BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	
R. NAG and S. RUDD,	OTA NO. 18073501
APPELLANT.	

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Tuesday, June 28, 2022

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings, taken in the State of California, commencing at 10:01 a.m. and concluding at 10:53 a.m. on Tuesday, June 28, 2022, reported by Ernalyn M. Alonzo, Hearing Reporter, in and for the State of California.

APPEARANCES:

Panel Lead:	ALJ JOSHUA LAMBERT
Panel Members:	ALJ SARA HOSEY ALJ JOHN JOHNSON
For the Appellant:	R. NAG JON GOLUB
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD DAVID HUNTER

I N D E X

E X H I B I T S

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California; Tuesday, June 28, 2022

10:01 a.m.

JUDGE LAMBERT: We're now on the record in the Office of Tax Appeals oral hearing for the Appeal of Ronjon Nag and Sally-Ann Rudd, Case Number 18073501. The date is June 28th, and the time is 10:01 a.m.

My name is Judge Josh Lambert, and I'm the Administrative Law Judge for purposes of conducting this hearing. And my co-panelists today are Judge John Johnson and Judge Sara Hosey.

FTB, can you please introduce yourself for the record.

MR. HUNTER: Sure. David Hunter on behalf of Respondent Franchise Tax Board. Good morning.

JUDGE LAMBERT: Thank you, Mr. Hunter.

And appellant and representative, can you please introduce yourselves for the record.

MR. GOLUB: Mr. Golub, attorney for Appellant.

MR. NAG: Ronjon Nag, Appellant.

JUDGE LAMBERT: Thank you both for attending.

And these are the issues: Number one, what is Appellant's adjusted basis in the Cell mania stock; and two, what is the qualified small business stock gain that Appellant may exclude from the disposition of the

Cellmania stock, pursuant to R&Taxation Sectio 18152.5.

Mr. Hunt, do you agree that these are the issues?

MR. HUNTER: Totally 100 percent. Thank you.

JUDGE LAMBERT: Thank you.

And, Appellant, do you agree that these are the issues, Mr. Golub.

MR. GOLUB: Mr. Golub. I agree.

JUDGE LAMBERT: Thanks.

FTB provides Exhibits A through X, and Appellant provides Exhibits 1 through 3.

Mr. Hunter, is that correct? Are they in order, or are there any objections?

MR. HUNTER: Hunter here. That's correct. No objections.

JUDGE LAMBERT: And, Mr. Golub, is that correct, and are there any objections?

MR. GOLUB: Mr. Golub. That is correct. No objections.

JUDGE LAMBERT: Okay. Thanks.

That evidence is now in the record.

(Appellant's Exhibits 1-3 were received in evidence by the Administrative Law Judge.)

(Department's Exhibits A-X were received in evidence by the Administrative Law Judge.)

And today Appellant will be testifying.

Is that still correct, Mr. Golub?

MR. GOLUB: Mr. Golub speaking. I don't believe he is going to testify.

JUDGE LAMBERT: Okay. So we will move on now. This is Judge Lambert speaking. So we'll move on now to --

Mr. Golub, you'll have your time to give your presentation. You'll have 45 minutes. And if you're ready, you can proceed with your presentation.

PRESENTATION

MR. GOLUB: Mr. Golub speaking. Thank you. I appreciate everyone's time this morning. And, you know, obviously you just met myself and Appellant, so it's good to meet you all.

I just want to provide some brief overview of the transaction that's so -- at issue for these two -- I mean, there are two issues, right, that just -- Judge Lambert just described. But there's sort of a transaction that underlines both of these issues. The transaction, I guess, it goes back to when Appellant cofounded the company in 1999. You know, he's an entrepreneur. He ran a successful company. It went through several rounds of financing. And then the company was acquired in 2010 through a merger with Research in Motion. And I'm just

going to call this merger, this -- the transaction for purposes of this discussion and hearing.

You know, the company before, you know, authorizing this transaction, never, you know, distributed earnings and profits, never paid any distributions to its shareholders. You know, all the facts are pretty much just as I understand it, and, you know, the attorney for the government can respond, but all the facts are really agreed to here. There's not really any question about what the facts are in the case, and it's been summarized, I think, in a lot of the written correspondence that you already have. So I won't go through every detail, but I just want to clarify that the facts aren't really the issue. It's legal -- it's legal issues that we have here.

So the first issue, you know, what is, you know, Appellant's basis in his stock for purposes of the qualified small business stock exclusion? I mean, it comes down to this issue of whether or not any of these distributions that were made after signing the letter of intent to sell the company and, in the weeks prior to closing, after the deal was agreed to by the board and after signing the merger agreement, was consented to by the board.

And even if -- I know some -- I don't know if all the distributions, but one of the two, I think, was made

after the merger agreement was actually signed. The fact that it wasn't closed yet, but it was signed, you know, whether those are separate, you know, distributions for tax purposes or whether they are proceeds, you know, for that transaction in which the Appellant, you now, relinquished his ownership of the company.

You know, the agreements relating to the transaction specifically authorized the distributions. And that's because, through the negotiations of the deal as evidenced by the term sheet that I think was already included in your materials, you know, there was an agreement that the company would be purchased for a specific price on a cash-free debt-free basis. Which, you know, it's very common for term sheets to state because, you know, they're sort of agreeing what's the value of the company and what are we going to pay. But we don't know exactly, you know, where are our accounts payable, where are our accounts receivable, where are all the debts and liabilities and assets lie. And that all changes between the time you negotiate the value of the company and the time that you actually close the deal, right, because things are constantly changing in terms of assets and company.

And so it's saying, you know, if you have positive assets at the time you closed, then that's an

increase above this price of -- that we've negotiated in the term sheet. If you have more liabilities than assets, on the other hand, then that's a decrease through the price you've negotiated in the term sheet. And that's how that's how a merger -- this merger agreement and all merger agreements tend to work. Because, again, the buyer and seller have agreed that, you know, there's a price but it's adjusted in this manner to account for the reality that the assets of this company are going to be changing on an ongoing basis before you close the transaction.

And then, you know, it turned out in this case that the company had more cash than liabilities. It had an excess. And so it would have produced a large working capital adjustment in the Appellant's favor. And so instead of, you know, just waiting until post-closing doing a working capital adjustment and requiring, you know, the buyer to increase purchase price, which a merger agreement would have done, I think the buyer's preference was to cause that cash to come out right around the time of the closing just prior to it, and so there would be less of a working capital adjustment.

But that doesn't mean those amounts are not proceeds for the deal. You know, it's all part of this one transaction that's been negotiated between the parts, is I think the point I'm trying to make. And to treat

them separately for tax purposes, I don't think makes a lot of sense.

The company couldn't even have distributed that cash if this transaction wasn't happening. It would have not been -- you know, wouldn't have had the operating capital to continue to operate. It never would have -- it never made those types of distributions in the past in its 11 years of operating. It never made one distribution before this -- this transaction was negotiations.

And so I just -- I just think in these facts it's a bit unreasonable to treat these amounts paid just prior to the closing as separate, you know, for tax purposes. In the end you've got a transaction that was negotiated by Appellant and, you know, all the shareholders of the company. And they end up giving up a -- I'm sorry. Did somebody say something? It's probably feedback.

So in the end, you know, the sellers they end up not owning the company anymore. They give up their stock. That's what happens by operation of law in the merger. And they all receive a certain amount of cash from all the proceeds, and that's what happened in reality. Appellant ended up with cash, and he doesn't own the company anymore. So it just seems like in reality these are all proceeds for that transaction in which he gave up his stock in the merger, which is treated as a stock sale for

tax purposes and not some separate, you know, distribution or non-dividend distribution that is apart from this transaction, which he's, you know, giving up his shares.

So if you treat them as one deal, you don't have an adjustment to the taxpayer's basis prior to the closing. And that's sort of what, you know, the government's position relies on. It relies on, you know, treating these as separate transactions and adjusting the taxpayer's -- I'm sorry -- the Appellant's basis before the transaction and then treating him differently as a result of those adjustments.

And if you agree that it's all really one transaction, in the case law -- I mean, this case law and everything we've submitted and what the government submitted, and the case law supports that treatment, then I think you need to find in favor of Appellant. I mean, there's a -- I just think it's a little bit unreasonable to treat these as separate transactions.

I'm going to move on to the second issue, and if I'm ahead of time, then that's great. The second issue is, you know, how -- how much gain is subject to exclusion under the qualified small business stock rules code, so the code sections cited by Justice [sic] Lambert. In sort of the heart of this issue is how is it -- how is the cap on the exclusion applied.

Does the code -- I mean, it has -- it has 18152.5(a). I'll just read it verbatim. It says, "For purpose of this part, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years." So there's a description of this 50 percent, you know, exclusion of the gain.

And then in subsection (b), it says -- kind of reading the code is boring, but I'm going to read it anyways, just a few sentences. "If the taxpayer has eligible gain for the taxable year for one or more dispositions of stock issued by any corporation, the aggregate amount of gains and dispositions of stock issued by the corporation, which may be taken into account under subdivision (a) for the taxable year, shall not exceed the greater of the either of the following."

It says, "A, $10 million reduced by the aggregate amount of eligible gain taken into account by the taxpayer in subdivision (a) for prior taxable years and the triple to disposition of stock issued by the corporation."

THE STENOGRAPHER: Mr. Golub, excuse me. May I interrupt you for a second?

MR. GOLUB: Yes.

THE STENOGRAPHER: Can you just slow down when you are reading so I can get that all down. Thank you.

MR. GOLUB: Do you want me to go back a bit, or do you want me to keep going?

THE STENOGRAPHER: Can you go back a couple of sentences, please.

MR. GOLUB: Okay.

MR. NAG: Or maybe Jonathan can display it even.

MR. GOLUB: Would that be helpful.

JUDGE LAMBERT: That won't be necessary. You don't have to display it. You can just read it. And we also have -- we can look it up ourselves. We've seen it before.

MR. GOLUB: Okay. So, again, getting to the cap, which is in (b). It says, "The cap is the greater of either of the following: $10 million reduced by the aggregate amount of eligible gain taken into account by taxpayer under subdivision (a) for prior taxable years. B, is 10 times the aggregate adjusted basis of qualified small business stock issued by the corporation and disposed of by the taxpayer during the taxable year."

So we've got this cap that's an either or. It's the greater of these two things, and it's described in subsection (b). And so when you're looking at how much gain someone can exclude, you know, it seeming that there's some ambiguity here. Because what the taxpayer -- sorry -- the Appellant is asserting is that he takes his

total gain for the transaction. He cuts that in half because of his 50 percent exclusion.

He says, okay. Well, whatever amount I had, half of that is excludable, so here's my half number. And then that is subject to a cap of exclusion of $10 million or, you know, the greater of $10 million or 10 times his adjusted basis. And, you know, there's -- you know, I'll get into it, but that's our reading. And that seems to be the most obvious reading because the 50 percent exclusion is in subsection (a).

Subsection (b) talks about this cap, the amount that you can exclude in total is the greater of these things. And it doesn't say, you know, it's the greater of $5 million or 50 -- or 5 times the taxpayer's adjusted basis. It says it's the greater of $10 million or 10 times the taxpayer's adjusted basis. That's the maximum you can exclude.

The government's reading is that this 50 percent in subsection (a), you know, sort of operates in a reverse order, that instead of taking your total gain and multiplying it by 50 percent, you instead take your total gain and then you multiple the cap of 10 million or 10 times your adjusted basis by 50 percent, and then you apply that.

So instead of taking half of your gain and

excluding it subject to your caps, you're taking half of the caps and applying that to your gain. And I can do a quick example. So if you add a $20 million gain and you apply it the way that we're describing it -- well, the way the Appellant is asserting is the correct method, then you would take your $20 million of gain. You would divide it in half. You have $10 million in gain. And then you would apply the cap procedure, which is you -- you know, if you add basis that was more than $1 million then, you know, you'd have a higher cap. But the cap is either $10 million or 10 times his basis, whichever is higher. So he would have a full $10 million of exclusion under that interpretation in the $20 million, you know, gain scenario.

If you apply the government's, interpretation, you instead take your $20 million in gain, but you don't -- you don't cut it in half first. Instead, you take the caps, and you cut those in half. You cut it to $5 million and 5 times the basis. So his excluded gain would -- his excludable gain would be up to $5 million. So there's a material difference in the interpretations. And in that scenario, you know, the taxpayer or the Appellant, you know, doesn't end up with as much excludable gain.

There are other scenarios where it worked in the

reverse. You know, where you take the government's position and you actually end up with the Appellant or the taxpayer with more gain. So if you had, for example, only $4 million of gain in your sale instead of 20, then the way the taxpayer is or the Appellant is asserting these provision work is you would take half of $4 million. You have $2 million of gain. And then you are only allowed to exclude $2 million in gain because the caps are still $10 million or 10 times basis. So $2 million is way less than that. So you would only exclude $2 million on gain because you first applied the 50 percent to the gain.

And if we took the government's position, however, and then it's revised to the facts with only $4 million of gain, the cap is reduced by 50 percent. It's $5 million or 5 times basis, and the amount of gain is not reduced. So all $4 million would be excludable. So, you know, there are scenarios that work, you know, in the government's favor or the taxpayer's favor depending on how you interpret this, and it goes in both directions.

We -- actually the government pointed out a Fordham Law Review article that discusses these two interpretations. And it's a little confusing to read, the Fordham, you know, article, and it's been included in our correspondence. But, you know, it's confusing because the titles and maybe one sentence are sort of internally

inconsistent. But basically, it says that, you know, there's these two -- these two readings. And they call the first more restrictive approach as interpreting the excludable amount the 50 percent of $10 million or 50 percent of 10 times basis. So a $5 million or 5 times basis exclusion.

And then there's a second more flexible interpretation that says, you know, the maximum inclusion is still $10 million or 10 times basis and you just cut the excludable gain in half. And then it goes on to say the more restrictive approach appears to be the better of the two. Which would mean, actually, that, you know, what the government is saying is better and more appropriate. But when you go on to read, they actually don't come to that conclusion.

So that's one thing that's a little confusing because the first sentence says, "The government's position better." But then when you read on, it actually says the Appellant's position is better. It says, "Since the limitation is framed as the greater of the two options, it appears to be more consistent to approach the limitations that provides in a manner that provides the highest benefit to the taxpayer."

The intent is to incentivize potential business owners to make the investment. It would seem much more in

keeping with the spirit and the intention of the statute to give the investor the greatest possible incentive by explaining the cap more than the less restrictive interpretation.

In addition, the statutory interpretation that operates with consistency is more plausible than the one that is inconsistent in the application. If the exclusion is calculated by reducing the full $10 million sales price by 50 percent, the cap is easily calculable. If 10 times the adjusted basis, however, is replacement for the general rule, it's easy to say, you know, 10 times adjusted basis is still the cap, because that's the way, you know, one interpretation reads.

However, if the replacement cap is defined by 50 percent of 10 times the adjusted basis -- because that's what, essentially, the government is asserting is -- we have to say that the cap is really 50 percent of 10 times adjusted basis. Then the cap is five times the adjusted basis. It's just -- it's very awkward to read it that way. I mean, if someone intended the code to apply that way, they could have clearly written, you know, the cap is 5 times adjusted basis.

For us to go and apply it 50 percent to a 5X basis number is very awkward. And so anyway it -- this Fordham article, you know, concludes, if the statutory cap

is actually intended to be 5 times adjusted basis it would seem to be far more consistent to directly define things that way. So, you know, the first sentence, like I said, kind of says it's coming to the opposite conclusion, but then when you read it, it actually concludes that Appellant's view of the interpretation is the better one.

Like I said, the government had pointed out this article, and I'm grateful for that. But -- so, I mean, I think you understand these two readings. And so what I think is going to be the problem is, you know, the government is likely going to come here and say, well, that's all and good, but the taxpayer has the burden of proof, or Appellant has the burden of proof. He has to prove that his reading is right.

And, you know, I mean, there's a law -- a lot of law in the burden of proof and Respondent has, you know, provided some of that in his, you know, responses and, you know, the documents you have. But, you know, most of that authority is about factual cases. You know, if the taxpayer cannot show the facts to claim their exclusion or their deduction, they shouldn't be eligible for that. Because how can the government go and prove the absence of a fact. It's sort of impossible, right.

So it makes sense when you have factual issues that the taxpayer would have the burden of proof. And in

some of the cases cited by the government, it more broadly says, if you know there's -- well, what does it say? The taxpayer should have the burden of proving they are eligible for a tax benefit. But then again, I think it's speaking to factual issues. It's not speaking to the taxpayer proving that an interpretation of law is the correct interpretation, because laws are created by the government.

You're sort of asking the taxpayer to prove something that the government drafted and, you know, made a rule that somehow we're supposed to prove what that rule means. I don't think that makes much sense. I mean, yeah, factual cases burden of proof should be on the taxpayer. In a case like this where the proper interpretation of the law is the issue, it doesn't really make sense. You've got general rules of contract that says that if one party has superior negotiating authority and they prepare a contract, then the authority will find that any ambiguous provisions in that contract will typically be interpreted in favor of the non-preparing party.

In this case, you know, the laws are a contract between the government and the taxpayers. The government prepared it entirely. They had all the control over it, and the taxpayer had none. And out of fairness, and there

are -- there is authority on this, that ambiguous statute should be interpreted in favor of the, you know, the citizen. Or in this case it's the taxpayer because it's a tax statute. But, you know, for the government to say we have to prove what the statute means, it doesn't make a lot of sense.

Going back to my other example, I mean, if that's what -- if this committee agrees with the government, like, we have to prove what the statutes mean, then you could have another case that comes before you with that opposite set of facts where the taxpayer had $4 million of gain, you know, and taking the government -- you know, the government could switch its position. The government could say, oh, actually, no. You apply the 50 percent to the gain, and the cap is not affected. And simply because the taxpayer would owe more taxes.

And the government could take that position, and then say, well, because you can't prove the laws are different, you have to pay these taxes. And so if we -- if we really take it that far, which is what the government is saying we should because the taxpayer, apparently prove what the statutes mean -- then you would have cases where the laws are applied inconsistently, which I don't think is anything that we want or that anybody should support, including this -- this panel.

So I think that the issue of the burden of proof should be looked at a little more closely here to consider. And, you know, we have authority -- you know, this, obviously, secondary authority in the Fordham Review Journal that says that the taxpayer -- sorry -- the Appellant's version is correct. When you read the statute, it seems to be the correct one. And, you know, this general rule of finding that an ambiguous provision should be construed in favor of the non-preparing party would also lend you to conclude that the Appellant is correct in this case in his view of the 50 percent limitation should be applied.

That's really all I have. Thank you.

JUDGE LAMBERT: Thank you, Mr. Golub.

And I'll turn to the panel now to see if they have any questions for you. And if Appellant answers any questions, he didn't swear in, so it wouldn't qualify as testimony just so you know.

But now I'll turn to Judge Johnson. Do you have any questions?

JUDGE JOHNSON: This is Judge Johnson. I have no questions at this time. Thank you.

JUDGE LAMBERT: Thanks.

This is Judge Lambert. And, Judge Hosey, do you have any questions?

JUDGE HOSEY: This is Judge Hosey. No questions right now.

JUDGE LAMBERT: Thanks.

And this is Judge Lambert. I wanted to ask Mr. Golub if on the special dividends issue, if the sale didn't go through, was there any requirement that the special dividends be returned, or were they connected in that way such that there was a requirement, you know, that the deal must go through if the special dividends happen, or would they have to give back the special dividends, or any kind of terms like that?

MR. GOLUB: This is Mr. Golub speaking. I'm not sure. We'd have to go back to that. What I -- the documents I have on it are board approval, and the board approval for the dividends or the payments -- whatever you want to describe them as -- that approval was in the same approval for the signing of the merger agreement. So they were all connected in the approval. I don't know if it said, well, these are actually not approved if the merger does not proceed.

But, you know, like I said, the company would have had no money to operate and the tax -- you know, the Appellant has clarified that in its previous statement and said nobody would have had sufficient capital. So in reality, in all likelihood, people would have to put the

money back if they wanted the company to continue. So whether or not it was required in some contract or form, in reality it probably would have happened.

JUDGE LAMBERT: Okay. Thanks. And the funds for the special dividend came from -- it didn't come from the buyer at all?

MR. GOLUB: No. The funds were excess cash the company had, probably from investment and maybe operations. I don't know for sure exactly where they came from, but my understanding is no, they did not come from the buyer.

JUDGE LAMBERT: Okay. Thanks.

Now I'll move on to FTB.

Thank you, Mr. Golub. I appreciate it.

And we'll move on to FTB at this time.

And, Mr. Hunter, if you would like to go on with your presentation, we gave you 25 minutes, if you're ready. Thanks.

MR. HUNTER: Sure I'm ready. Thank you, Judge Lambert.

PRESENTATION

MR. HUNTER: And this will be the presentation. Again, as counsel for Appellant stated, I will confirm the facts are not in dispute in this case, and you don't have

to judge anyone's credibility. I'll just give you a little bit of a mind map. We're talking about two issues here as they relate to the taxpayer's obligation just to follow the law in reporting of gain from the sale of his stock.

The first issue is proper reporting of basis for capture under Internal Revenue Code Section 301, which we'll analyze. We shouldn't have to get to the second issue which involves application of the small -- qualified small business stock statute Revenue & Taxation Code Section 18152.5. So as we all know, Appellant was CEO cofounder of Cellmania. In 2010 Research in Motion, better known as Blackberry, offered to purchase the company. And in doing so, the parties entered into a merger agreement, which clearly indicated that the transaction price was calculated on a cash free and debt free basis.

The merger agreement also contained a special section in which it described a special dividend. And this special dividend includes all cash distributions reasonably required in order to distribute all or substantially all cash and cash equivalents to the stock holders prior to the merger. The merger agreement provided that this special dividend would not cause the closing cash balance of the company to be less than what

was needed to still operate the company as a growing concern.

We've heard this described as operating capital. Cellmania, in fact, declared these special dividends in July and August of 2010. Cellmania also completed and submitted a 2010 federal Form 5452 corporate record of non-dividend distributions with its federal corporate income tax return. Appellant's share of this distribution was about $5.1 million. Cellmania reported these payments on Form 1099-DIV, which is used to report dividends and other distributions to taxpayers.

Now, Internal Revenue Code Section 301(c)(2), to which California law conforms, provides that to the extent that a non-liquidating distribution exceeds ENP or earnings and profits, it is treated under Section 301(c)(2) as a tax-free return of the shareholders' capital, and any amount in excess of basis is treated as a gain from the sale or exchange of the property or of the stock. And look, this is important. Because from a tax perspective, a dividend is defined as a cash distribution that's being made from the corporation's ENP or earnings and profits.

Any other distribution is a non-dividend distribution and must be reported as such. That's the distinction here. In this case, Appellant had adjusted

basis of $1.6 million in his Cellmania stock. He received $5.1 million in that first distribution. As this was a non-dividend distribution, Respondent correctly found that receipt of this $5.1 million reduces his basis to zero.

Appellant did not report the receipt of this cash as a non-dividend distribution. Instead, he rolled it into the receipt of his share of the proceeds when Blackberry purchased all of the outstanding stock in Cellmania, which is a separate transaction. Appellant argues that the cash existing in Cellmania at the time of the sale was being negotiated was, in fact, part of the negotiated value of Cellmania when it was sold.

However, the evidence in the record before you clearly shows that the distribution was considered a distribution of cash to the shareholders from Cellmania's cash, not cash coming in from Research in Motion. That would only leave operating capital in the Cellmania account when this company was sold. Also, the board declared this special dividend to achieve this purpose, and Appellant signed this board action. Cellmania reported this distribution as a non-dividend distribution on federal Form 5452, and also reported this distribution as a separate transaction on Form 1099-DIV.

The merger agreement clearly indicated that the outstanding shares of Cellmania stock were being purchased

on a cash free and debt free basis. And when Appellant received a total of $30.6 million in sales proceeds from his Cellmania stock, this was reported on a separate Form 1099-B, proceeds from broker and barter exchange transactions, like disposition from a sale of stock.

So, in other words, Appellant claims that his receipt of $5.1 million on account of his stock ownership was part of the merger transaction, but the company reported this as a separate transaction on a separate form, and also described it on its own tax return as a non-dividend distribution separate and apart from the sale of all outstanding Cellmania shares of stock to Blackberry. Here is where the analysis should end, because if Appellant has no tax basis remaining in his Cellmania stock, there's no reason to even consider an exclusion of gain on stock under the qualified small business stock statute when the company was sold.

And now that we know his basis was zero, we can move on to the second issue. Revenue & Taxation Code Section 18152.5, again, was California's qualified small business stock statute which closely mirrored Internal Revenue Code Section 1202. And we've broken it down. Basically this law does two things. It says, if the stock involved in the transaction meets the definition of qualified small business stock, guess what? There's an

exclusion from taxable gain.

At subsection (a) it states that the taxpayer may exclude 50 percent of the qualified taxable gain eligible for exclusion. And at subsection (b) it defines that qualified eligible taxable gain as the greater of $10 million or 10 times the taxpayer's adjusted basis in the stock. That's the way the legislature wrote it, drafted this statute. It is what it is. As previously shown, Appellant's basis in the Cellmania stock was reduced to zero. If as such, his option is to report excludable gain of $5 million, which is 50 percent of $10 million; A, B.

There's been some talk here about general contractual tenets of law, but we're talking about a pronouncement by the California legislature. And as we set forth in our briefing where statutory language is clear and unambiguous, there's no need to construct the statute or resort to legislative materials or other external sources. We just read the law and apply the same to the facts at hand.

Respondent is correct in finding that Appellant's basis in the Cellmania stock was first reduced to zero by virtue of that non-dividend distribution. And then the remainder was gain received on the disposition of his outstanding shares of Cellmania stock when the company was

sold to Blackberry, and his excluded gain on the sale of the stock is capped at$5 million.

Thank you.

JUDGE LAMBERT: This is Judge Lambert. Thank you, Mr. Hunter.

And I'm going to turn to the panel and ask if they have any questions.

Judge Johnson, did you have any questions?

JUDGE JOHNSON: This is Judge Johnson. No questions. Thank you.

JUDGE LAMBERT: Okay. Thank you.

And, Judge Hosey, do you have any questions?

JUDGE HOSEY: This is Judge Hosey. No questions right now.

JUDGE LAMBERT: Thanks.

And this is Judge Lambert. I have no questions at this time.

So, Mr. Golub, it's now your time to give your closing remarks or respond to anything that FTB stated. You can take 5 minutes. Or if you want to take a little longer, since you didn't use all your time before, please present your closing remarks and anything else you would like to add. Thanks.

MR. GOLUB: Okay. Mr. Golub speaking. Thank you.

CLOSING STATEMENT

MR. GOLUB: I just want to address a few things, so I don't think it'll be long.

Respondent's counsel pointed out that, you know, the company itself made a -- you know, issued a 1099, made a tax report regarding, you know, the non-dividend distribution goal set. You know, just because one taxpayer files an erroneous report doesn't mean another taxpayer should necessarily follow. In reality, you know, a lot of company accountants will file these 1099s because if they don't treat it as a sort of non-dividend distribution, if they treat it as transaction proceeds, there's just no 1099 filed, right.

There's -- I mean, only 1099-B only applies if, you know, you're over $100 million or something. So in most transactions there's just no report that's filed. And so in practice, they just file them because they want to be conservative. They want there to be some report about it and, you know, that's what they did, right. That doesn't mean it's right. And the taxpayer, you know, should report honestly and consistently and did in what he believed was the appropriate way to report the transaction.

I don't think, you know, the way the company reported it really had bearing on that. The other issue

is, you know, I'm not sure, but it seemed like Respondent's attorney was saying that once you conclude the first issue then -- let's say it's, you know, concluded against Appellant and his basis is reduced to zero. That, for some reason, the second issue goes away entirely. And, you know, I disagree with that. It really doesn't if you've seen it in everything we submitted.

There is a middle point where you -- it actually does make a difference in the taxes payable if you rule against Appellant on the first issue but in favor of Appellant on the second issue. Because his basis might be zero, but if the 10 times -- you know, if the $10 million cap still applies, then it's a $10 million, you know, exclusion for him because it's the greater of the two, right.

So, you know, you'd have to rule against Appellant on both issue 1 and 2 for there to be, you know, basically the adjustment that the government made. You have to rule against them on both issues. There's, you know, the way taxpayer reported it is that you won both those issues. But if you decide one or the other, then there's actually a different tax that should be owed, not -- it's not all the government's. So I just want to clarify that.

And then, you know, the government's attorney

said something like, we apply a statute when it is unambiguous on its face, and we don't have to look to any outside evidence. I mean, the government submitted this law review article that says it's ambiguous. And so it seems a little contrary to now say it's not ambiguous in any way. So I just -- I'm just pointing out that seems a little inconsistent with what's been discussed before. I think if you just read it, it's pretty plainly ambiguous. So I just want to point that out as well.

That's -- those are the three issues I had. I'll just reiterate again on the burden of proof. Like I said, if we're responsible for proving an ambiguous statute, it really does sort of lead to a conclusion that the government can willingly impose the tax in the way that suits them, and that the taxpayer should win in all those cases, even if it's inconsistent with one case to another. And I think that's something the committee should support.

JUDGE LAMBERT: Thank you, Mr. Golub.

Mr. Hunter, I was just wondering if you could respond to what Mr. Golub was saying about this issue to -- you know, arguments that I think Mr. Golub was saying -- noting that you were saying that Issue 2 doesn't apply at all. Is that what you were stating? Could you clarify or respond?

MR. HUNTER: Sure. What the facts in this record

as presented and with the non-dividend distribution being made, when you have a situation where the taxpayer's adjusted basis is reduced to zero, then mathematically when you perform that calculation, we have -- again, reading the statute Section (a) will take 50 percent of the eligible gain, which under Section (b) is capped at $10 million. So you end up at a figure of $5 million. And that's it.

So if you decide for the government on the first issue, then that is the resulting number on the second issue which supports and confirms the government's assessment. Now, there was a hybrid result, and I laid that out in, I believe, a supplemental brief. But that's only if you find for the taxpayer on the first issue and give him -- I'm sorry -- give Appellant a $1.6 million adjusted basis and then apply the statute correctly under Issue 2.

When it comes to finding in favor of the government for Issue 1, and then still having an open issue for -- well, have having the second issue remain open, we're talking about how to apply that statue. And so, yeah, I admit it. I submitted this law review article the Fordham law review or what-have-you, because under -- we had several rounds of supplemental briefing, and Office of Tax Appeals was really trying to get to the bottom of

this.

Find anything that there is out there, any kind of legislate history, anything, because there's no case law. There's nothing on this. And so I presented anything that we could find. I could tell you with my agency going back 20 years, we've only applied the statute in this manner. There is absolutely no risk of the government whipsawing taxpayers and applying it one way in one situation or the other way in another situation. That hasn't been done. Won't be done. And, again, this statute has been repealed.

So those are my thoughts when it comes to finding for the government on the first issue but somehow scratching our head on the second issue. Just apply the law as it's written. Forget about law review articles written by third-year law school students that got published, and let's keep this decision based on the record before you.

Thank you.

JUDGE LAMBERT: Thank you, Mr. Hunter.

Mr. Golub, did you have anything to add to that at all?

MR. GOLUB: Mr. Golub speaking. No. I think there's clearly a different result if you find in favor of the government on Issue 1 and you find in favor of the

taxpayers' interpretation on Issue 2, just to clearly answer that question, there's a different result. I don't know if government's response there was -- was ultimately clear, but he implied, you know, either a $5 million cap or a $10 million cap. Obviously that effects how much gain would be excludable.

And that's -- that's it.

JUDGE LAMBERT: Thank you, Mr. Golub.

And I'm going to ask the panel if they have any final questions.

Judge Johnson, did you have any questions?

JUDGE JOHNSON: This is Judge Johnson. I think I do have a question or two for Mr. Golub.

You -- when discussing in your rebuttal the sort of way that Cellmania the company reported it, the distribution, and how it could differ from the way that it should be reported for Appellants. And I wanted to ask about Research in Motion. Did they report the distributions as part of their purchase price for the stock?

MR. GOLUB: No. They would -- Mr. Golub speaking. They would not have reported it that way. I mean, the way that -- I mean, I don't know how they reported it in reality. But, you know, based on general tax principles, I mean, if they purchased for a specific

amount, then it's unlikely they would have included that amount. If instead they left the cash in the company and did a working capital adjustment, then it would have been that way, right, because they would have increased the working capital adjustment.

So and then just to follow up on that though, in reality, you know, again, there's a chance that they had to put cash into this company to keep it operating, right, because the cash was just pulled out before the transaction. So in reality, if they had to put some more cash in, then, yeah. That's just more contribution capital same as -- you know, again, same endpoint as if they increased the purchase price.

So let's say they needed to put that cash back in to operate, which is a strong likelihood based on, you know, Appellant saying the company wouldn't have been able to operate without additional cash. Then you would have ended up in that same spot. It's not purchase price. But in tax purposes, it would have been more basis because it would have been contribution capital that funds that ongoing operation.

JUDGE JOHNSON: Judge Johnson. Thank you. Okay. So you did mention the working capital adjustment as an option but they chose not to do that. They asked that distributions be made instead to get it down to the

purchase price that was agreed to originally, right, between Research in Motion and Cellmania.

So if we assume that Cellmania has not included any distributions as part of their purchase price and Research in Motion, right, and Cellmania did not include it as part of the transaction. It was the distribution separately. Does that mean Appellants treated these proceeds differently than both companies involved in the transaction? Kind of narrowed that down. So Appellants were treating these distributions as part of the transaction proceeds, but both of the companies said that's not part of the transaction; is that right?

MR. GOLUB: Yeah. So, again, I wouldn't know exactly how the buyer treated it. But like I said, the company, you know, they had -- they either filed no information report, or they filed the information report. So they chose to file an information report. So the opposite would have been nothing. And so, you know, we wouldn't have known if it's inconsistent or not. You know, if the company think it's proceeds, the company won't file any report.

JUDGE LAMBERT: Thank you very much. I appreciate it. No further questions. Thank you.

JUDGE JOHNSON: This is Judge Lambert. Thank you.

And, Judge Hosey, do you have any questions?

JUDGE HOSEY: This is Judge Hosey. No questions. Thank you both for your time.

JUDGE LAMBERT: Thanks.

And this is Judge Lambert, and I have no further questions. So if there's nothing further, I'm going to conclude the hearing. And I want to thank both parties for appearing today.

We will issue a written opinion within 100 days. And if there's nothing more, thank you all for attending, and the record is now closed. And have a good day.

(Proceedings adjourned at 10:53 a.m.)

HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 7th day of July, 2022.

_____

ERNALYN M. ALONZO
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