BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
) Nos. 81A-1477
RONALD R. AND FAWN SILVERTON,) and 83A-559-MW
RONALD R. SILVERTON, AND)
RONALD R. AND HILDA SILVERTON)

Appearances:

For Appellants: Ronald R. Silverton, in pro. per.

For Respondent: Kendall E. Kinyon
Assistant Chief Counsel

OPINION

These appeals are made pursuant to section 18593[1/] of the Revenue and Taxation Code from the actions of the Franchise Tax Board on the protests of Ronald R. and Fawn Silverton, Ronald R. Silverton, and Ronald R. and Hilda Silverton for the years and in the amounts as follows:

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

Appeals of Ronald R. and Fawn Silverton, et al..

Appellants	Years	Proposed Assessments (1)	(2)
Ronald R. and Fawn Silverton	1968	$3,658.63	$ 7,890.50
Ronald R. Silverton	1969	6,348.47	18,499.70
Ronald R. and Hilda Silverton	1970	7,457.12	13,939.48

Two questions are presented by these appeals: (1) whether litigation costs advanced on behalf of clients, where reimbursement was contingent on the successful settlement or prosecution of the clients' claims, were deductible as ordinary and necessary business expenses; and (2) whether appellants have shown that tbe proposed assessments made by the Franchise Tar Board on the basis of federal adjustments were erroneous. Fawn Silverton and Hilda Silverton were, at different times, married to Ronald R. Silverton. "Appellant" herein shall refer to Ronald R. Silverton,

During the appeal years, appellant owned and operated, as a sole proprietorship, a law firm with its principal office in Los Angeles and additional offices in other California cities. A large part of appellant's practice was devoted to personal injury and workman's compensation. claims. Once it was determined that such a case had sufficient merit, the case was accepted on a contingent fee basis. Appellant would then pay the necessary costs of litigation and preparation, and, when the case was concluded, either by judgment or settlement, appellant's costs were reimbursed from the amount recovered. Appellant's fee was then computed as a percentage of the net amount remaining. If the case was lost, or the amount recovered was less than the costs advanced by appellant, the client was not required to reimburse appellant for the eosts advanced. Appellant treated the costs advanced in contingent fee cases as current business expenses and deducted them for the year in which expended, regardless of whether the cases to which they were attributable had been concluded. When a case was closed, the amounts received as expense reimbursements and fees were reported'as income for the year in which received.

The Franchise Tax Board began an audit of appellant's returns for 1968 through 1970, but, upon learning of a contemporaneous audit by the Internal Revenue Service (IRS), limited its audit to appellant's

treatment of his contingent fee cases. The Franchise Tax Board determined that the litigation costs advanced by appellant were nondeductible loans rather than deductible business expenses and recomputed appellant's income accordingly. This recomputation also required an adjustment to appellant's medical deductions. In addition, the Franchise Tax Board disallowed appellant's claimed head-of-household filing status for 1969. (The latter two adjustments are not contested in this appeal.) These adjustments were reflected in notices of proposed assessment (NPA's) for the years 1968 through 1970, issued January 31, 1972.

Appellants protested and requested a hearing, A hearing was scheduled and held for Fawn and Ronald R. Silverton, but no hearing was set for Hilda Silverton. At the hearing, it was argued that no action. would be taken on the protest until the federal audit was concluded.

A federal assessment against only Ronald R. and Hilda Silverton was issued sometime in 1973, disallowing appellant's deduction of the advanced costs and certain other expense deductions, recharacterizing an expense as a capital expenditure, and assessing penalties for negligence and late filing. Despite requests, the Franchise Tax Board did not receive a copy of the federal adjustments from either appellant or the IRS. At appellant's request, action by the Franchise Tax Board was deferred pending final resolution of federal proceedings in the United States Tax Court and the Ninth Circuit Court of Appeals. The Franchise Tax Board eventually obtained copies of the tax court decision, the appeals court decision, and the final federal assessments. Based on the federal decisions, the Franchise Tax Board recomputed appellant's income in accordance with California law. The original NPA's were affirmed and additional proposed assessments (the "second assessments") for 1968 through 1970 were issued on April 30, 1982, Appellants protested the new assessments, a hearing was held, and the *new* NPA's *were* revised and affirmed.

The Franchise Tax Board's original proposed assessments for *1968,* 1969, and 1.970 were the result of its determination that the litigation costs advanced by appellant in his contingent fee cases were not business expenses, which would be deductible under section 17202, but were nondeductible loans made to appellant's clients,' This issue was also before the United States Tax Court in

appellant's case at the federal level. The tax court decided that the advanced costs were loansrather than deductible business expenses, this decision was affirmed by the Ninth Circuit Court of Appeals, and appellant's application to the United States Supreme Court for certiorari was denied. (Silverton v. Commissioner, ¶ 77,198 T.C.M. (P-H) (1977), affd. by unpubl. opin., 647 F.2d 172, cert. den., 454 U.S. 1033 [70 L.Ed.2d 477] (1981).)

The disposition of this issue in appellant's case at the federal level is highly persuasive of-the result which should be reached in this appeal. (Appeal of William C. and Kathleen J. White, Cal. St. Bd. of Equal., June 23, 1981.) The substantive arguments which appellant raises here are the same as those raised in his federal proceedings, where they were rejected. Appellant notes that the tax court, in a iootnote, expressed some doubt over the result it reached, but felt bound by earlier court decisions. Although, as appellant suggests, we may not be bound by these federal decisions, we will follow them, both because we find them persuasive and because appellant has provided us with no legal authority or'eoidence which would provide a basis for reaching a different conclusion.

Appellants also raise a number of affirmative defenses against the original Franchise Tax Board proposed assessment. Appellant Hilda Silverton asserts the defense of laches because she was not included in the protest hearing. However, since the liability of both Hilda and Fawn Silverton derives entirely from appellant's, and he was present at the hearing, we do not see that Hilda Silverton's rights have been impaired in any way.

Appellants also allege that statutes of limitations have been violated. However, the statutes referred to by appellants are found in the California Code of Civil Procedure and are inapplicable, since the Revenue and Taxation Code provides the statutes applicable to this proceeding. The defense of laches is also inappropriate since the taxpayers themselves requested deferral of action by the Franchise Tax Board pending the federal determination,

With regard to the. second assessments made by the Franchise Tax Board, based on federal action, it -is well settled that the Franchise Tax Board's determination is presumed correct and the taxpayer must show that it is

erroneous. (Appeal of Bernard J. and Elia C. Smith, Cal. St. Bd. of Equal., Jan. 9, 1979.)

One of the deductions disallowed by the IRS was designated as "extraordinary employee expenses." These expenses were apparently incurred in connection with liaison activities of appellant's employees with representatives of groups represented by appellant under group legal plans. The Franchise Tax Board apparently disallowed the deduction of all of these expenses, purporting to follow the decision of the tax court on this issue.

However, a close reading of the tax court decision reveals that the court specifically allowed, as deductible business expenses, $10,000, $25,000, and $27,500 for the years 1969, 1969, and 1970, respectively. (Silverton v. Commissioner, supra, ¶ 77,198 T.C.M. (P-E) at 77-830.) Since the Franchise Tax Board is relying for its assessment on this tax court decision, these amounts must be allowed as deductible business expenses.

The IRS also disallowed deductions for prepaid interest expense and treated the cost of a trailer used as an office as a capital expenditure rather than a deductible business expense.. The tax court sustained both these actions. In this appeal, appellant has simply restated the arguments made before the tax court on these issues. He has presented nothing to show that the decision was erroneous and, therefore, we must sustain the Franchise Tax Board's action on these issues.

Appellants also raise the affirmative defense of the statute of limitations. Section 18451 requires a taxpayer to notify the Franchise Tax Board of any changes made to their gross income or deductions by the IRS within 90 days after the final determination. The Franchise Tax Hoard has six months from the date of such notification to issue an NPA based on the federal action. (Rev. & Tax. Code, § 18586.3.) If the taxpayer does not notify the Franchise Tax Board, it has four years from the date the change is filed with the federal government in which to issue an NPA. (Rev. & Tax. Code, § 18586.2.) The notice required is the original or a copy of the final determination "as well as any other data upon which such final determination . . . is claimed.' (Cal. Admin. Code, tit. 18, reg. 18586.3, subd. (a).) A final determination, where a petition for redetermination is filed with the tax court, is the judgment of the court of last resort, when the time for petitioning for rehearing

or appealing to a higher court has expired. (Cal. Admin. Code, tit. 18, reg. 18586.3, subd. (e)(2).)

Since appellant appealed from the tax court decision and applied to the Supreme Court for a writ of certiorari, the determination did not become final until the application was denied, on November 9, 1981. Appellant did not notify the Franchise Tax Board of the final determination within 90 days thereafter, so the Franchise Tax Board had 4 years from the final determination to issue NPA's. The second assessments were issued on April 30, 1982, well within that period. Therefore, the statute of limitations is no bar to the second assessments.

Fawn Silverton contends that the statute of limitations bars the second assessment against her for 1968. She argues that, since there was no federal assessment against her for that year, the Franchise Tax Board was required by section 18586 to issue a proposed assessment against her within four years after the 1968 return was filed, which it did not do. We agree with Fawn Silverton's argument.

The Franchise Tax Board cannot rely on an extension of time which is applicable to only one spouse for issuing a deficiency assessment against the other spouse, even when a joint return has been filed. (See Ekdahl v. Commissioner, 18 B.T.A. 1230, 1233 (1930); Est. of Lillian Virginia Sperling v. Commissioner, ¶ 63,260 T.C.M. (P-8) (1963); Magaziner v. Commissioner, ¶ 57,026 T.C.M. (P-8) (1957). But cf. Benjamin v. Commissioner, 66 T.C. 1084 (1976) (both spouses bound by extended statute of limitations where extension was caused by only one spouse's omission of income).) Therefore, the extension of time which was the result of appellant's federal proceedings cannot be used by the Franchise Tax Board as the basis for issuing the second assessment against Fawn Silverton, more than four years after the due date of the 1968 return, where there was no federal action against her. We find, therefore, that the Franchise Tax Board's second assessment against Fawn Silverton for 1968 is barred by the statute of limitations.

Hilda Silverton also appears to argue that she is entitled to the tax relief afforded an "innocent spouse" under section 18402.9. To be entitled to this relief, a spouse must establish certain specific facts. Hilda Silverton has made no attempt to establish those

facts, Therefore, she cannot obtain relief under that code section.

On the basis of the foregoing, we must modify respondent's action reversing it as to certain of the 'extraordinary employee expenses" and as to the second assessment against Fawn Silverton, but sustaining it in all other respects.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board on the protests of Ronald R. and Fawn Silverton, Ronald R. Silverton, and Ronald R. and Hilda Silverton for the years and in the amounts as follows:

Appellants	Years	Proposed Assessments (1)	(2)
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Ronald R. and Hilda Silvqrton	1970	7,457.12	13,939.48

be and the same afe hereby modified in accordance with the foregoing opinion.

Done at Sacramento, California, this 10th day of September, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

_____, Member

*For Kenneth Cory, per Government Code section 7.9

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In the Matter of the Appeals of	)	
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ORDER DENYING PETITIONS FOR REHEARING AND MODIFYING OPINION

Upon consideration of the petitions filed October 10, 1986, by the Franchise Tax Board, and filed October 2, 1986, by Ronald R. and Fawn Silverton, for rehearing of the appeal of Ronald R. and Fawn Silverton, et al., we are of the opinion that none of the grounds set forth in the petitions constitute cause for the granting thereof and, accordingly, it is hereby ordered that the petitions be and the same are hereby denied.

In its petition, the Franchise Tax Board substantiated the fact that a modification called for in the opinion had been made in the Notices of Action dated July 29, 1983. Therefore, it is also ordered that the first two full paragraphs on Page 5 of the original opinion, beginning with the words, "One of the deductions..." be and the same are hereby deleted and the following substituted in their place:

> The IRS disallowed deductions designated as "extraordinary employee expenses." The tax court specifically allowed, as deductible business expenses, $10,000, $25,000, and $37,500 of these expenses for the years 1968, 1969, and 1970, respectively. (Silverton v. Commissioner, supra, 677,198 T.C.M. (P-H) at 77-830.) The Franchise Tax Board allowed those same amounts in its Notices of Action dated July 29, 1983. Appellant has presented no facts or argument on this issue which show that greater amounts should be allowed. Therefore, the amounts allowed by the Franchise Tax Board must be sustained.

It is further ordered that the last 'paragraph of the original opinion is hereby modified by deleting the words, "as to certain of the 'extraordinary employee expenses' and". In all other respects, our order of September 10, 1986, is hereby affirmed.

The appellants' petition raised two issues. First, they alleged that the second assessments included income attributable to advanced litigation costs which had already been included in the first assessments. After reviewing the proposed assessments and the Notices of Action dated July 29, 1983, we conclude that that income was not included twice and, therefore, no modification is necessary in the second assessment. Appellants' request that this board order the Franchise Tax Board to hold an oral hearing has been mooted by a meeting between members of the Franchise Tax 3oard staff and appellants' representative on February 13, 1987, at which time it was determined that the matter could not be resolved by agreement of the parties.

Done at Sacramento, California, this 28th day of July, 1987, by the State Board of Equalization., with Board Members M. Collis, Mr. Bennett, Mr. Carpenter and Ms. 3aker present.

Conway H. Collis, Chairman

William M. Bennett, Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9