

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:)
)
MCGARVEY-CLARK REALTY INC. AND) OTA CASE NOS. 18083623
AVIS BUDGET GROUP, INC.,) 18083632
)
) APPELLANT.)
_____)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Friday, December 16, 2022

Reported by:

Maria Esquivel-Parkinson,
CSR No. 10621, RPR

Job No.:
39621 OTA(B)

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TRANSCRIPT OF PROCEEDINGS, taken at
400 R Street, Sacramento, California,
commencing at 1:08 p.m. and concluding
at 3:40 p.m. on Friday, December 16, 2022,
reported by Maria Esquivel-Parkinson,
CSR No. 10621, RPR, a Certified Shorthand
Reporter in and for that State of California.

1 APPEARANCES:

2
3 Panel Members:

ANDREA LONG
JOHN JOHNSON
ANDREW KWEE

5
6 For the Appellant:

JEFFREY VESELY, ESQ.
ZACHARY ATKINS, ESQ.

7
8 For the CDTFA:

OFFICE OF TAX APPEALS

9
10 MICHAEL LAISNE, Tax Counsel
BRIAN WERKING, Tax Counsel
11 TODD WATKINS, Tax Counsel
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I N D E X

E X H I B I T S

(Appellant's Exhibits 1 through 28 were
admitted on page 6)

(FTB's Exhibits A through AA were admitted on
page 6)

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1 Sacramento, California; Friday, December 16, 2022

2 1:08 p.m.

3
4 ALJ LONG: We are now on the record.

5 Good afternoon. I am Andrea Long, the lead ALJ
6 for this appeal. We are here today for the consolidated
7 appeals of McGarvey-Clark Realty, Inc., and Avis Budget
8 Group, Inc. The OTA case number is 18083623 and
9 18083632. It is Friday, December 16, 2022, and it is
10 1:08 p.m. The hearing is taking place in Sacramento,
11 California.

12 We will begin with the parties stating their
13 names and who you represent for the record, and we will
14 start with FTB.

15 MR. LAISNE: Michael Laisne, Brian Werking, and
16 Todd Watkins for Franchise Tax Board, Respondent.

17 ALJ LONG: And for Appellants?

18 MR. VESELY: Yes. Jeffrey Vesely and Zach
19 Atkins from Pillsbury Winthrop Shaw Pittman for
20 Appellants.

21 ALJ LONG: Thank you. And with me on the panel
22 today are Judges Andrew Kwee and John Johnson. And with
23 no objections by both parties, Judge Kwee is
24 substituting in for Judge Lambert.

25 I'm the lead ALJ for this appeal. I will be

1 conducting the proceedings in this matter, but my
2 co-panelists and I are equal participants. We will be
3 reviewing the evidence, asking questions, and reaching a
4 determination in this appeal. The parties have agreed
5 that the issues before us today are whether the
6 Franchise Tax Board issued a timely notice of proposed
7 assessment to each Appellant, whether Appellants'
8 transaction constitutes a statutory merger that
9 qualifies as a tax-free organization under IRC Section
10 368(a)(1)(A), and whether the late filing penalties were
11 properly imposed.

12 Appellant submits Exhibits 1 through 8 [sic]
13 which are hereby admitted without objection; and FTB
14 submits Exhibits A through AA, which are hereby admitted
15 without objection.

16 (Appellants' Exhibits 1 through 28 admitted.)

17 (FTB's Exhibits A through AA admitted.)

18 ALJ LONG: Okay. I think we are ready to begin
19 each party's presentation. Appellants, you have 60
20 minutes to make your presentation, and you may begin
21 when you're ready.

22 MR. VESELY: I want to make sure -- you said
23 Exhibits 1 through 28, not just 8? I thought --

24 ALJ LONG: Correct.

25 MR. VESELY: Okay. Thank you.

1 PRESENTATION

2 BY MR. VESELY, Counsel for Appellant:

3 Good afternoon, and thank you for the
4 opportunity to present our appeal today. As you are
5 aware, the -- this appeal involves tax year 1999. There
6 are three issues involved. First, whether the notice of
7 proposed assessments, the NPAs issued by the FTB to
8 Appellants, were time-barred by the statute of
9 limitations; second, even if the NPAs were timely, which
10 we do not concede, whether the NPAs are invalid because
11 the AFLMC merger -- which I will define below --
12 qualified as a tax-free reorganization under IRC Section
13 368(a)(1)(A); and finally, third, whether the delinquent
14 filing penalties assessed against Appellants are
15 erroneous.

16 Now, the first issue, statute of limitations
17 issue. It is Appellant's position that an NPAs which
18 were issued in 2013 are more than 13 years after the
19 returns were filed for the 1999 tax year are barred by
20 the statute of limitations.

21 Under California law an NPA must be issued
22 within four years after the return was filed. Balance
23 returns for 1999 were filed in 2000. No general waiver
24 of the statute of limitations was executed by Appellants
25 for 1999. Only a limited waiver was executed. The

1 waiver was limited to adjustments resulting from a final
2 federal determination or adjustments for 1999.

3 In order for the FTB's NPAs to be timely, there
4 must have been a final adjustment made by the IRS to
5 Appellants' gross income, penalty, credit or tax for the
6 1999 tax year related to the merger between PHH Holdings
7 Corporation and Avis Fleet Leasing Management
8 Corporation, which is AFLMC. And that is the AFLMC
9 merger that we're talking about. There was no such
10 final adjustment made by the IRS for 1999 related to the
11 AFLMC merger. As such, the FTB's NPAs were untimely and
12 thus are invalid.

13 The second issue is assuming without conceding
14 that the NPAs were somehow not time barred, the FTB's
15 NPAs are still erroneous because the AFLMC merger was
16 tax-free. The merger occurred in 1999 and satisfy the
17 requirements of IRC Section 368(a)(1)(A) and Treasury
18 Regulations Section 1.368-2(b)(1) existing at that time.

19 In 1999 IRC Section 368(a)(1)(A) merely
20 required that the transaction be a statutory merger or
21 consolidation. In 1999 at the time of the merger, the
22 Treasury Regulation Section 1.368-2(b)(1) simply stated
23 that to qualify as a Type A reorganization or a tax-free
24 merger, the transaction had to be a merger effected
25 pursuant to the corporation laws of the United States,

1 or a state or a territory or the District of Columbia.

2 The AFLMC merger was carried out pursuant to
3 the corporation laws of the state of Texas, thus the
4 merger satisfied the requirements existing under federal
5 law and California law -- excuse me -- in 1999 to be
6 considered a tax-free merger.

7 And finally, the FTB's imposition of the
8 delinquent filing penalty is improper as Appellants do
9 not owe any additional tax for 1999 tax year. We will
10 address each of these issues.

11 Now, the first issue is the statute of
12 limitations issue. And under California law the
13 standard statute of limitations for issuing an NPA is
14 under Section 19057, which provides in pertinent part:
15 Every notice of proposed deficiency shall be mailed to
16 the taxpayer within four years after the return was
17 filed.

18 Now, that statute of limitations may be
19 extended by a waiver by the taxpayer, executed by the
20 taxpayer. And that's under Section 19067. No general
21 waiver of the statute of limitations was executed by
22 Appellants in 1999. Only a limited waiver based on a
23 final federal determination was executed. Appellants'
24 Exhibit 2 is a copy of the waiver that we're talking
25 about. We'll look at it a little bit closer in a bit.

1 Now, the statute of limitations for issuing an
2 NPA resulting from a final federal determination has a
3 number of statutes that we need to look at. And the one
4 that's as important as anything in this case is 18622 of
5 the Revenue Taxation Code. And subdivision (a) provides
6 in pertinent part: If any item required to be shown on
7 a federal tax return, including gross income, deduction,
8 penalty, or tax for any year of any taxpayer is changed
9 or corrected -- and those are key words, changed or
10 corrected -- by the Commissioner of Internal Revenue
11 results in a change in gross income or deductions, that
12 taxpayer shall report each change or correction within
13 six months after the due date of each final federal
14 determination of the change or correction.

15 Now, it's important to note not only the change
16 of correction language but also the word "final" that's
17 in here. Only final federal determinations are required
18 to be reported. And final means final. Initial
19 positions by the IRS an audit that don't become the
20 final determination are not final determinations, and
21 that's important for this case -- excuse me.

22 Now, another statute that starts to get into
23 the statute of limitations in this area is 19059(a), and
24 it provides in pertinent part: If a taxpayer required
25 by subdivision (a) of Section 18622 -- which we just

1 read -- to report a change or correction by the
2 Commissioner of Internal Revenue and does report the
3 change or correction within six months after the final
4 federal determination, or the IRS reports that change or
5 correction within six months after the final federal
6 determination, a notice of proposed deficiency
7 assessment resulting from those adjustments -- again,
8 key words here that we need to keep in mind, resulting
9 from those change or correction. If you step back and
10 look at the statutes, they equate change or correction
11 with adjustments, and that's what we've got to look at
12 here -- resulting from those adjustments may be mailed
13 to the taxpayer within two years from the date when the
14 notice is filed with the FTB by the taxpayer or the IRS.

15 Now, the next statute, 19060(b), is also
16 relevant here, very relevant in this case, because it
17 talks about the notification being after the six-month
18 period. It provides: If after the six-month period
19 required in Section 18622, a taxpayer or the IRS reports
20 a change or correction by the Commissioner of Internal
21 Revenue, a notice of proposed deficiency assessment
22 resulting from the adjustment may be mailed to the
23 taxpayer within four years from the date the taxpayer or
24 the IRS notifies the FTB of that change or correction.

25 Now, in this case the AFLMC merger occurred on

1 June 30th, 1999. The IRS did not make any changes or
2 corrections to Appellants' 1999 federal return related
3 to the AFLMC merger. No adjustments. Thus under the
4 plain language of Section 18622, 19059 and 19060,
5 Appellants were not required to report any final federal
6 adjustment or determination related to the merger with
7 respect to the 1999 tax year since there was none.

8 Now, let's look at this a little closer about
9 the reporting requirement, and it's very clear under the
10 statutes that Appellants did not have a reporting
11 requirement under 18622 with respect to the 1999 tax
12 year related the AFLMC merger. Appellants' treatment of
13 the AFLMC merger as a tax-free merger in 1999 on their
14 tax returns was not changed by the IRS. The only final
15 federal determination related to the merger was the
16 federal closing agreement entered into by the IRS and
17 Appellants for tax years 1998 to 2002 and signed on
18 February 13, 2007. And that is Exhibit -- Appellants'
19 Exhibit 1, and we're going to go over that one pretty
20 closely here shortly.

21 Now, under California law and actually --
22 actually regulation 19059, a federal closing agreement
23 is noted specifically under 19059(e)(1) as an example of
24 what is a final federal determination. So it says the
25 following: 19059(e) says: "A final determination is

1 irrevocable termination or adjustment on taxpayer's
2 federal tax liability from which there exists no further
3 right of appeal either administrative or judicial. For
4 example." and then subdivision (1): "A closing
5 agreement" -- as -- an example here -- "made under
6 Section 7121 of the Internal Revenue Code finally and
7 irrevocably adjusting and settling the taxpayer's tax
8 liability." That's what we have here. We have a
9 closing agreement under 7121.

10 Now, that same position with respect to that a
11 closing agreement is a final determination here was also
12 in Exhibit 21 for Appellants. We gave a copy of the
13 Chief Counsel Ruling 2001-1278, which specifically
14 states the same there. And there's been case law at the
15 Board of Equalization that also confirmed that. One
16 example is Appeal of Meyer. That was 96-SBE-012. All
17 of these things say the same thing, that that is a final
18 determination -- a federal determination, excuse me.

19 Now, in this case the federal closing agreement
20 is crystal clear that the only tax year that the IRS
21 adjusted was 2002. Appellants' 1999 federal tax return
22 was not adjusted by the IRS under the closing agreement.
23 A review of several key paragraphs of the closing
24 agreement underscores the fact that the IRS did not
25 adjust Appellants' 1999 federal tax return.

1 First, most importantly, nowhere in that
2 closing agreement is there a final federal determination
3 that the AFLMC merger in '99 was not tax-free. There's
4 a lot of whereas paragraphs but not the conclusion that
5 that was not tax-free. And that's page 5 through 7 of
6 the closing agreement.

7 Second, there was no additional tax liability
8 for the 1999 tax year under the closing agreement. Only
9 for 2002, page 7, paragraph 8 is explicit in this
10 regard.

11 Third, the additional income tax assessed by
12 the IRS, which was approximately \$60 million under the
13 closing agreement, was only for the 2002 tax year and
14 was related to a settlement of a wide variety of issues.
15 See pages 6 and 7 of the closing agreement.

16 Fourth, Appellants were not required to file an
17 amended return for 1999 under the closing agreement.
18 Page 7, paragraph 7.

19 Fifth, indeed, Appellants were prohibited from
20 amending their 1999 return to claim depreciation or
21 amortization deductions, which if the AFLMC merger had
22 been taxable would have otherwise been available to
23 them. See page 7, paragraph 5.

24 Sixth, the sale of the European fleet assets in
25 2001 resulted in a gain of \$621 million, an amount

1 calculated using the original basis for those assets and
2 not a stepped-up basis, cost basis, had the AFLMC merger
3 been a taxable transaction. See page 6, paragraph 1.

4 Appellants were required to pay federal tax on
5 the \$621 million gain on the sale of European fleet
6 assets, an amount significantly larger than would have
7 been the case if the merger, AFLMC merger, was not
8 tax-free and the assets had a stepped-up basis. It's
9 all in the closing agreement.

10 Number 7, Seventh, interest on the \$60 million
11 tax amount due for the 2002 tax year only accrued from
12 March 15th, 2003, the due date of the 2002 return, not
13 from the due date of the 1999 return. Page 7,
14 paragraph 9.

15 And finally, Appellants paid tax and interest
16 totaling \$71.5 million for the 2002 tax year on
17 June 15th, 2006. And that's at page 7, paragraph 10.

18 Now, notably, if the AFLMC merger was not
19 tax-free, the gain from the transaction, the 1999
20 transaction, would have been approximately 1.5 billion,
21 with a "B," dollars.

22 And the tax, the federal income tax on that
23 amount would have been roughly 525 million with
24 approximately 71 million of interest or a total of
25 almost \$600 million rather than the 71.5 million

1 Appellants paid under the closing agreement. In all,
2 the closing agreement is very clear that there was no
3 adjustment, no change, no correction to the 1999 tax
4 filing position of tax-free merger under the AFLMC
5 merger under the closing agreement.

6 Now, the key case in California is an old one,
7 and thank God it was before I started practicing. Even
8 it's called Montgomery Wards vs. the FTB 1970. And it
9 talks about the application of the predecessor of 19059.
10 And in that case -- I won't read it all to you, but I
11 strongly urge you read it again because it's a good one
12 to look at of how the different statutes of limitation
13 kick in with respect to federal adjustments.

14 The FTB acknowledged in that case, at
15 Footnote 10, that the extension of the statute of
16 limitations under the predecessor of 19059 was limited
17 to adjustments as may result from changes and
18 corrections made by the IRS to the taxpayer's federal
19 return.

20 Very important again: Results from changes and
21 corrections made by the IRS. Same resulting from
22 federal adjustment language. Throughout that decision,
23 the Court of Appeal refers to deficiencies resulting
24 from adjustments to the taxpayer's federal return, not
25 to any return of a taxpayer but to "the" federal return.

1 And those are pages 168, 169, and 170.

2 Now, since Appellants' treatment of AFLMC
3 merger as a tax-free statutory merger was not changed by
4 the IRS under the closing agreement, i.e., the IRS made
5 no adjustments to Appellants' 1999 return, federal
6 return related to the merger, Appellants had no
7 reporting requirement under Section 18622 for 1999. And
8 since there were no final adjustments for 1999 related
9 to the AFLMC merger, there was nothing for Appellants to
10 report to the FTB for 1999 -- excuse me -- under 18622.
11 As such, the standard four-year statute of limitations
12 under Section 19057 for issuing an NPA applies in this
13 case.

14 Now, since the 1999 return was filed on or
15 about October 15th, 2000, the NPA for 1999 was required
16 to be issued on or about October 15th, 2004, four years
17 later. The FTB's NPA in this case was issued
18 November 20, 2013, or over nine years later. Now, as
19 noted previously and this is a very important fact in
20 this case, Appellants did not agree to extend the
21 California statute of limitations for all purposes.
22 They only executed a limited waiver for the issuance of
23 an NPA resulting from a final federal determination for
24 1999 to 2002.

25 Now, Exhibit 2 is a copy of that waiver, and it

1 is -- it is very important to take a look at that thing
2 because that exhibit has three things on the face of it.
3 At the top of it, it says -- the title says the "Consent
4 to Extend Statute of Limitations When Federal
5 Adjustments Reported." In the body of the waiver, it
6 says -- makes references to Sections 19059 and 19060.
7 Both the statutes deal with adjustments from final
8 federal determinations.

9 And finally, at the bottom of the waiver on the
10 right, it has the terms "RAR waiver." This -- and
11 throughout the audit files it's very clear that the
12 auditor recognized that. So what we have here is a
13 waiver that was very limited. It was limited to simply
14 the half -- from something resulting from a final
15 federal determination, not for all purposes. So since
16 there was no final federal determination for 1999 or
17 adjustment under 1999 for -- '99 related to the merger,
18 such waiver does not say the FTB's NPA for 1999.

19 So in conclusion, the NPAs for 1999 are
20 untimely. There was no final federal determination or
21 adjustment made for 1999 related to the AFLMC merger.
22 Appellants' treatment of the AFLMC merger as a tax-free
23 statutory merger on its '99 return was not changed by
24 the IRS. Under Section 18622 there was nothing for
25 Appellants to report related to the merger for 1999.

1 And finally, the waiver which was executed was
2 a limited waiver and does not save the FTB's NPAs since
3 there was no final federal determination or adjustments
4 under '99 made in '99, related to the merger, thus the
5 four-year statute under Section 19057 applies. The NPAs
6 were due in 2004. They were issued in 2013. They're
7 nine years late.

8 Now, I'd like to go to issue number two. So
9 issue number two has to do with whether the merger was
10 tax-free or not. And assuming without conceding -- and
11 believe me, we don't concede this whatsoever -- that the
12 '99 NPAs were somehow timely, the AFLMC merger qualified
13 as a tax-free statutory merger under Section -- IRC
14 Section 368(a)(1)(A) and Treasury Regulation Section
15 1.368-2(b)(1) in '99 when the merger occurred. Okay.

16 So what are the requirements? What did those
17 provisions say? IRC Section 368(a)(1)(A) provided and
18 still provides a quote: The term "reorganization" means
19 a statutory merger or consolidation.

20 California conforms to that under Section
21 17024.5(a), 23051.5(a)(1), and Section 24451 of the
22 Revenue and Taxation Code.

23 In 1999 -- this is key, a key fact here -- the
24 Treasury Reg Section 1.368-2(b)(1) provided the
25 following quote: In order to qualify as a

1 "reorganization" under Section 368(a)(1)(A), the
2 transaction must be a merger or consolidation effected
3 pursuant to the corporation laws of the United States or
4 a state or a territory or the District of Columbia.

5 And we have a copy of that as Exhibit 11 in the
6 files.

7 Regulations that the IRS -- or Treasury has
8 promulgated are applicable for California purposes. As
9 you well know, 23051.5(d) is the statute for that under
10 the Revenue and Tax Code. Most importantly, for
11 purposes of this appeal, in 1999 when the merger
12 occurred, there was no requirement under the IRC or the
13 Treasury regs that the target corporation had to be
14 liquidated or otherwise cease its separate legal
15 existence for all purposes.

16 Now, the AFLMC merger occurred on June 30,
17 1999, and was carried out pursuant to the corporation
18 laws of the state of Texas which allowed the survival of
19 both PHH Holdings and AFLMC after the merger, the two
20 parties to the merger. Texas law, which was enacted in
21 1989 -- or ten years prior to this merger -- was in
22 effect in 1999, permitted both entities in the merger to
23 survive. We have Exhibits 19 and 25. Nineteen is
24 actually the official notice taken by the Office of Tax
25 Appeals of the Texas statutes, and 25 is -- gives

1 Section -- Article 5.01, which allows a little more
2 color to it. But both of them are very consistent.
3 There was no requirement that the target corporation had
4 to be liquidated.

5 Now, in this case there is no dispute that the
6 AFLMC merger was done in accordance with Texas law. See
7 FTB's opening brief at page 2. They do not take issue
8 with that. So under the plain language of IRC Section
9 368(a)(1)(A) and Treasury Regulation Section
10 1.368-2(b)(1), which were in effect on the date of the
11 merger June 30, 1999, the AFLMC merger qualified as a
12 tax-free statutory merger under IRC Section
13 368(a)(1)(A).

14 Now, the straightforward conclusion right from
15 the words of the statute and the regulations it is
16 further supported by the IRS amendments to Treasury
17 Regulation 1.368-2(b)(1) subsequent to 1999. Indeed,
18 amendments to the Treasury regulations subsequent to '99
19 provide compelling evidence that the AFLMC merger
20 qualified as a tax-free statutory merger under
21 Section 368(a)(1)(A) of the IRC.

22 First, on January 23, 2003, almost four years
23 after the AFLMC merger took place, the IRS amended its
24 Treasury regs to add a liquidation requirement to the
25 definition of the term "statutory merger or

1 consolidation."

2 Now, see temporary Treasury Regulation Section
3 1.368-2(t)(b)(1)(ii)(B), and that's Appellants'
4 Exhibit 18. Now, what's important there is not only the
5 addition of the liquidation requirement there is the
6 effective dates, and those were -- those were crucial in
7 this case. So the effective date of the amendment under
8 the Treasury regulations, and indeed Subdivision
9 (b)(1)(v) is explicit, says that it was January 24th,
10 2003. The temporary reg specifically provided that the
11 amendment applied to all transactions incurred --
12 incurring on or after January 24, 2003. Prospective.
13 Not retroactive, prospective. The regulations,
14 temporary regs go on to say, Well, what about
15 transactions before that date? What do you use?

16 And it's -- the regs say that taxpayer should
17 apply Treasury Regulation Section 1.368-2(b)(1) as in
18 effect before January 24, 2003. It's also on under
19 (b)(1)(v) of the temporary regs. Now, that section
20 should sound kind of familiar because that's the one
21 that's applicable to our years. The Treasury
22 Regulations 1.368-2(b)(1) in effect before January 24th,
23 2003, as I said before, did not have a liquidation
24 requirement. That is the one that we need to be looking
25 at for our case here.

1 Now, the IRS went on three years later, in
2 2006, January 26, 2006, and they issued final
3 regulations in this area incorporating the liquidation
4 requirement first introduced in the 2003 temporary regs.
5 Exhibit 20 is a copy of those final regulations. And,
6 indeed, what you want to look to is final Treasury
7 Regulation Section 1.368-2(b)(1)(ii)(b) and that sets
8 forth the liquidation requirement in the regs. But
9 again, the key part for our case here today is that --
10 the effective dates that are laid out there and they are
11 under subdivision (b)(1)(v), again.

12 Effective date of the amendments was
13 January 23, 2006. And the final regs specifically
14 provided that the amendment applied to transactions
15 occurring on or after January 23, 2006 prospective.
16 Seven years after our -- six years -- six and a half
17 years after our transaction. For transactions occurring
18 before January 23, 2006, the final regulations, like the
19 2003 temporary regulations, instructed taxpayers to use
20 Treasury Regulation Section 1.368-2(b)(1) as in effect
21 before January 24, 2003. And that is under (b)(1)(v)
22 again. Again, that particular version of the
23 regulations, which is what's in effect during our years,
24 did not have a liquidation requirement. It was the
25 version that we need to be looking to here.

1 Now, stepping back, by amending the Treasury
2 regs and making those amendments prospective, the IRS
3 made it very clear that the liquidation requirement was
4 a change in the law. This is further supported by the
5 IRS specifically instructing the taxpayers with
6 transactions occurring before January 24th, 2003, to use
7 the Treasury regulations which were in existence at that
8 time and which had no liquidation requirement.

9 In summary, with respect to the merger issue,
10 the AFLMC merger was a tax-free statutory merger. It
11 fell directly within the plain language of IRC Section
12 368(a)(1)(A) and Treasury Regulation Section
13 1.368-2(b)(1) existing at that time. The subsequent
14 amendments to Treasury Regulations Section 1.368-2(b)(1)
15 in 2003 and finally in 2006 confirm that result. The
16 merger was tax-free for our purposes.

17 Now, the final issue is the penalty issue.
18 Now, the imposition of delinquent filing penalty in this
19 case is improper because Appellants do not owe any
20 additional tax for 1999 because the NPAs were untimely
21 and thus invalid. Even if the NPAs were somehow
22 determined to be timely -- excuse me -- the imposition
23 of the penalty would still be improper because the
24 merger was a tax-free transaction and no additional tax
25 would be due for the 1999 tax year on that basis as

1 well.

2 Section 19036 provides the following:

3 "Notwithstanding any provision to the contrary, any
4 interest, penalty, or addition to tax, imposed under
5 Part 10 (commencing with Section 17001) Part 11 --
6 (commencing with Section 23001) or this part may be
7 assessed and collected in the same manner as if it were
8 a deficiency."

9 Thus since there would be no tax deficiency in
10 this case because of untimely NPA or that the merger is
11 tax-free, the NPAs would be invalid in all amounts --
12 tax, interest, and penalties, which were imposed --
13 proposed to be assessed must be reversed. I would
14 reserve the rest of my time for rebuttal. Thank you.

15 ALJ LONG: Thank you. We will go on to FTB's
16 presentation. You may begin when you're ready.

17
18 PRESENTATION

19 BY MR. LAISNE, Counsel for FTB:

20 Good afternoon. Michael Laisne, Brian Werking,
21 and Todd Watkins appearing on behalf of Respondent
22 Franchise Tax Board.

23 This case is a case first and foremost about
24 consistency, consistency for California tax purposes
25 with the conclusion of an IRS audit resulting in an IRS

1 closing agreement and consistency of a revenue ruling
2 with previous historical context, legislative history,
3 case law, and IRS guidance.

4 There are three overarching issues in this
5 appeal. First, whether the statute of limitations was
6 open at the time the notice of proposed assessment was
7 issued; second, whether the AFLMC transaction met the
8 requirements for a tax-free statutory merger under IRC
9 Section 368(a)(1)(A), also known as a Type A merger or
10 statutory merger; and, three, whether the delinquent
11 filing penalty applies.

12 In this case, as outlined in the briefs, an
13 alleged tax-free statutory merger was entered into under
14 the laws of Texas resulting in multiple entities
15 surviving the merger in 1999. The IRS audited
16 Appellants for tax years 1998 through 2002. One of the
17 conclusions of the audit can be found in Form 886-A,
18 Respondent's Exhibit G, which concludes that the merger
19 failed both due to the law stated in Revenue
20 Ruling 2000-5 and because it did not meet the continuity
21 of shareholder interest requirements; however, a closing
22 agreement was entered into by Appellants and the IRS
23 which placed that liability in 2002.

24 I'll now let my co-counsel Brian Werking have
25 the floor to discuss the statute of limitations issue

1 and the related facts in greater detail.

2 MR. WERKING: Thank you, Michael.

3
4 PRESENTATION

5 BY MR. WERKING, Counsel for FTB:

6 The first issue in this appeal is whether
7 Respondent mailed the 1999 proposed deficiency
8 assessment within a open statute of limitations. The
9 1999 proposed deficiency assessment mailed to Appellants
10 on November 20th, 2013, was timely mailed within an open
11 statute of limitations because the proposed deficiency
12 assessment resulted from a federal determination that
13 the 1999 AFLMC transaction was a taxable sale, and
14 Appellants timely executed a waiver to extend the
15 statute of limitations to assess additional tax for the
16 1999 tax year until December 31st, 2013.

17 Section 18622 requires taxpayers to report each
18 change or correction to any item required to be shown on
19 a return, including tax within six months after the
20 final federal determination date. Subdivision (d) of
21 that statute specifies that the final federal
22 determination date that triggers the six-month period is
23 the date on which each adjustment or resolution
24 resulting from an IRS examination is assessed.

25 IRC Section 6203, the underlying regulations

1 and Revenue Ruling 2007-21 provide that the final
2 federal determination date is the date on which the
3 adjustment is reported as an assessment on an IMF or an
4 account transcript. This interpretation of the final
5 federal determination date has been affirmed by the
6 Board of Equalization in its opinion denying a petition
7 for rehearing in the appeal of Unified Precious Metals
8 adopted on August 25th, 2015, and by the OTA in the
9 appeal of Yazdininian adopted April 19, 2019, Appeal of
10 the Estate of Chewning adopted July 9th, 2019, and the
11 Appeal of Fonseca adopted November 5th, 2021, and should
12 similarly be applied here.

13 If, after the six-month period required to
14 report a federal adjustment, a taxpayer or the IRS
15 reports the change or correction, Section 19060 allows
16 Respondent four years from the date of the notification
17 to mail a proposed deficiency assessment resulting from
18 the change or correction.

19 Pursuant to Section 19067 where a taxpayer
20 executes a state waiver before the statute of
21 limitations has expired, Respondent may issue a proposed
22 deficiency assessment during the waiver period.

23 In this case, the IRS examined Appellants' tax
24 year -- tax returns for taxable years 1998 through 2002.
25 During the examination, the IRS determined that the

1 AFLMC transaction that occurred in 1999 was a taxable
2 sale and not a tax-free merger. The IRS determination
3 is provided on the federal explanation of items,
4 Respondent's Exhibit G, page 4, captioned "Internal
5 Revenue Services' Position," and within the recitals of
6 the closing agreement, Respondent's Exhibit H, page 3.

7 Appellants and the IRS agree -- agreed in the
8 closing agreement written precisely to address the
9 taxability of the AFLMC transaction that occurred in
10 1999 and agreed the IRS would assess additional tax to
11 Appellants' 2002 tax account to compensate the IRS for a
12 gain that Appellants would otherwise have reported on an
13 amended 1999 return.

14 On July 17, 2006, in accordance with the terms
15 of the closing agreement, the IRS assessed the
16 additional tax. Therefore July 17th, 2006 is the final
17 federal determination date and Appellants were required
18 to report the federal adjustment increasing its tax to
19 Respondent within six months of that date.

20 Appellants do not dispute that they did not
21 report the additional tax assessment attributable to the
22 IRS determination that the 1999 AFLMC transaction was a
23 taxable sale within six months after July 17th, 2006.
24 Since Respondent did not learn of the additional tax
25 assessment until it received the IRS revenue agent's

1 report explanation of items, on October 20th, 2009,
2 Respondent had four years from that date to mail the
3 proposed assessment resulting from the federal
4 adjustment pursuant to Section 19060.

5 By the terms of Section 19060, Respondent is
6 not limited to proposing an assessment facts for the
7 same tax year that IRS assessed tax although the
8 California tax effecting a federal adjustment, is
9 usually in the same tax year as at the federal -- as the
10 federal level, there are times when the California tax
11 effect is in a different tax year. This may happen when
12 there are differences between state and federal law with
13 respect to a specific tax issue or as here, there was a
14 settlement covering several taxable years that specified
15 a tax effect attributable to a transaction that occurred
16 in one tax year, in this case 1999, be posted to a
17 different tax year account, in this case 2002.

18 Respondent's ability to propose an assessment
19 for the 1999 tax year, the year in which the transaction
20 occurred, is consistent not only with the result from
21 authority in Section 19060 but also consistent with the
22 federal determination that the 1999 AFLMC transaction
23 was a taxable sale as provided, as the IRS's position in
24 the explanation of items, Respondent's Exhibit G,
25 page 4.

1 It is consistent with the recitals and the
2 terms and conditions in the closing agreement. The
3 closing agreement indicates: One, that the Appellants
4 reported no gain or loss in 1999 on the AFLMC
5 transaction; two, that if it had treated the AFLMC
6 transaction as a sale, it would have had reported
7 taxable gain from the AFLMC transaction; and three, the
8 IRS determined the AFLMC transaction was not a tax
9 neutral reorganization but instead a sale in 1999.

10 It is also consistent with the parties'
11 agreement that instead of requiring appellants to file
12 an amended return for 1999 to report the gain from the
13 AFLMC sale as otherwise required, Appellants would pay
14 additional tax on the 2002 tax year but be precluded
15 from deducting the depreciation and amortization
16 available from 1999 through 2005 from the 1990 [sic]
17 transaction being a taxable sale but allow Appellants'
18 amortization deductions beginning in 2006 through the
19 remainder of the amortization period resulting from the
20 1999 transaction being a taxable sale.

21 Accordingly, Respondent correctly determined
22 that the transaction underlying the additional tax
23 assessed on Appellants' 2002 tax year account occurred
24 in 1999 and should properly have been reported on
25 Appellants' 1999 California return. Therefore, the

1 proposed deficiency assessments at issue for the 1999
2 tax year result from the federal determination and
3 additional tax assessed on Appellants' 2002 tax account.

4 Pursuant to Section 19060, the statute of
5 limitations to mail a proposed deficiency assessment
6 resulting from the federal determination was
7 October 20th, 2013, four years after the date Respondent
8 received the RAR information informing Respondent of the
9 federal adjustments.

10 On September 25, 2012, before the expiration of
11 the statute of limitations to assess, Appellants'
12 executed a waiver extending the statute of limitations
13 until December 31st, 2013. Accordingly, the 1999
14 proposed deficiency assessment mailed to Appellants on
15 November 20th, 2013, before the expiration of the waiver
16 was timely made.

17 And with that, I will turn it back over to
18 Michael to address issues two and three.

19 MR. LAISNE: Thank you, Brian.

20 Moving on to the second issue, the Appellants
21 have met their burdens, the second issue as laid out in
22 the briefs can be broken down into three sub issues.
23 The first is whether Appellants showed Revenue Ruling
24 2000-5 should not be applied retroactively. The second
25 is whether Appellants have shown that Revenue Ruling

1 2000-5 should not be given deference. And the third is
2 whether the continuity of shareholder interest
3 requirement was satisfied.

4 Regarding the burdens, the first item to note
5 is that Respondent is following the federal conclusion
6 in accordance with RTC Section 18622, so the IRS's
7 determination is presumed correct.

8 Also, when California law conforms to federal
9 law, federal rulings applicable to the IRC are highly
10 persuasive authority. This revenue ruling is precisely
11 that type of persuasive authority that governs because
12 both California law and federal law are the same.

13 From a federal perspective, as noted by the
14 Ninth Circuit Court in Walt Disney Company vs.
15 Commissioner, IRS revenue rulings are entitled to great
16 deference and have been said to have the force of legal
17 precedent unless unreasonable or inconsistent with the
18 provisions of the IRC.

19 Moving on to a discussion of the law and
20 guidance applicable to IRC Section 368(a)(1)(A), under
21 the Internal Revenue Code a reorganization can qualify
22 for tax-free treatment if it meets the requirements of
23 IRC Section 368(a)(1)(A). IRC Section 368(a)(1)(A)
24 defines reorganization to include a statutory merger or
25 reorganization. The Treasury regulations effective at

1 the time of the AFLMC transaction stated a merger must
2 be effectuated pursuant to the corporation laws of the
3 United States or a state or a territory or the District
4 of Columbia. Additionally, continuity of shareholder
5 interest is required for a tax-free Type A merger.

6 The AFLMC transaction was not entitled tax-free
7 treatment because the Texas statute used by Appellants
8 resulted in multiple entities surviving the transaction,
9 inconsistent with the law contained in Revenue Ruling
10 2000-5.

11 Now, moving on to Revenue Ruling 2000-5. It
12 disallows tax-free statutory mergers completed pursuant
13 to state merger statutes resulting in multiple entities
14 surviving the transaction, such as the AFLMC
15 transaction.

16 The revenue ruling provides a history of
17 relevant statutes and discusses their applicability. It
18 discusses reorganization as defined in the 1921 Revenue
19 Act. It explains that in 1934 the 1921 provision
20 discussing reorganizations was split into two with the
21 1934 predecessor to IRC Section 368(a)(1)(C) being an
22 acquisition by one corporation of substantially all the
23 properties of another corporation, which is the
24 equivalent of the parenthetical the 1921 Act. The 1934
25 Act created a second category of statutory mergers,

1 which is the predecessor to the current Type A mergers.

2 Revenue Ruling 2005 explains that because most
3 corporate law merger statutes ensure that one entity
4 continues to exist after a merger, the surviving
5 corporation automatically acquired all of the target
6 corporation's assets. Historically, corporate law
7 merger statutes have operated to ensure, as stated in
8 Cortland Specialty Co. citing the ruling, that merged
9 corporations cease to exist and the merging corporation
10 alone survives, thus Congress did not need to add a
11 substantially all of the properties requirement for Type
12 A mergers.

13 Revenue Ruling 2000-5 reasons further that
14 compliance with State corporate merger statutes is not
15 enough and states that in addition to business purpose,
16 continuity of business enterprise, and continuity of
17 shareholder interest requirements, there's a requirement
18 that only one entity survive the merger.

19 The ruling then explains the history of
20 divisive mergers stating that Congress concluded that
21 IRC Section 355 is the exclusive means of achieving a
22 tax-free divisive merger and there is no explicit
23 liquidation requirement for statutory mergers because
24 Congress contemplated that only one entity would survive
25 under state corporate merger statutes. Congress

1 addressed this in both 1954 and 1984 according to the
2 cited Senate reports in the ruling.

3 In summary, Revenue Ruling 2000-5 provides
4 that: One, state corporate merger statutes were
5 generally meant to require only one surviving
6 corporation; two, simply complying with a state merger
7 statute is not enough to satisfy IRC Section
8 368(a)(1)(A); three, Congress intended for IRC Section
9 355 to be the only path for a divisive tax-free merger;
10 and four, for these reasons a purported State statutory
11 merger that does not satisfy IRC Section 355 as another
12 merger type does not qualify for tax-free treatment.
13 There appears to be no dispute that pursuant to the
14 revenue ruling the AFLMC transaction is a taxable
15 transaction if it applies.

16 A few other historical facts worth noting are
17 that in 1920 the IRS stated in its solicitor Opinion 4
18 quoting a federal court decision that a merger of two or
19 more corporations takes place when one of source -- one
20 of such corporations retains its corporate existence and
21 absorbs the other or others which, thereby, lose their
22 corporate existence. And that's Respondent's Exhibit N.

23 Additionally, one of the purposes of the
24 Revenue Act of 1934 was to prevent tax avoidance,
25 including Congress's desire to prevent taxable sales

1 from being treated as tax-free reorganizations. At the
2 time of the passing of the 1934 Act, one prominent
3 commentator specifically noted that a statutory merger
4 was a technical merger where only one entity survived
5 the merger. Moreover, Black's Law Dictionary around the
6 time defined "merger" as only one entity surviving.

7 Further, in 1984 the Senate and Joint Committee
8 made the comment regarding the addition of IRC Section
9 368(a)(2)(G) when comparing a Type C to a Type A merger
10 stating in the case of a statutory merger or
11 consolidation the transporter is liquidated by operation
12 of the law. This further shows that Congress was not
13 anticipating and was not approving the idea that
14 statutory mergers would be divisive in transactions like
15 this one.

16 Also, the proposed regulations, temporary
17 regulations and final regulations under Treasury
18 Regulation Section 1.368-2(b) all adopt the requirement
19 as contained in Revenue Ruling 2000-5. At the time of
20 the release of the revenue ruling, one big partner and
21 commentator went as far as to praise the ruling for its
22 consistency.

23 Further, the American Bar Association did not
24 criticize the addition of the requirement in the
25 regulations, which one would expect if there were issues

1 with the ruling to the extent claimed by Appellants in
2 the briefing.

3 Regarding retroactivity, generally revenue
4 rulings apply retroactively. And as noted in Baker vs.
5 U.S. cited by Appellants in their reply brief, the
6 revenue ruling needs to be devoid of rational basis to
7 not be applied. Given the history discussed earlier,
8 the reasoning and conclusion of the revenue ruling
9 should not have been unexpected.

10 The Anderson factors brought up by Appellants
11 in the briefing are, one, whether or to what extent the
12 taxpayer justifiably relied on settled prior law or
13 policy and whether or to what extent the retroactive
14 regulation alters that law; two, the extent, if any, to
15 which the prior law or policy has been implicitly
16 approved by Congress; three, whether retroactivity would
17 advance or frustrate the interest in equality of
18 treatment among similarly situated taxpayers; and, four,
19 whether according retroactive effect would produce an
20 inordinately harsh result.

21 In terms of the first factor, justified
22 reliance on settled prior law and to what extent the
23 retroactive regulation changes that law, there were
24 several examples of legislative history and case law, as
25 just discussed. Then there's the history of IRS

1 guidance and case law, the definitions used to define
2 merger by practitioners, courts and dictionaries, the
3 purpose of the 1934 Act to curb tax avoidance, and the
4 fact that the only path to a tax-free divisive merger
5 was through IRC Section 355. As stated by Congress,
6 Appellants' reliance was not justified based on these
7 points, and the revenue ruling did not change the law,
8 it correctly interpreted the law.

9 As to the second factor, as mentioned, Congress
10 in 1954 and 1984 stated that the only path to a divisive
11 merger was through IRC Section 355. Further, the Senate
12 and the Joint Committee made the statement that Type A
13 mergers resulted in the liquidation of an entity by
14 operation of the law. This further shows that Congress
15 was not anticipating and was not approving the idea that
16 statutory mergers would be divisive in transactions like
17 this one.

18 In addition, when examining the second factor,
19 the Court believed Congress did not give any indication
20 that it wanted to change the law and found in favor of
21 taxpayers in that case.

22 Here, this is not a law change. In fact,
23 Congress meant for IRC Section 355 to be the sole path
24 for there to be a divisive reorganization; therefore,
25 this factor is in favor of granting the ruling

1 retroactive treatment.

2 Regarding Factors 3 and 4, 3 being whether
3 retroactivity would advance or frustrate the interest in
4 equality of treatment among similar situated taxpayers;
5 and, 4, whether according retroactive effect would
6 produce an inordinately harsh result, there are many
7 examples of legislative history, Treasury documents, and
8 court cases that statutory mergers of this nature were
9 not permitted.

10 In Plymouth (phonetic), the Court found in
11 favor of the IRS regarding the third factor. Here, too,
12 there is no unequal treatment of taxpayers. All
13 taxpayers in the United States were bound by the same
14 restrictions under Revenue Ruling 2000-5.

15 Finally, under the fourth factor, there's quite
16 a bit of history behind the law, which would indicate
17 that a divisive reorganization would not be permitted
18 under the statutory merger provision. The
19 reasonableness present in Revenue Ruling 2000-5 can be
20 found in Appellants' own reason for their settlement.

21 In appellants' IDR response contained in
22 Exhibit F, they stated that since the rules and their
23 interpretation in this area of taxation are complex and
24 not definitively conclusive, the IRS and the taxpayer
25 decided to resolve the dispute via a settlement. For

1 all these reasons, Revenue Ruling 2000-5 should be given
2 retroactive treatment.

3 The Appellants in the briefing next contend
4 that the revenue ruling is not entitled to deference
5 under Skidmore. The first factor is the thoroughness
6 evident in the authority's consideration. The
7 thoroughness presented in this case is acceptable given
8 that one of the purposes of the Revenue Act of 1934 was
9 to prevent tax avoidance and Revenue Ruling 2000-5
10 properly focused on items such as the requirement that
11 Congress wanted Section 355 to be the sole path of a
12 divisive merger as well as applicable case law cited.

13 The second factor is the validity of the
14 authorities' reasoning. For the reasons stated
15 previously regarding retroactivity and for Skidmore
16 Factor 1, the reasoning is also valid.

17 The third factor is consistency with earlier
18 and later pronouncements. Respondent notes that Revenue
19 Ruling 2000-5 is consistent with earlier and later
20 pronouncements. It's consistent with legislative
21 history, case law, and IRS guidance. When considering
22 the consistency with later pronouncements, the most
23 relevant items to examine are the proposed temporary and
24 final Treasury regulations under Section 1.368-2(b)(1)
25 that were released around the time of the revenue

1 ruling. All these later pronouncements adopt Revenue
2 Ruling 2000-5's conclusion regarding the survival of
3 only one entity and lend a great deal of persuasive
4 weight.

5 Additionally, the IRS pursued this case under
6 2000-5 and received a settlement. Further, for reasons
7 stated in our retroactivity argument and then the first
8 Skidmore factor, there is nothing that materially harms
9 the consistency with previous and subsequent
10 pronouncements.

11 The fourth factor considers all those factors
12 which give the authority power to persuade, the
13 blacking (phonetic) power to control. As discussed,
14 there was a great deal of historical context to this
15 revenue ruling and its conclusion. Further, at the time
16 of the passing of the Revenue Act of 1934, one
17 commentator specifically described the statutory merger
18 as a technical merger under a state statute to complete
19 a successful tax-free statutory merger with only one
20 entity surviving the merger. For all these reasons,
21 Revenue Ruling 2000-5 should be entitled to deference.

22 For the third sub issue regarding continuity of
23 shareholder interest, the IRS closing agreement,
24 Respondent's Exhibit H, stated as a fact that PHH
25 Holdings received stock equal in value to only

1 11 percent of the total value of stock of holdings
2 immediately prior to the transaction.

3 Eleven percent is far below the required
4 minimum threshold for a retained proprietary interest
5 for purposes of Treasury Regulation Section 1.368-1(e)
6 as noted in Revenue Procedure 7737. The conclusion
7 regarding the lack of continuity of shareholder interest
8 in the transaction based on the retention of only
9 11 percent proprietary interest was also stated by the
10 IRS in Form 886-A, Respondent's Exhibit G.

11 Third and finally, regarding the delinquent
12 filing penalty: There appears to be no dispute if
13 Respondent's assessments are sustained, the penalty
14 applies and no defenses have been raised. In the end
15 there should be consistency in what the IRS determined
16 with the California tax liability. Revenue Ruling
17 2000-5 is consistent, fair, reasonable, and thorough and
18 should be given deference and applied retroactively.

19 Finally, Appellants have not shown that the
20 continuity of shareholder interest requirement was
21 satisfied. For all these reasons, Respondent's
22 assessment should be sustained.

23 Thank you. And we're happy to take any
24 questions.

25 ALJ LONG: Thank you. Am going to turn to my

1 panel members to see if they have any questions. We'll
2 start with Judge Johnson.

3 ALJ JOHNSON: Thank you. I do have a -- can
4 you hear me okay?

5 THE COURT REPORTER: (Nods affirmatively)

6 ALJ JOHNSON: I okay -- a question for
7 Appellants. Regarding the waiver of statute of
8 limitations 3570(c) waiver, if there were no
9 adjustments, federal adjustments to the 1999 tax year,
10 why would Appellants sign a waiver extending the statute
11 of limitations based on 18622 and 19060.

12 MR. VESELY: Well, there was an audit going on
13 at the time, your Honor, that -- and the waiver covers
14 1999 through '02, and that was the audit the FTB was
15 doing of Appellants at that time, and at that time the
16 decision -- we weren't there, but our understanding was
17 that the audit was going on and FTB was making whatever
18 adjustments they were going to make, and the Appellants
19 agreed to do a waiver but only agreed to do a waiver
20 that was tied to federal adjustments, so not a general
21 waiver. And I think that's the important part.

22 ALJ JOHNSON: Okay. Thank you.

23 And then some more questions. It's going to be
24 for both parties, so I might go back and forth a little
25 bit. I'll start with the Franchise Tax Board. Which

1 documents -- we have closing agreements the 886-A
2 explanation items, the RAR is mentioned -- I don't know
3 if we have it in the record or not as well as possible
4 Form 4549 documents. Which are we looking at that
5 represent the final federal determination?

6 MR. WERKING: Well, the date of the final
7 federal determination is located on the BMF in this
8 case. That's Respondent's Exhibit J, page 28,
9 Transaction 300. But the substance of what -- you know,
10 why did the IRS assess this additional tax in 2008, it
11 really is the IRS's determination that the 1999 AFLMC
12 transaction was a taxable transaction. And where do we
13 find that? Where do we see that. Which I believe is
14 your question. And that is from the -- the -- the
15 886-A. We can see the IRS explains on page -- it's
16 Respondent's Exhibit G, page 4. We can see the -- the
17 IRS's position that they determined that the 1999 AFLMC
18 transaction did not qualify as a reorganization. And
19 then we can also look to the IRS's reasoning in that
20 document for why they agreed to their settlement, which
21 is provided in pages 4 through 6 of that same exhibit,
22 where the IRS compared the net present value of the
23 potential additional tax that would be collected where
24 the additional tax from determining the 1999 transaction
25 was taxable being assessed in the 1999 taxable year and

1 Appellants' claim resulting in additional depreciation
2 and amortization of goodwill for 1999 through 2014
3 compared with also treating the 1999 AFLMC transaction
4 as a taxable transaction but assessing the additional
5 tax in 2002 with Appellants being precluded from taking
6 the additional depreciation and amortization deductions
7 for the taxable years 1999 through 2005 and allowing
8 Appellants to claim the remaining amortization
9 deductions that are available through 2014 because the
10 1999 transaction was taxable and also foregoing a
11 deduction for the payment of interest an additional tax
12 payment in 2006. But based on the IRS's comparison,
13 they would realize a greater value of additional tax
14 assessing the tax in 2002 with these additional
15 restrictions on Appellants than assessing the tax in
16 1999.

17 We can also look to the recitals of
18 Respondent's Exhibit -- of the actual closing agreement,
19 Respondent's Exhibit H, and there the IRS determined
20 that the 1999 transaction was a taxable transaction but
21 would assess the tax in 2002 with those limitations on
22 Appellants, that they would only be able to claim
23 amortization deductions resulting from the 1999
24 transaction being a taxable transaction, but only for
25 taxable years beginning 2006 and forward. And this is

1 found in Respondent's Exhibit H, page 7, Number 6,
2 paragraph 6.

3 So the explanation of items, the closing
4 agreement, and referring to the BMF is where we can
5 piece together what -- what is the basis for this final
6 federal determination and what is the date of the final
7 federal determination.

8 ALJ JOHNSON: Okay. Thank you.

9 And for Appellants -- and part of the reason
10 why I ask this, I believe in your -- your briefs made a
11 point that the RARs were not final, they're not part of
12 the actual final determinations.

13 So same kind of question, are you looking at
14 closing agreements and the 886-A as far as what
15 constitutes the final federal determination?

16 MR. VESELY: The final federal determination is
17 not 886-A. There's no way because that is not what the
18 final determination was that's laid out in the closing
19 agreement. Recitals in a closing agreement mean
20 nothing. They're recitals. The actual determination in
21 the closing agreement, and that is the final federal
22 determination under the FTB's own regulations, that
23 audit report, anything that's preliminary like that,
24 unless that ends up being the final -- the final-final
25 here, which it did not, you know, there's no way that

1 that is the final federal determination in this matter.

2 It's real interesting when you look at the BMF
3 reports, your Honor. The date is really irrelevant for
4 our purposes of deciding this case, whether it's the
5 date of the -- of the closing agreement or the date it
6 actually gets entered in the BMF report. It's not
7 entered in 1999 in the BMF report. The liability,
8 that's \$60 million plus the interest, is entered in the
9 2002 BMF report. There is nothing for 1999 related to
10 this merger in the BMF report for 1999.

11 So whatever, you know, counsel is arguing about
12 here, that's all well and good, but that doesn't get you
13 there. That's -- you can't piece this together. I
14 guess we go back to, like I said in my opening, if the
15 liability -- you know, if the merger was taxable in
16 1999, it was 550 million, almost \$600 million with
17 interest is what the tax liability was -- interest was,
18 not, you know, 71 million like what was, you know, the
19 final determination in the closing agreement.

20 I think that's the problem is that when you
21 really parse through the closing agreement, where do you
22 see that they adjusted anything having to do with the
23 merger in 1999? And that's our problem with what the
24 FTB did in this case.

25 And I'll be happy to talk more about that, but

1 that's -- that's our essence of our position.

2 ALJ JOHNSON: Okay. Thank you.

3 MR. VESELY: Oh, your Honor, one more thing.
4 I'm sorry.

5 ALJ JOHNSON: Sure.

6 MR. VESELY: Because counsel was referring to
7 the closing agreement, I think it is important to look
8 at page 7, paragraph 7, "Taxpayer will not be required
9 to file an amended federal tax return for its 1999 tax
10 year to report its alleged \$1.5 billion gain."

11 It's kind of important that the word "alleged"
12 that's in there. That's not a recital. That is part of
13 the agreement. So I think we have to really parse
14 through that agreement very carefully to see what was
15 exactly determined by the IRS.

16 ALJ JOHNSON: On that note, regarding the
17 adding alleged to the value of the transaction there,
18 going further down, I believe it's paragraph 13 on the
19 same page.

20 MR. VESELY: One second, your Honor.

21 ALJ JOHNSON: Sure.

22 MR. WERKING: Okay. Exhibit H, page 7.

23 MR. VESELY: Oh, yeah. Okay.

24 ALJ JOHNSON: Could it be that that adding
25 alleged there was part of that paragraph 13 where the

1 IRS is making no statement as to the actual value, so,
2 therefore, they're not making a finding but they're
3 agreeing that this is the number that was discussed in
4 paragraph 7?

5 MR. VESELY: Your Honor, I don't know -- I
6 don't know. You know, when we enter into any kind of
7 closing agreements or whatever, it's very common to not
8 have -- nobody's is giving up anything, you know. And
9 that's the way I've read that paragraph, frankly. You
10 know, I don't know if it means anything more than that.
11 But, you know, again, you know, we agree to disagree
12 almost kind of thing, if you will. But I don't know
13 that gets FTB off the hook here of the timing of all of
14 this. That's the problem. And I think -- and I really
15 do think that -- that and waiver that we were looking at
16 before is really crucial here. So --

17 ALJ JOHNSON: I'm going to kind of the
18 statements again about closing agreements, how they're
19 structured, put together. Really, the purpose of the
20 closing agreement is kind of forego further audit,
21 litigation, attorney's fees and all that kind of stuff.
22 You're not necessarily trying to nail down specificities
23 as to how the tax law is being applied but more an end
24 result goal that both parties will agree to to forego
25 further costs and expenses. Seeing as how on this is a

1 Form 886-A closing disagreement, it's closing out an
2 entire year, it's not a 906 that might close out
3 specific issues, it's closing out '98 through 2002
4 resulting in one lump sum additional tax. It was
5 applied to 2002 tax year, not to 1999, does that affect
6 at all the impact of how this closing agreement that
7 closes out 1999 and resulted in additional tax for the
8 closing agreement in the aggregate. I guess you could
9 say, does that show that potentially there were
10 contemplations of tax effects for 1999 that resulted in
11 changes?

12 MR. VESELY: Well, I think if you step back and
13 think about that for a second, if, indeed, there was tax
14 effects for 1999 that was contemplated here and they
15 were contemplating saying that that merger was taxable,
16 then the taxpayer would have been allowed additional
17 depreciation -- or the Appellants, I'll use a general
18 term -- additional depreciation, additional amortization
19 and is specifically not, you know, allow to do that,
20 which would have been there, you would have gotten a
21 stepped-up basis.

22 You know so the 2001 transaction, which is
23 referenced in there, which they ended up having to pay
24 the whole tax on that, that thing in 2001 would have
25 been a lot lower gain. That would have been -- that was

1 tied to the 1999. If the 1999 merger was taxable, there
2 would have been increased amortization depreciation
3 deductions, a stepped-up basis there. Generally
4 speaking, what the IRS would have required is you've got
5 to amend your 1999 return. They said, "Nope. You
6 can't -- you don't have to do that." And, oh, by the
7 way, you're prohibited from going back in there to claim
8 additional depreciation and amortization deductions.

9 There are no adjustments in '00 and '01 in that
10 closing agreement if you notice there. So when you step
11 back and say, "Well, what did they exactly do here,"
12 what we do know is that they did not adjust 1999. They
13 did not change the filing position of tax-free that the
14 taxpayers had put forth in that closing agreement. And
15 that is the final federal determination here. You know,
16 that's the problem that FTB has, frankly, is that the
17 closing agreement does make a determination for 2002,
18 and that is the year that, you know, the amount is paid
19 in tax. That was reflected in the audit with the FTB,
20 that 2002 change and everything else.

21 So it's -- you know, I've looked at this thing
22 inside and out and said, "Okay. Where's the '99
23 change?" And so you still -- you think about it for a
24 second, and what FTB is trying to do in this case, which
25 I think is very -- it's -- it's -- there really aren't a

1 whole lot of limits to how they can apply their final
2 federal determination here, and kind of taken what I was
3 going to say on rebuttal, but I'll say it right now is
4 that they look at the "any year" language in 18622, and
5 if you look at that "any year," that is only looking at
6 the federal side.

7 So if we were to look at 18622, it talks about
8 the Feds or the IRS making an adjustment in any year.
9 And the reason it was "any year" in there always was
10 that it was to deal with if they are going into an open
11 year, which is no big deal, or a closed year. Can IRS
12 go into a closed year? They can only go into it if it's
13 a annual carryover issue so that you've got to go in to
14 look at when was proper for the later years. Same thing
15 with the credit carryover. And indeed, I'll go into
16 this in more detail for you with the history, but,
17 again, that "any year" does not apply to the FTB can
18 assist, issue an assessment for any year.

19 So if I got an assessment that for federal
20 purposes that's 2002 doesn't mean they can just go in
21 willy-nilly to any year, which is essentially what they
22 are doing here, frankly.

23 But the second part of it, and, you know,
24 counsel just referred to resulting from the adjustments.
25 Wow. You know, let's think about that for a second.

1 So we're talking about resulting from the
2 adjustments to 2002, which basically in that closing
3 agreement says you don't do all these things that you
4 would if it had been taxable in 1999. You don't get
5 additional depreciation. You don't get additional, you
6 know, amortization. You don't get a stepped-up basis.
7 You don't -- and all of that that's in the closing
8 agreement somehow results in them being able to assess
9 in 1999 that the merger was taxable, you know, with all
10 due respect, please. There's no limit to that. How
11 would a taxpayer ever know what should be reported and
12 when?

13 ALJ JOHNSON: And that's a question I'll have
14 later on as well.

15 MR. VESELY: Okay.

16 ALJ JOHNSON: But going back to that point you
17 mentioned earlier on, of course, giving up the step-up
18 in basis, the amortization and the other, benefits that
19 would happen later on were that 1999 AFLMC transaction
20 be not deemed to be a tax-free merger. And Respondent
21 earlier pointed to Exhibit G, page 6, I believe. And we
22 had the last two paragraphs on there.

23 And what the IRS has done in that is the
24 explanation of the items, again on the Form 886-A.
25 They've said, if we're going to pursue -- let me see

1 here -- the course of disallowing the merger as a
2 368(a)(1)(A) reorganization, if we're going to disallow
3 that, they measured out the tax effect of that, what
4 that would be.

5 Next paragraph, they went and compared that to
6 what taxpayers were offering and -- which is a higher
7 amount, actually, it looks like of tax that was going to
8 be paid or due. And they said based on that, we agree
9 to find taxpayer's resolution acceptable and we'll go
10 with that option. And I think what you see then,
11 perhaps, is in the closing agreement, they kind of put a
12 stop on all the benefits you would get had the merger
13 been seen as not tax-free, sort of to balance out --
14 balance out going with Appellants' position in the --
15 the closing agreement.

16 To that extent, does that add evidence or
17 suggest that the closing agreement adjustments were
18 based on what IRS saw as adjustments that should be made
19 to 1999?

20 MR. VESELY: Well, I mean, I saw that as well,
21 your Honor. I guess what hits me on this is we don't
22 know what went on exactly in all the discussions. I
23 mean, I wasn't there. You weren't there. You know, we
24 got what this is. This is not a final determination
25 though. I mean, ,this is -- this is, you know,

1 documents that -- that, you know, during the audit stage
2 and so on and so forth. But let's think about that for
3 a second though. When parties settle -- settle matters
4 an old FTB lawyer once said to me, he said, well, you
5 know, you know what, Jeff? You can go talk Italian to
6 your clients and we'll talk French to mine and we'll
7 come -- I don't care how we get to the number
8 necessarily. So getting to the number is just fine, but
9 the idea here is: What is the adjustment that is
10 supposed to be tied to 1999? Is it really that you all
11 of a sudden now have a taxable transaction in that year
12 and you're relying -- and supposedly you're relying on
13 this federal determination to issue an NPA for that year
14 under a waiver that says resulting from the federal
15 adjustments, not for all purposes? There's no limits to
16 disposition. And as a result, I think they've got a
17 problem, not only with whether this is really a tax-free
18 merger or not, which we'll talk about more in my
19 rebuttal, but the fact of the matter is, I think that
20 they have a problem with their statute of limitations
21 because it's not resulting from a federal -- they don't
22 like the result in this closing agreement. That's the
23 problem.

24 I mean, let's cut to the chase. They want that
25 five -- you know, they want the 12 and a half million

1 dollar assessment in 1999 because of the, you know, they
2 didn't get it by following the federal determination
3 here. So I -- I -- you know, they're asking you guys to
4 really jump through a lot of hoops to get to their
5 position, and I think that's a problem here. I think
6 it's a problem both on the tax-free merger conclusion
7 and the statute of limitations, frankly.

8 ALJ JOHNSON: Sure. And let me give Respondent
9 a chance on his questions as well.

10 MR. VESELY: Sure.

11 ALJ JOHNSON: So you mentioned that the 886-A
12 explanation of items is what you look at to explain what
13 the federal adjustments were. Or I'm --

14 MR. WERKING: Partial.

15 ALJ JOHNSON: Partially, correct, okay. And
16 then Exhibit H there, the closing agreement itself, if
17 your sort of analysis was restricted just to that
18 closing agreement and perhaps even not the "whereas"
19 statements but the "hereby determine and agree to"
20 statements at the second half of that, would you still
21 maintain that this federal adjustment shows that the
22 statute of limitations is open for a state sided
23 adjustment to the 1999 tax year?

24 MR. WERKING: I would. I think -- sorry. Yes,
25 I would. I think -- I think you can -- you can

1 garner -- even -- even not looking at the 886-A to rely
2 on as a primary document to determine what the final
3 federal determination is, you can gain some information
4 by looking at 886-A as to what is and the reason why the
5 information is contained in the closing agreement.

6 But, specifically, when you do look at -- I'd
7 direct you to the closing agreement, page 7, and it is
8 paragraph 6. That's an item that, you know, is earlier
9 addressed in the 886-A to kind of give us an idea of
10 what -- why is that there, what does that mean. That is
11 one of those items that are -- the closing agreement is
12 addressing that, yes, we're treating the taxable -- the
13 1999 transaction as a taxable transaction and,
14 therefore, there's this resulting -- this -- this
15 additional amortization deduction that will be available
16 to Appellants.

17 And, you know, the paragraphs 4 and 5 above are
18 also those -- those limitations that were placed on
19 Appellants that were explained in the 886-A but are
20 contained within the terms and conditions of this
21 closing agreement, because taking the 1999 transaction
22 as a taxable transaction, Appellants would otherwise be
23 able to take those amortization and depreciation
24 deductions.

25 So I think that information, you know,

1 clarifies and -- and indicates that, yes, the
2 determination was that there is -- the 1999 transaction
3 is a taxable transaction, but we're going to -- the IRS
4 is going to take this position to allow the tax to be
5 assessed in 2002 with the caveat that there's these
6 extra limitations to make it their benefit. But I think
7 it leans to show that, yes, that alone, that document
8 alone does show that the 1999 transaction was determined
9 to be a taxable transaction.

10 ALJ JOHNSON: Thank you. And to address part
11 of the concerns that were raised by Appellant, if you
12 have a closing agreement, that doesn't make actual
13 concrete adjustments to the tax year 1999, you know, it
14 makes adjustments to a different year, perhaps, that are
15 all covered in the same closing agreement, sort of in
16 general and perhaps to this case as well, what level of
17 specificity is going to be required to put a taxpayer on
18 notice that the requirements to inform FTB under 18622
19 have been triggered?

20 MR. WERKING: I mean, I think there you have to
21 look at all the information that is available. And in
22 this case, it was clear the adjustment that was being
23 reviewed, the transaction, that was being reviewed was
24 the 1999 transaction, whether that was a taxable
25 transaction or a tax-free merger.

1 And so by looking at the explanation of items
2 in this case, you know, it was apparent and is clear
3 that the tax that results from that review of that item
4 in this case being assessed in 2002, but it resulted
5 from that examination of this particular item. And so
6 that -- that puts the taxpayers on notice as to this is
7 the actual transaction that -- that leads to the
8 additional tax being assessed. And then you have to
9 look to -- so under California law, if this is a taxable
10 transaction in 1999 as the IRS determined, what is the
11 resulting tax effect to report?

12 ALJ JOHNSON: Thank you. I guess under that
13 same line of reasoning, obviously, Franchise Tax Board
14 was not a party to the closing agreement, weren't at the
15 table for those discussions and there might be some
16 agreements that were made that -- between those two
17 parties that FTB cannot try to enforce upon the
18 taxpayers perhaps since that's not an agreement between
19 the taxpayer and the Franchise Tax Board. So once
20 the -- once those changes are made, the Franchise Tax
21 Board, you're going to be looking at the California tax
22 effects that were just saying. Is that correct?

23 MR. WERKING: Exactly.

24 ALJ JOHNSON: Okay. Is there -- was there a
25 possibility -- maybe you don't know in this case -- of

1 FTB to just say, "We're going to do the same thing the
2 feds did and put it all in 2002?"

3 MR. WERKING: I don't want to speculate on
4 other instances, but in this case, because we had the
5 information that we knew, you know, what was the basis
6 for this change, for this adjustment and additional tax
7 assessment in 2002, because we have that information,
8 you know, the California tax effect of that
9 determination, that the 1999 transaction is taxable,
10 that, you know, should be placed in 1999. Perhaps with
11 different information or less information an assessment
12 may follow the year in which the tax is actually
13 assessed.

14 ALJ JOHNSON: Okay. Thank you.

15 MR. VESELY: Your Honor, if I may respond to a
16 couple things?

17 ALJ JOHNSON: Yeah. Just checking the -- I
18 think that's my last question.

19 MR. VESELY: Sure. I'm sorry.

20 ALJ JOHNSON: Go ahead. Go ahead and --

21 MR. VESELY: Okay. All right.

22 ALJ JOHNSON: -- if you want to add a few
23 points.

24 MR. VESELY: Well, a couple things that counsel
25 just said were interesting. I mean, again, as I said in

1 my opening, that we've got to read that closing
2 agreement carefully. There's a lot of things in there
3 that we want to be real careful about here. And really,
4 look at the last paragraph of the closing agreement on
5 paragraph 18. It says, "The closing agreement contains
6 the complete agreement of the parties."

7 We're not talking about that you all of a
8 sudden kind of overlay the 886-A, which is not a final
9 federal determination. Indeed, under their own
10 regulations, a final determination is an irrevocable
11 determination of regulation 19059(e), irrevocable
12 determination or adjustment of the taxpayer's federal
13 tax liability from which there exists no further right
14 of appeal.

15 Under an 886, an RAR, that is not the case.
16 Those are not irrevocable by any means. So when you
17 really talk about those two things here, if a taxpayer
18 is trying to piece together what do I need to report or
19 not report, this is not appropriate notice. This --
20 that's what it's all about. I mean, you've got to give
21 the taxpayers notice.

22 And, frankly, if you think about it, you know,
23 the claim for refund statute from federal
24 determinations, 19311, is tied to the same stuff we're
25 talking about. So how would you know which years that a

1 claim for refund should be filed for? You know, should
2 I file for 2002? 1999? What should I do? Should I
3 take a guess? That's not the way to administer the law.
4 But anyway --

5 ALJ JOHNSON: Okay. Thank you both. No
6 further questions.

7 MR. VESELY: Okay.

8 ALJ LONG: Thank you.

9 Judge Kwee, do you have any questions for
10 either party?

11 ALJ KWEE: This is Judge Kwee. Yes. Sorry.
12 I'm just collecting my thoughts. So we have the \$60
13 million assessment for the year 2002. And then there
14 was the closing agreement, and I guess I'm just
15 wondering, you know, what the closing agreement,
16 asserting it for 2002, and then we have IRC Section
17 18622, which is that, you know, if an amount reported
18 on -- or shown on a federal return for any years
19 changed, you have to report that to FTB. And I guess
20 looking at that "for any year" language, you know, you
21 have this 60 million assessment for 2002 for fed
22 purposes, but I -- it's my understanding of the
23 taxpayer's argument is that you couldn't -- FTB couldn't
24 assert that 18622 for a different tax year for 1999,
25 when for example, like, there's, you know, a federal

1 assessment for 2002 but it would impact it for the state
2 purposes for 1999. And I guess if that's the position,
3 I'm just wondering if there is any sort of a legislative
4 history or something similarly --

5 MR. VESELY: Oh, I'd be happy to go through it
6 with you in great detail. I've got -- we put it into
7 the briefs as well. But the fact of the matter is
8 18622, the predecessor to that -- and this was before
9 1967. And there was a legal ruling that the FTB issued,
10 and it's our Exhibit 3, Legal Rule 280 issued in 1964.

11 And that legal ruling was -- the reason for
12 that legal ruling was, under the law as it read at that
13 time, the taxpayer was required to report any
14 adjustments made to the amount of taxable income
15 federally. So the terms were amount of taxable income
16 federally. The legal ruling looked at it and it also
17 looked at the -- you know, analyzed the term "any year."

18 And if you -- if you look at 18622, your Honor,
19 it's real interesting because I have to -- the more
20 times we read all this jazz, you find something new.
21 And what 18622 says, and this is (a), "If any item
22 required to be shown on a federal tax return, including
23 gross income, deduction, penalty, credit or tax for any
24 year of any taxpayer is changed" -- stop right there.
25 And it's "changed by the Commissioner of Internal

1 Revenue," I'm sorry. The "any year" is tied to the
2 federal government looking at your tax returns, at those
3 years there. And it's not to talk about that you can
4 take an adjustment in 2002 and apply it to 1999. That's
5 not what the statute says. There's no way -- no reading
6 of that statute that gets you there.

7 And what was done in that legal ruling back in
8 1964 -- because it only referred to taxable income.
9 What they had in the legal ruling was a net operating
10 loss that -- well, the taxpayer had a zero taxable
11 income. That's what the audit staff was asking about,
12 zero taxable income. The feds made an adjustment there
13 to disallow some deductions, but they were already at
14 zero so there was nothing, you know, to add to it.

15 What the legal ruling concludes, it says, well,
16 since it says taxable income and there's no adjustment
17 to taxable income, the taxpayer does not have to report
18 that under the predecessor to 18622. That led to a
19 '67 -- 1967 amendment where they changed it from taxable
20 income to gross income. And, you know, it's made a few
21 changes since then, but that was to take into account
22 the fact that if the IRS goes into a year and disallows,
23 you know, deduction for some reason, however, it has no
24 taxable effect for federal purposes because of NOLs or
25 something like that, California can pick that up as a

1 report. The taxpayer has to report that adjustment
2 under the current law for that year. That's really --
3 that's all it's really getting to. And what it has to
4 is that where does this effect for other tax years come
5 in? It's not just wide open, you know, well, wild west
6 show to hit any tax year.

7 The FTB in their own Manual of Audit
8 Procedures -- actually, also in the other legislation
9 that came afterwards, which is in our briefs. There's a
10 Senate Finance report which I could -- I'll read for you
11 here that talks about, well, this carries over from
12 the -- if you've got carryovers.

13 So they make an adjustment, you know, in one
14 year and there's NOL carryovers that actually affect
15 then, the later years or a credit carryover in later
16 years, those adjustments can be done. But that's the
17 limited exception to the general rule that if the Feds
18 adjust something in 2002, then California can adjust it
19 for 2002 if indeed it follows the rules that way.

20 It doesn't mean you can just go into any year.
21 The "any year" in that statute has to do with what the
22 Feds are looking at, not what California can do. That's
23 nowhere in there. And I think that's one of the
24 problems with their position.

25 The second one is the resulting from federal

1 adjustments. Well, you know, by gosh. That -- that --
2 that -- that is a term that is being stretched and
3 strained beyond recognition right now by them in this
4 case. And resulting from federal adjustments, we're
5 saying they could -- they could issue an assessment
6 resulting from a federal adjustment where the Feds never
7 took the position that the merger was taxable in that
8 final federal determination. Not in the audit report,
9 but the final federal determination. You know, that's
10 not what the law provides. Simple as that.

11 So I'm not sure if I answered your question.
12 I'm sorry.

13 ALJ KWEE: Oh, yeah. You provided a very
14 detailed answer. Thank you. And I apologize. I'm new
15 to this panel. I'm new to this appeal so I was still
16 trying to wrap my head around everything that was going
17 on here.

18 MR. VESELY: Sure.

19 ALJ KWEE: My concern really was just if that
20 were their interpretation of it could potentially, you
21 ability, create a loophole where there's like an
22 agreement to assess something for one year, a different
23 year, or if there's, you know, like a difference between
24 state and fed that, you know, potentially FTB would be,
25 you know, out of luck there just because of the way it

1 was structured.

2 But I think you've answered it, and I will --
3 I'll review the Exhibit 3 and the documentation that you
4 were referring to.

5 I'm sorry. I'm getting a note that you can't
6 hear me or the parties can't hear me online.

7 But I did have one additional question and that
8 had to do with early on -- earlier on in your
9 presentation you were talking about the waiver.

10 MR. VESELY: Mm-hmm.

11 ALJ KWEE: And there were two aspects there. I
12 think one you had referred to at the very end, and I
13 think this was the Exhibit 2. I don't remember the page
14 number. On the very bottom right, there was the like it
15 indicated -- it was titled RAR, you know --

16 MR. VESELY: Right.

17 ALJ KWEE: -- the revenue agent report.

18 MR. VESELY: Yeah. It's our Exhibit 2 and
19 actually FTB's Exhibit L, I think, or something like
20 that. It's the same waiver.

21 ALJ KWEE: Okay. Well, that wasn't -- I'll get
22 to my question again and then I'll let you --

23 MR. VESELY: I'm sorry. I'm sorry.

24 ALJ KWEE: I'll tell you when, yeah, I have my
25 question.

1 But yeah. So I did see that. And then on the
2 top right, I noticed on the top right of the title it's
3 also referring to the, you know, the federal action or,
4 you know, federal adjustments.

5 MR. VESELY: Mm-hmm.

6 ALJ KWEE: But if you look at the actual text
7 of the waiver, it didn't seem to include any limitation
8 on one -- it could be asserted by FTB, so it looks like,
9 you know, I guess one interpretation might be that this
10 was maybe the title they gave the form or the form that
11 they used in this certain situation, but it didn't look
12 like there was an actual limitation substantively, if
13 you go to the actual text, that only applies. So I
14 guess maybe I -- or maybe that's maybe where I'm asking,
15 if -- if there was something -- if you wanted to address
16 that, the actual text of the waiver seemed pretty
17 extensive.

18 MR. VESELY: Well, it -- yeah. I mean, this
19 waiver is a standard form for the FTB. This is not a
20 form that was made up for this case. And this is a --
21 this is quite different than the normal waiver, the
22 general waiver that exists. For example, in this waiver
23 they actually refer to the two case statutes in this
24 case, 19059 and 19060, right in the middle there. Those
25 have to do with resulting from a federal adjustment.

1 Okay. And, you know, this particular waiver -- and,
2 indeed, Franchise Tax Board's audit -- auditor went
3 through an analysis in her reports -- or his reports.
4 I, forget who it is -- and talked about what is the
5 statute of limitations here, but resulting from the
6 federal adjustments. This is not a general waiver under
7 California -- under FTB. You can ask them that
8 question. They'll have to concede that. This is not
9 anything other than a limited waiver.

10 ALJ KWEE: Okay. Okay. Thank you.

11 I'm sorry. Judge Long, do you mind if I ask a
12 question of FTB?

13 ALJ LONG: Yeah.

14 ALJ KWEE: Just -- I guess, FTB, did you want
15 to respond to that, or did you have a position on that?

16 MR. WERKING: Yes. We do agree that this is a
17 limited waiver. It only extends the statute of
18 limitations for, you know, assessing additional tax that
19 results from a federal adjustment in this case. Our
20 position is that the 2002 assessment results from the
21 determination by the IRS that it's a -- the '99
22 transaction was a taxable transaction.

23 ALJ KWEE: Okay. Perfect. Thank you.

24 I will turn it back to Judge Long.

25 ALJ LONG: Thank you. This is a question for

1 FTB. Mr. Vesely mentioned earlier on about the -- the
2 closing agreement, how it states in the recitals IRS's
3 determination that this is not a neutral tax
4 reorganization; whereas, in the determine -- or in the
5 determination it mentions that it's an alleged gain.

6 Do you have a response or a position to how we
7 should be considering these statements in the recital
8 versus the determination portion of the closing
9 agreement?

10 MR. WERKING: I think both are helpful. Same
11 with looking at the explanation of items. It's helpful
12 in understanding exactly why did the IRS agree to assess
13 tax in 2002. We -- that's what you need to know. What
14 is the federal determination? What did they determine
15 to agree to this assessment of tax in 2002 when they
16 believe the tax should be assessed in 1999?

17 And so looking at the recitals is helpful. And
18 you can see that even in the terms and conditions of the
19 actual closing agreement that -- that it does follow the
20 same information that is contained in that analysis in
21 the explanation of items that comparing, you know, the
22 tax that would have been due had the taxpayer amended
23 the return in 1999, but instead, because of the, you
24 know, additional tax that -- that the IRS would collect
25 determined or allowed or decided or agreed to tax the --

1 assess the tax in 2002 but with those limitations on
2 Appellants' ability to take deductions for a period of
3 time resulting from the 1999 transaction being a taxable
4 transaction but still allowing a portion of it as well
5 to continue, which I think is very important to -- to
6 look at to determine exactly why did the IRS assess tax
7 in 2002 and what would be the California tax effect of
8 that reason, that determination.

9 ALJ LONG: Thank you. We will -- all right.
10 The next portion of our hearing is for the rebuttal, but
11 looks like we're nearing the two-hour mark, so I think
12 now is a good time for a 15-minute break.

13 MR. VESELY: Okay.

14 ALJ LONG: So I guess we will come back around
15 3:05, if I did my math correctly.

16 (Break taken at 2:50 p.m.)

17 ALJ LONG: We are back on the record. We will
18 continue with Appellant's rebuttal, and you may begin
19 when you're ready.

20 MR. VESELY: Thank you, your Honor.

21
22 REBUTTAL STATEMENT

23 BY MR. VESELY, Counsel for Appellant:

24 Since we have spent a lot of time on the
25 statute of limitations issue, I'll cut down on that part

1 of my thing. But I do want to repeat a few things that
2 we need to keep in mind. Here. I believe I've said it
3 a number of times here, 18622 and 19060 require the
4 notification if the feds, the IRS makes an adjustment in
5 a particular year on the taxpayer's federal return. The
6 taxpayer is required to report that.

7 In this particular case, the final federal
8 adjustment that was made is for the 2002 tax year.
9 Counsel has talked about the BMF report and other things
10 like that. He talked about 886-A. Those are all well
11 and good. The 886-A is not the final. It's not a final
12 determination. The BMF report has nothing to do with a
13 final determination. It has to do with the date there.
14 The BMF report in this case only talks in terms of a
15 2002 amount being assessed. 2002, not 1999.

16 So what do we have in this case? There's
17 nothing that counsel can point to in the closing
18 agreement that says that the 1999 tax year was adjusted
19 under the closing agreement. They did not change the
20 reporting of the merger as tax-free for 1999, no matter
21 what counsel wants to say.

22 I think counsel kind of reversed himself a bit
23 before the break, and he talked about the 2002 was
24 resulting from the 1999 merger. Well, that's not the
25 analysis. Was the 2002 adjustment -- what kind of an

1 assessment could FTB propose resulting from the 2002
2 adjustment. And, frankly, nothing in the agreement.
3 Recitals are not the agreement. Recitals are just --
4 you know, they're -- they're not what parties agreed to.
5 So that's something -- you know, Judge Long, you asked
6 that question. That's not the agreement. The agreement
7 is the body of what was done here, and nothing was done
8 to the 1999 tax year. And that's crucial here because
9 that's what 18622 and 19060 require.

10 So when we step back one more time, the
11 treatment of the merger as tax-free on the taxpayer's
12 1999 return, by the way. It was not adjusted. And I'm
13 talking about on the federal return. It was not
14 adjusted. Nothing was changed. And all the other
15 paragraphs that I mentioned that basically would go the
16 other way if it was taxable and we've already referred
17 to just to confirm that point.

18 Now, Judge Kwee actually made a comment that
19 caught my attention and my colleague's attention is
20 about a loophole. There's no loophole here for a
21 taxpayer. To be honest with you, it's the other way
22 around. If FTB is permitted to do this like that ,
23 that's creating a -- I'll call it a governmental
24 loophole because this -- it's opening a Pandora's box.
25 There's no limit to what year you would be applying a

1 final federal determination. That can't be the case.

2 I mentioned to you that the legislative history
3 was very clear from 1964, 1967, and then post that with
4 respect to the predecessor to 18622. And basically
5 what -- what was said and what I think is real important
6 here is actually the FTB's own -- own words in their
7 manual.

8 And this is Exhibit 9, Appellant's Exhibit 9.
9 And it says -- it's the Manual of Audit Procedures. It
10 says, "The tax effect of a Revenue Agent Report
11 adjustment may apply to different years for California
12 purposes than for federal purposes for such issues as
13 net operating losses, tax credits and other carryover
14 items."

15 It's not -- it's not a wide open thing. You've
16 got some limits there and a reason -- there's a
17 rationale for that. Because you may have an adjustment
18 in a year that is adjusting income or deductions,
19 whatever it might be, and it will affect the amount of
20 the NOL in that year that you carry over into another
21 year, or it might affect the credits that would be
22 carried over into another year. That's the limited
23 exception to saying if I adjust -- if the FTB or the IRS
24 adjusts 2002, you know, the FTB can adjust 2002 because
25 that's the nice and neat way it goes. That's what

1 Montgomery Ward is very clear about when you look at
2 that opinion.

3 So I think that that's the problem. There's
4 the loophole that we've got to be worried about here.
5 And I think that's the part that we are, you know, very
6 concerned about. This is -- this is not -- there's
7 nothing here that supports their position that they
8 should be adjusting 1999.

9 And as I said earlier, one of biggest issues
10 that we've got and what FTB is really trying to do here
11 is they don't like the conclusion of what IRS did. They
12 don't like the fact that they didn't go full boar on
13 that being taxable in 1999. And they're going to do it
14 themselves.

15 So let's step back and think about that. They
16 only can do 1999 under that limited waiver that we
17 talked about, and that limited waiver is required
18 resulting from the final federal determination. The
19 only final federal determination related to anything
20 remotely close to this is the 2002 final federal
21 determination.

22 Now, that determination was done where it's not
23 taxable, where the merger is not taxable. So to say
24 that now that they can go into '99 and say, Well, you
25 know what? We're going to go resulting from that

1 federal adjustment, which we are completely 180 degrees
2 opposite. We want to get that assessment in 1999.
3 Well, they're too late because it's not resulting from
4 any final federal determination there; and therefore,
5 that limited waiver does not save them. So I think
6 that -- that itself is a major part of what we've got
7 here. I think that -- the other part that I think was
8 discussed a bit. Okay. What about the calculation of
9 the -- of the settlement with the IRS? Well, that's all
10 well and good, but that's not the final federal
11 determination of how you calculated it. I mean, there's
12 nothing in there that says that '99 was adjusted. And
13 that, I think, is -- is -- that's crucial in this whole
14 matter. But let me -- let me go on and I want to
15 address some of the statements made by counsel with
16 respect to the merger issue.

17 Now, counsel relies very heavily on Revenue
18 Ruling 2000-5. The problem with that Revenue Ruling
19 2000-5 are manifold. First of all, that was published
20 in January 31st, 2000, for approximately seven months
21 after the AFLMC merger. And the FTB is asking you folks
22 here to apply that revenue ruling retroactively to the
23 merger. Its position must be rejected for a number of
24 reasons.

25 First of all, it is in direct conflict, the

1 conclusions in that revenue ruling, with the statute IRC
2 368(a)(1)(A) and the Treasury Regulation Section
3 1.368-2(b)(1) existing at that time. They can't -- they
4 can't disagree. That's exactly what those documents --
5 they do not talk in terms of a liquidation requirement.

6 The liquidation requirement here -- and we
7 talked about it being settled law, et cetera. The only
8 thing that was settled law at that time -- and we're
9 going to get into the Anderson factors here in a
10 second -- was that you needed a statutory merger, since
11 1934. And we'll talk about it in a second. That was to
12 put people on notice: What do you need? But it was
13 also contemplated that the state's -- the state's -- the
14 state's merger statutes were not identical. They were
15 all over the place. It was understood there, and I'll
16 point you to it where? Right in FTB's own exhibits,
17 frankly.

18 So the liquidation requirement that they want
19 to put in through the revenue ruling to go retroactive
20 to 1999, how do they square that with the subsequent
21 Treasury Reg changes in 2003 and '6? And if you notice
22 counsel never mentioned effective dates. All he
23 mentioned was, yeah, there's a liquidation requirement
24 in those regulations. That's true, there is. But the
25 liquidation requirement for the 2003 temporary regs was

1 prospective after January 24, 2003, and if you did a
2 transaction before that date, you applied the former
3 regulation.

4 God, I looked like heck for -- to find Revenue
5 Ruling 2000-5 mentioned in these Treasury reg changes.
6 Not -- not even a semblance of it in there. Oh, by the
7 way, there's nothing about 2000-5 somewhere in that
8 closing agreement either. That's pretty interesting.
9 Where is it if it was so doggone important?

10 So when you look at the temporary regs in 2003
11 and then you look at the final regs in 2006, the
12 effective dates in both of those are crucial in this
13 case because what they're asking you to do is to say
14 that revenue ruling somehow trumps the regulations and
15 say that that should be applied retroactively, where
16 regulations say just the opposite. It says you apply
17 the old regulation which had no liquidation requirement.

18 So how does that work? Let's just talk about
19 that a little bit. Where in the pecking order are
20 Treasury regs versus revenue rulings? Well, it's very
21 clear what they are? 26 CFR Section
22 601.601(d)(2)(b)(v)(d). Sorry about that, all those.
23 It basically says revenue rulings do not have the force
24 and effect of Treasury regulations. That's the IRS's
25 own words. A revenue ruling is merely an official

1 interpretation published by the IRS to provide
2 information and guidance to taxpayers and IRS officials.

3 It doesn't take precedence over a Treasury
4 regulation, but they're asking you to basically say that
5 it does here for the purposes of applying this thing
6 retroactively. I don't think that's a -- you know,
7 rendering an opinion that says that's going to be a
8 tough one, to be candid with you, like that.

9 But let's talk about this a little further.
10 You know, putting aside the fact that a revenue ruling
11 cannot trump the -- oh, sorry about that -- cannot take
12 precedence over the -- over the Treasury regulations
13 here, its liquidation requirement cannot be applied
14 retroactively to the merger here. The revenue ruling
15 merely set forth, as we said in our briefs, really a
16 litigating position of the IRS at that time. That's all
17 it did like that. it was inconsistent with the statute
18 and the regs that existed at that time.

19 The other part of it that's interesting is that
20 counsel did discuss the Anderson factors, but let's talk
21 about those a little more in-depth here.

22 The first factor -- and this is a 1980 case,
23 and it was cited in the briefs. The first factor is
24 whether and to what extent a taxpayer justifiably relied
25 upon settled prior law or policy and whether and to what

1 extent he punitively -- the punitively retroactive
2 regulation or revenue ruling alters that.

3 So what happened here? Appellant justifiably
4 relied on prior settled of law, policy which allowed law
5 tax-free mergers without requiring liquidation of a
6 target corporation. Until the IRS published Revenue
7 Ruling 2000-5, there's nothing out there you can find
8 that they say this.

9 Now, they talk about a lot of things, of how
10 this was a dictionary definition and other things like
11 that. That's not the law. The law here is what --
12 pursuant to a state merger statute, which is the Texas
13 statute in this particular case which had been around
14 for ten years. There's no question about that and they
15 don't disagree with that.

16 The revenue ruling introduced a new liquidation
17 requirement. So when you take that and then you add on
18 the subsequent amendments to the Treasury regs, which I
19 just referred to in the 2003 and 2006, yes, they
20 introduced the liquidation requirement there, but they
21 don't all of a sudden say, "Well, you know what? Four
22 years prior to 2003, apply the revenue ruling." They
23 don't say that. You apply the prior regulation. Very
24 interesting. Why did they do that? There's not a
25 specific mention on the revenue ruling here. So why did

1 the IRS instruct taxpayers to do so? Well, it certainly
2 wasn't to give retroactive effect to the revenue.
3 Ruling, that's for sure.

4 Now, the interesting thing here, FTB's own
5 Exhibit Q -- and this is the ABA tax section comments
6 regarding the 2006 final Treasury regulations and the
7 liquidation requirement that -- that came up at that
8 point in time. But those comments are actually very
9 helpful to our position in this thing.

10 Just a few excerpts. Page 11 of those
11 comments. Quote, We can find no evidence that Congress
12 intended in 1934 a target corporation must strictly
13 cease its existence for all purposes in connection for a
14 Type A reorganization.

15 Now, counsel seems to have said that, "Oh, this
16 has always been known that you have to have that."
17 Well, that's interesting. It's not exactly what these
18 guys are saying. And I think that they're, you know,
19 not -- these aren't just comments out of the blue.
20 These are comments by well-respected group here.

21 The comments went on at page 12 to say, "In
22 1934 there was no uniformity regarding what was a merger
23 in one State versus another in 1934." So we say that
24 you could have a liquidation requirement in one and not
25 in the other? I mean, it was all over the place.

1 But the one that really caught my attention is
2 actually at page 16, Footnote 57. It says, "Therefore,
3 we do not see why the current cessation or liquidation
4 requirement should be considered well-established and
5 deep-rooted principle for a Type A reorganization." Not
6 quite exactly what FTB is arguing here.

7 Appellants clearly satisfy this first Anderson
8 factor. They justifiably relied on settled law that
9 said you look to see whether there was a state or United
10 States or territory or District of Columbia statute that
11 actually -- the merger statutes there. That's what --
12 that's what the regs say.

13 And this one is the one that really gets you,
14 if you think about. Revenue Ruling 2005-5 changed
15 settled law without any notice. So it came out --
16 unlike the subsequent amendments that we have to the
17 Treasury regs in 2003 and '06, there was a whole body of
18 comments and things like that in that with those
19 regulations, lots of notice. That's why it took so
20 long, frankly. It took until 2006 to get them
21 finalized.

22 So I think that the fact of the matter is even
23 without considering the subsequent amendments to the
24 Treasury regs and really the precedence that they have
25 over the revenue ruling here, this factor weighs

1 heavily, heavily in favor of invalidating the
2 retroactive of application of the revenue ruling.

3 The second Anderson factor is "The extent, if
4 any, to which the prior law or policy has been
5 implicitly approved by Congress as by legislative
6 reenactment of the pertinent Code provisions." Now, the
7 Treasury through its regulations, has generally since at
8 least 1955 interpreted a statutory merger or
9 consolidation to mean a merger or consolidation affected
10 pursuant to the corporation laws of the United States or
11 a state or territory or the District of Columbia. Since
12 '55. That's pretty settled law.

13 During the 65 years from 1934 to 2000, until
14 the time when the revenue ruling came out, Congress had
15 amended various provisions of Section 368 at least 17
16 times, but each time decided against changing the
17 definition of a Type A reorganization overriding the
18 Treasury's interpretation of a tape -- Type A
19 reorganization at the time.

20 Again, let's look at a couple of FTB's
21 exhibits. Provide -- which provide additional support
22 regarding the 1934 amendments where Congress added the
23 term "statutory" to the merger statutes.

24 Exhibit M, page 3, says, "The definition of a
25 reorganization has been restricted so that the

1 definition of will conform more closely to the general
2 requirements of corporate law." It goes to notice here.
3 That's notice.

4 Exhibit P, page 2, "In determining the tax
5 effects of a reorganization transaction, one has at the
6 a very outset to go to the statutory definition and to
7 ascertain whether the transaction is within the term as
8 they are defined." Notice again.

9 Exhibit P, pages 2 and 3. Quote, A definition
10 of this character must necessarily be specific in its
11 term, otherwise, taxpayers cannot be advised in advance
12 of the tax effects of their business transactions. And
13 unless they are so advised, they will in numerous
14 instances not go forward with adjustments, which are
15 necessary for the successful conduct of their business.

16 All of these comments here in FTB's own
17 exhibits go to providing prior notice. When you lay --
18 when you layer that on with the fact of failure of
19 Congress to amend 368(a)(1)(A) and keep it in place from
20 34 on, that's implicit approval of the definition under
21 the regs itself. And that implicit approval of the
22 then-existing law supports rejecting, one more time, the
23 retroactive application of the revenue ruling in this
24 appeal. The Appellants satisfy the second factor.

25 With respect to the third factor, Anderson

1 factor, that is where the retroactivity would advance or
2 frustrate the interest and equality of treatment among
3 similarly situated taxpayers. Taxpayers who engaged in
4 Type A reorganizations or statutory mergers after
5 Revenue Ruling 2000-5 was issued were on notice of the
6 new liquidation requirement set forth in that revenue
7 ruling and thus were able to structure their
8 transactions to meet that new requirement. However,
9 since the merger in our case here occurred approximately
10 seven months before the revenue ruling, Appellants were
11 not able to restructure anything. They're being treated
12 differently here. So the retroactive application of
13 Revenue Ruling 2000-5 would lead to an unequal --
14 unequal treatment between Appellants and other similarly
15 situated taxpayers. This Anderson factor also weighs
16 heavily against retroactive application.

17 And, finally, the last factor, Anderson factor,
18 whether according retroactive effect would produce an
19 inordinately harsh result. There's no question about
20 this one. Retroactive application of Revenue Ruling
21 2000-5 in this case produces an inordinately harsh
22 result because taxpayers were not -- Appellants were not
23 put on notice on the new liquidation requirement in the
24 revenue ruling and was thus prevented from structuring
25 the merger differently.

1 And again, putting aside the subsequent
2 amendments of the Treasury regs, this is all with -- not
3 even looking at what happened there, which you can't
4 square the revenue ruling retroactive treatment with
5 later changes to the Treasury regs. It would be an
6 abuse of discretion to apply the new liquidation
7 requirement retroactively without providing any prior
8 notice. So similar to the other three Anderson factors,
9 this factor weighs heavily in favor of not permitting
10 the retroactive application of the revenue ruling.

11 Now, counsel all talked about deference as
12 well. Well, first of all, you know, it really was
13 nothing more -- and we had some articles that we
14 attached to our opening brief. It was nothing more than
15 a litigating position for the IRS. It was in conflict
16 with the existing law, like I mentioned, in 1999. And
17 it was directly contrary to the subsequent amendments to
18 the Treasury reg. So this is -- now we're talking about
19 deference. Okay? You're going to give deference to
20 retroactive application of a revenue ruling where it's
21 completely at odds with the later or the subsequent
22 enactment of the -- or promulgation of the Treasury regs
23 with their effective dates there. That doesn't make any
24 sense to me.

25 And that last part, should it be given

1 deference? Well, you know, frankly, it has to yield to
2 the Treasury regulations, as I indicated before. 26 CFR
3 601.601(d)(2)(b)(v)(d). It has to yield. It can't be
4 given deference over the Treasury regs.

5 Okay. The final -- the final item that counsel
6 brought up was the continuity of shareholder interest
7 issue, and I would just point this -- your Honors to
8 four of the exhibits that we had attached to our -- or
9 four of our exhibits in this case, I'll put it that way.

10 The issue that counsel in their briefs had
11 pointed to was whether or not there was an additional \$3
12 billion -- \$3 billion in additional consideration for
13 the merger that -- that -- that really would cause this
14 percentage. It's 11 percent that counsel is referring
15 to here. There is no \$3 billion in additional
16 consideration for the merger, and their assertions are
17 really not -- not correct.

18 If you look at Appellants' Exhibit 24 -- and
19 that's the articles of merger filed on June 30, 1999,
20 with the Texas Secretary of State. If you read annex
21 section labeled "Merger Consideration," you won't find
22 that \$3 billion as being consideration for this merger.
23 The same thing happens in Appellants' Exhibit 26, which
24 is the sent Form 8-K filed July 15th, 1999. If you look
25 at page 2, item 2, and as well as Exhibit 99.1, page 5,

1 all part of that exhibit, they all talk in terms of
2 what's the merger consideration. You will not find that
3 \$3 billion number in there.

4 If you look at Appellants' Exhibit 27, the Avis
5 Rent-A-Car Form 8-K filed July 15th, 1999, and you look
6 at page 2, Item 2., and if you look at the agreement and
7 plan of merger, Exhibit 2.1, Section 1.3, under "Merger
8 Consideration," nowhere is the \$3 billion mentioned as
9 additional consideration.

10 And finally, Appellants' Exhibit 28, which is
11 the Avis Rent-A-Car Form 10-Q filed August 16th, 1999.
12 Note 4 under acquisition, paragraphs 3 and 6 speak in
13 terms of what was the consideration in this transaction.
14 That \$3 billion is not in there. So when you take that
15 out, that 11 percent changes, and that's not -- there's
16 no -- there's no issue with continuity of shareholder
17 interest in this case.

18 So in conclusion for the merger issue here,
19 under the plain language of 368(a)(1)(A) of the IRC and
20 the Treasury Regulation Section 1.368-2(b)(1), which
21 were in effect on the date of the AFLMC merger, the
22 merger qualified as a tax-free statutory merger under
23 368(a)(1)(A). The 2003 temporary regs and the 2006
24 final regs provide further support and compelling
25 evidence that the merger qualified as a tax-free

1 statutory merger under 368(a)(1)(A).

2 In particular -- and I know you've heard it
3 from me many times already -- the effective dates are
4 everything here. The prospective application of the new
5 liquidation requirement and the specific instructions to
6 taxpayers that for transactions occurring before
7 January 24, 2003, you're to look to the Treasury regs in
8 effect in our years, not look to Revenue Ruling 2000-5,
9 there was no liquidation requirement under the prior
10 regulations. That's why they made a change here. They
11 had to make something specific. It was a change in the
12 law. That is compelling evidence in favor of this being
13 tax-free.

14 The 2003 temporary regs and the 2006 final regs
15 take precedence over Revenue Ruling 2000-5. And if you
16 applied that revenue ruling retroactively, like FTB
17 would like to do, it would be directly contrary to the
18 regs which takes precedence over them. So how does that
19 work?

20 So the idea of applying the revenue ruling
21 retroactively under the Anderson factors, it just
22 doesn't fly. Everything about it points to not applying
23 it retroactively, and in particular, again, being
24 contrary to the Treasury regs.

25 So in all, the AFLMC merger was a tax-free

1 statutory merger under federal and California law, and
2 the FTB's position must be rejected on this basis as
3 well as because the NPAs are untimely. And the NPAs
4 must be reversed in their entirety. I welcome any
5 questions.

6 ALJ LONG: Thank you. I'm going to turn to my
7 panel members for any questions for either parties at
8 this time.

9 Judge Johnson, do you have any questions?

10 ALJ JOHNSON: No questions. Thank you.

11 ALJ LONG: Judge Kwee?

12 ALJ KWEE: I don't have any questions. Thank
13 you.

14 ALJ LONG: I do have a question for FTB.
15 Appellants spoke about the temporary Treasury
16 regulations and the final regulations and how they
17 perceive a conflict with the revenue ruling. What is
18 FTB's position?

19 MR. LAISNE: Well, for one thing, it's
20 important to keep in mind that regulations are by
21 default prospective, revenue rulings are retroactive by
22 default. And so when the regulations are referring back
23 to following the old regulations, the revenue ruling was
24 retroactively being applied for those regulations as
25 well.

1 In addition, regarding the Skidmore factors and
2 in relation to this basically, you know, there isn't a
3 case where there has been guidance from an agency where
4 that guidance was picked up by a regulation and then
5 that guidance was overturned or not given deference
6 by -- by a Skidmore analysis. We had looked into that
7 and we also gave an IDR to Appellants for that as well,
8 and that type of case doesn't exist.

9 ALJ LONG: Thank you. I believe that concludes
10 the hearing for today. I don't believe we have any last
11 questions, do we?

12 I see no other questions. So thank you for
13 attending the hearing today. This will conclude the
14 hearing. The panel will meet and decide the appeal
15 based on the briefings, the arguments presented, and the
16 exhibits admitted as evidence. We will send both
17 parties our written opinion within 100 days from today.

18 Again, thank you for your participation. The
19 case is submitted and the record is closed. And this
20 concludes the Office of Tax Appeals, Friday,
21 December 16th, 2022, hearing calendar. Thank you.

22 MR. VESELY: Thank you.

23 (Conclusion of the proceedings at 3:40 p.m.)

24 ---oOo---

REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)

COUNTY OF SACRAMENTO) ss.

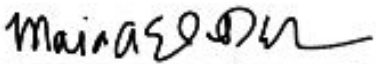
I, MARIA ESQUIVEL-PARKINSON, do hereby certify that I am a Certified Shorthand Reporter, and that at the times and places shown I recorded verbatim in shorthand writing all the proceedings in the following described action completely and correctly to the best of my ability:

CASE: IN THE MATTER OF THE APPEAL OF
MCGARVEY-CLARK REALTY, INC., 18083623
AVIS BUDGET GROUP, INC., 18083632
DATE: Thursday, December 16, 2022
LOCATION: OTA 400 R Street, Sacramento, CA 95811

I further certify that my said shorthand notes have been transcribed into typewriting, and that the foregoing pages 1 through 92 constitute an accurate and complete transcript of all my shorthand writing for the dates and matter specified.

I further certify that I have complied with CCP 237(a)(2) in that all personal juror identifying information has been redacted if applicable.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California on this 10th day of January, 2023.


Maria Esquivel-Parkinson
CSR No. 10621, RPR

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