his personal tax return because he funded the creation of the software that allegedly was sold and because he owned a trademark for the word mark, “Medwrite.”

#### DISCUSSION

FTB contends that appellant is liable, as transferee, for the taxes (including penalties, fees, and interest) due from his wholly owned corporation, Medwrite, pursuant to R&TC sections 19071 through 19074. The transferee liability procedures set forth in those provisions (in particular, R&TC section 19073) are, in pertinent part, substantially similar to those found in Internal Revenue Code (IRC) section 6901. Accordingly, federal authorities interpreting IRC

section 6901 are relevant and persuasive in interpreting and applying R&TC section 19073. (See generally *Franchise Tax Bd. v. Superior Court* (2013) 221 Cal.App.4th 647, 661, fn. 11; *Douglas v. State of California* (1942) 48 Cal.App.2d 835, 838.)

The liability of a transferee may be enforced either at law or in equity and the transferee's liability includes tax, "interest, additional amounts, and additions to the tax provided by law."<sup>9</sup> (R&TC, § 19073(a).) "Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax." (R&TC, § 19073.)

The parties agree that California law applies in determining whether there is transferee liability. During the tax years at issue (2012-2014), California applied the Uniform Fraudulent Transfer Act (UFTA), which was codified at Civil Code section 3439 et seq. Effective January 1, 2016, the UFTA was amended and renamed as the Uniform Voidable Transactions Act (UVTA) (Civ. Code, § 3439 et seq.). Many of the UVTA's provisions are substantially the same as those of the UFTA, and the UVTA provides that, to the extent that the provisions of both acts are "substantially the same," the UVTA provisions "shall be construed as restatements and continuations [of the UFTA], and not as new enactments." (Civ. Code, § 3439.14(d).) Both acts provide that in determining whether transferee liability exists, one applies the law in effect at the time the transfer was made or the obligation was incurred. (Civ. Code, § 3439.10(b); former Civ. Code, § 3439.12.) The UVTA also makes clear that where, as here, the allegedly fraudulent transfer was made by an entity located in California, one applies California's fraudulent conveyance statute. (Civ. Code, § 3439.10.)

According to the NOAs that form the basis of this proceeding, FTB has determined that:

The filing of the 2014 amended income tax return show the selling of [Medwrite's] assets of \$2,212,341.00. The mere fact of the sale reported from [Medwrite] to your personal return demonstrate[s] you received asset [sic] from [Medwrite]. This does not avail you [sic] of your responsibility to ensure [Medwrite's] liability is paid timely and in full.

FTB's briefs essentially mirror the allegations contained in the NOAs. FTB states in its briefs:

1. "In this case, Medwrite, Inc. distributed \$2,212,341<sup>[10]</sup> from the 'Sale of R & D Software' to appellant during the 2014 tax year."

<sup>9</sup> Transferee liability *at law* is generally found when a transferee has expressly assumed the liability (i.e., pursuant to a contract or operation of law). There was no such express assumption here, and here FTB seeks to enforce transferee liability *in equity*.

<sup>10</sup> Henceforth, we generally refer to this figure as \$2.2 million.

2. “[T]here is no evidence that Medwrite, Inc. received any consideration in return for this distribution.”
3. “Medwrite, Inc. was previously liable for California tax in the 2012 taxable year, at the time of the [2014] transfer.”
4. “Thus, [FTB] has made a prima facie showing of insolvency, and the burden of proof to show insolvency shifts to the transferor or the transferee to prove that the transferor was solvent or had sufficient assets to pay existing debts at the time of the transfer.”

Based on these allegations, it appears FTB is relying on the provisions of former Civil Code section 3439.05 to impose transferee liability.<sup>11</sup> That section provided as follows:

A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

FTB has the burden of proving the essential elements of transferee liability. (See *Appeal of Zubkoff and Potash* (90-SBE-004) 1990 WL 117932 (*Zubkoff*). In *Zubkoff*, our predecessor, the State Board of Equalization, applying the provisions of the Uniform Fraudulent Conveyance Act (the California fraudulent conveyance statute that preceded the UFTA), held that FTB must prove the following five elements to establish transferee liability in equity: (1) the taxpayer-transferor transferred property to the transferee for less than full and adequate consideration; (2) at the time of the transfer and at the time transferee liability is asserted, the taxpayer-transferor was liable for the tax; (3) the transfer was made after the liability for the tax accrued, regardless of whether the tax was actually asserted at the time of the transfer; (4) the taxpayer-transferor was insolvent at the time of the transfer or the transfer left the taxpayer-transferor insolvent; and (5) FTB has exhausted all reasonable remedies against the taxpayer-transferor. These five requirements are substantially the same as the requirements FTB must establish under the UFTA, except that with respect to the first requirement, the new standard is that the party seeking to establish transferee liability must establish that the taxpayer-transferor transferred property to the

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<sup>11</sup> Current Civil Code section 3439.05 contains the same language quoted below except the word “fraudulent” has been replaced with the word “voidable.”

transferee “without receiving a reasonably equivalent value in exchange.” (Civ. Code, § 3439.05(a).)

Initially, we must clearly identify the transfer upon which FTB bases its transferee liability determination. FTB’s NOAs assert that the \$2.2 million gain Medwrite reported on its 2014 return was transferred to appellant; they state that “the mere fact of the sale reported from [Medwrite] to [appellant’s] personal return demonstrate[s] [appellant] received asset [sic] from [Medwrite].” While we agree that there was a transfer of \$2.2 million from Medwrite to appellant, that transfer was not, as FTB contends, a transfer of the same \$2.2 million that was reported as income by Medwrite. According to the asset purchase agreement, Medwrite received \$4.5 million in 2014 from the sale to iMedX, and it anticipated receiving contingent consideration of another \$3 million in 2015. When Medwrite reported a little over \$2.2 million on its return from the sale, *it was only reporting approximately half the sales proceeds*. Appellant apparently decided that he and Medwrite each would report half of the gain from the initial \$4.5 million payment.<sup>12</sup> Appellant eventually did report approximately half of the 2014 sale proceeds when, in 2016, he filed an amended return for 2014 reporting \$2.2 million of income from the sale of an “interest.”

Appellant nevertheless contends that there was no transfer to him of \$2.2 million *from Medwrite* because he was entitled to receive half the sales proceeds directly from iMedX under the asset purchase agreement. This contention is without merit. Medwrite was identified as the “Seller” of the assets that were the subject of the asset purchase agreement, not appellant. Except for one asset (the Medwrite trademark that appellant never transferred to iMedX<sup>13</sup>), the assets that were to be sold under the agreement were owned by Medwrite, not appellant, and Medwrite’s own books and records do not indicate that Medwrite owed anything to appellant for his having allegedly developed software that was sold to iMedX. Appellant’s claim that Medwrite sold software to iMedX also is refuted by the asset purchase agreement itself, which

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<sup>12</sup> The two amounts reported as income for 2014 from the iMedX sale total \$4,424,682, which is \$75,318 less than the \$4.5 million paid by iMedX to Medwrite in 2014. No explanation has been provided by appellant for this discrepancy.

<sup>13</sup> Although appellant has shown that he was the registered owner of a trademark (for a word mark relating to Medwrite), there has been no showing that this trademark was transferred to iMedX, or that it was worth 50 percent of the amount iMedX agreed to pay to Medwrite for its assets.

states that the software and hardware that Medwrite used its business was not owned by Medwrite. Furthermore, it appears that iMedX paid the initial \$4.5 million payment due at the closing directly to Medwrite, not half to Medwrite and half to appellant.<sup>14</sup> In sum, because we find that appellant has provided no valid justification for the transfer of \$2.2 million of the sales proceeds from Medwrite to him, we also find that FTB has satisfied its burden of showing that appellant did not provide “reasonably equivalent value” in exchange for the transfer. (See former Civ. Code, § 3439.05.)

We also reject appellant’s contention that, because Medwrite had not yet filed its California tax returns for any of the years at issue, FTB was not a creditor of Medwrite on the date of the transfer. “Tax liabilities accrue on the due date of the tax return, and if such liabilities are not paid at that time, the [taxing authority] is considered to be a creditor as of the close of the applicable tax period.” (*Espinosa v. Commissioner*, T.C. Memo. 2000-66, citations omitted; see also *Zubkoff, supra.*)

This brings us to the issue of whether Medwrite was insolvent at the time of the 2014 transfer. As noted earlier, FTB bears the burden of proof on this issue. Under the UFTA, “[a] debtor is insolvent if, at fair valuations, the sum of the debtor’s debts is greater than all of the debtor’s assets.” (Former Civ. Code, § 3439.02(a).) The financial information we have for Medwrite is rather meager; it consists primarily of balance sheet information reported on Medwrite’s returns for the years at issue and a summary schedule of Medwrite’s assets submitted by appellant for the years 2012-2017. None of those documents show that Medwrite was insolvent at any time during 2014, the year of the purported transfer.<sup>15</sup> Medwrite’s reported assets (of \$10,056,507 at the beginning of 2014 and \$8,867,840 at year-end, \$4,953,949 of which was cash) vastly exceeded its total reported liabilities (of \$24,768 at the beginning of 2014 and \$60,516 at year-end). Of course, Medwrite’s reported liabilities did not include Medwrite’s

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<sup>14</sup> Whether the \$2.2 million transfer from Medwrite to appellant occurred in 2014 or in a later year (and treated as if it had occurred in 2014) is unclear. We note that the only documentary evidence regarding the agreement between appellant and Medwrite to split the gain from the iMedX sale was generated after the close of the 2014 tax year. However, since both parties acknowledge that \$2.2 million of the iMedX sales proceeds ended up in appellant’s possession (or constructive possession) in 2014, we accept that as a fact for purposes of our analysis.

<sup>15</sup> The evidence before us does not indicate that Medwrite was insolvent in the following year either.



California tax obligations for the years at issue.<sup>16</sup> Those liabilities totaled, as of the date of the NOAs, \$992,454.26, although the amounts that were due as of the date of the transfer in 2014 would have been significantly smaller. However, even if we were to assume that the entire amount of the proposed liabilities were due at the time of the transfer, and that the noncash assets reflected on Medwrite's financial statements had no value, Medwrite's assets (its cash) still would have exceeded Medwrite's total liabilities (including California tax liabilities) by almost \$4 million.<sup>17</sup> Accordingly, it does not appear that Medwrite was insolvent before, or immediately after, the transfer of the \$2.2 million of assets to appellant that forms the basis of FTB's transferee liability determination.

FTB notes in its briefs that there were several other Medwrite transactions that might have involved transfers to appellant: (i) in 2015, Medwrite was owed \$3,874,023 from another one of appellant's wholly owned corporations, KPMD, Inc., and wrote off that debt as uncollectible; and (ii) in 2016, Medwrite wrote off approximately \$3 million in connection with a business project in Dubai and India. While these write-offs certainly look suspicious, they were not the basis asserted for transferee liability in FTB's NOAs. Furthermore, with respect to the allegedly uncollectible debt, FTB has not provided us with any information indicating that the debt was not uncollectible, or explained why, if it was collectible, that its write-off by Medwrite would support a determination of transferee liability as to appellant as opposed to KPMD, Inc. And with respect to the written-off investment in a "project" in Dubai and India, we know virtually nothing about the investment other than the fact that it generated a claimed write-off.

Nevertheless, the facts show that Medwrite was extremely careless in its accounting procedures, recordkeeping, and in its compliance with the tax laws. Appellant describes Medwrite's accounting and recordkeeping as "a mess" and admitted that:

[T]he books and records of [Medwrite and appellant's other wholly owned] entities were woefully deficient, in that all intercompany transfers of funds were treated as income to the recipient company, and an ordinary deduction to the paying entity. Hence, income included intercompany transfers ("due to/from") and deductions were similarly treated as ordinary and necessary business expenses.

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<sup>16</sup> FTB has not provided us with any information concerning whether Medwrite had federal tax liabilities that should be considered in determining Medwrite's solvency.

<sup>17</sup> Cash of \$4,953,949, less reported liabilities of \$60,516, less California tax liabilities of \$992,454.26 equals \$3,900,978.74.

Medwrite's assets (worth millions of dollars) appear to have been transferred to appellant or his other wholly owned companies with little if any records documenting the transfers, much less justifying them. And appellant admits that during the years at issue, Medwrite paid hundreds of thousands of dollars of his personal expenses. However, in this proceeding FTB is *not* attempting to pierce Medwrite's corporate veil or assert that appellant is liable for the debts of Medwrite under an alter ego theory of liability. Instead, it asserts transferee liability, focusing upon a single transfer that it alleges occurred in 2014.

Our analysis is similarly focused. The evidence in the record shows that Medwrite received an initial payment of \$4.5 million from iMedX on the closing date of October 31, 2014, and expected to receive another \$3 million of contingent consideration in the following year. Medwrite's cash assets alone exceeded its liabilities by millions of dollars after the transfer (which FTB alleges took place in 2014). Accordingly, we find that Medwrite was solvent at the time of the transfer, and we reject FTB's transferee determination.

FTB cites several cases for general statements of law that it believes supports its position. For example, FTB cites *Sutain v. Commissioner*, T.C. Memo. 1979-428, at p. \*23 (*Sutain*), for the proposition that: "If the assets of a corporation are distributed among the stockholders before all debts and other obligations entitled to priority are first paid or provided for, each stockholder is severally liable to the creditors to the extent of the amount received by him." In *Sutain*, the transferor, a corporation, sold its assets in 1973 to a third party and, on the same day, adopted a plan of dissolution in complete liquidation pursuant to which the sales proceeds and any other assets remaining in the corporation were distributed to the corporation's two shareholders. The distributions to the shareholders were liquidating distributions that left the transferor without assets and the transferor was unable to pay the tax liabilities that were subsequently assessed for its 1972 and 1973 tax years. In the situation before us, however, unlike the situation in *Sutain*, Medwrite's 2014 transfer to appellant was not part of a plan of liquidation. The company continued to hold significant assets, and make various investments, for over a year. Thus, *Sutain* is not applicable to the situation before us.

FTB also claims that *D'Agostino v. Commissioner*, T.C. Memo. 1973-202 (*D'Agostino*) supports its position. It does not, because *D'Agostino*, like *Sutain*, involved a liquidating distribution that left the transferor corporation insolvent and unable to pay its creditors.

FTB advances *Zubkoff, supra*, for the proposition that “the requirement of insolvency is met if a transfer is one of a series of liquidating transfers which ultimately renders the taxpayer-transferor insolvent.” But there has been no showing that the purported 2014 transfer of \$2.2 million to appellant was one of a series of liquidating transfers. No plan of liquidation had been adopted by Medwrite, and it continued to hold significant assets, including a substantial amount of cash, throughout 2014 and 2015. Furthermore, at the time of the transfer, Medwrite expected to receive an additional \$3 million of contingent consideration from iMedX.

Finally, FTB contends that because it has established that the 2014 transfer was not for adequate consideration and that Medwrite had an existing tax liability at the time of the transfer, it has made out a prima facie showing of insolvency, and the burden of proving solvency shifts to appellant. FTB cites *Neumeyer v. Crown Funding Corp.* (1976) 56 Cal.App.3d 178, a decision applying the Uniform Fraudulent Conveyance Act (the predecessor to the UFTA) as support. However, the rule FTB derives from *Neumeyer* has been taken out of context. In *Neumeyer*, the transferor was unavailable at the trial and had not been seen by any of the parties for several years. In light of the evidence in the record indicating the fraudulent nature of the transfer, and the impossibility of the plaintiff sustaining the burden of proving insolvency because of the transferor’s disappearance, the court found it appropriate to shift the burden of proof on the issue of insolvency to the transferee. These facts are not comparable to the situation before us in this appeal.

Furthermore, subsequent California decisions have distinguished *Neumeyer* on grounds that are applicable to this appeal:

The facts of *Neumeyer* distinguish it from the case at bar. In *Neumeyer* there was no evidence of solvency, but there was evidence strongly suggesting insolvency and it would have been impossible for the plaintiff to produce additional evidence conclusively proving insolvency. In the case at bar, however, the evidence ... favors solvency. Furthermore, the debtor-in-possession was obviously in at least as good a position to offer evidence on the issue of its own insolvency as were the Defendants, who have been removed from the corporate affairs for the past 11 years.

*Neumeyer* also cites cases from New York, Maryland, and Pennsylvania for the proposition that in those states the burden of proof can shift to the defendant when the plaintiff shows evidence of a lack of consideration for the transfer, and evidence of significant debts of the transferor at the time of the transfer. *Neumeyer* acknowledges but distinguishes a

California case, *Miller v. Keegan*, 92 Cal.App.2d 846, 207 P.2d 1073 (1949), however, which held that the presumption of solvency did not shift because the plaintiff in that case had failed even to make a prima facie showing of insolvency. Thus, the *Neumeyer* court's application of cases from other jurisdictions appears to rely on the court's inference that the plaintiffs in those cases had made a prima facie showing of insolvency. In the case at bar, the only evidence in the record indicates solvency (excluding the Contracts). Thus there has been no prima facie showing of insolvency, and even under the *Neumeyer* reasoning the burden of proof must remain with the Trustee.

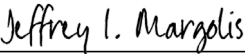
(*In re Curry & Sorensen, Inc.* (9th Cir. B.A.P. (2020) 112 B.R. 324, 328, some internal citations omitted; see also *Falkenstein v. Shipco Transport, Inc.* (U.S. Dist. Ct., C.D.Cal., Oct. 15, 2015, No. CV1308052-BRO) 2015 WL 11256774, at p. \*13, fn 13 [presumption of proving insolvency not shifted to transferee because “[t]he evidence here, unlike the evidence in *Neumeyer*, favors solvency.”].) For these reasons, we find FTB's authorities inapplicable, and reject its transferee liability determination.

#### HOLDING

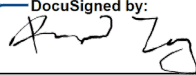
Appellant is not liable as transferee for the unpaid tax liabilities, penalties, fees, and interest of Medwrite for 2012-2014 on account of a transfer of \$2.2 million from Medwrite to appellant that allegedly occurred in 2014.


#### DISPOSITION

FTB's determination is reversed.

DocuSigned by:  
  
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Jeffrey I. Margolis  
Administrative Law Judge

We concur:

DocuSigned by:  
  
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Richard Tay  
Administrative Law Judge

DocuSigned by:  
  
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Kenneth Gast  
Administrative Law Judge

Date Issued: 4/30/2021