OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18103936
C. PARKES	

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Patricia Verdugo, Attorney
Joseph A. Vinatieri, Attorney

For Respondent: David Hunter, Attorney

R. TAY, Administrative Law Judge: On August 23, 2023, the Office of Tax Appeals (OTA) issued an Opinion sustaining the action of respondent Franchise Tax Board (FTB) in issuing a proposed assessment of tax for the 2008 tax year. In the Opinion, OTA held appellant had not shown error in FTB's disallowance of flow-through partnership losses.

Appellant timely filed a petition for rehearing (petition) under Revenue and Taxation Code (R&TC) section 19048. OTA will grant a rehearing where one of the following grounds exists and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the appeal proceedings which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise that occurred during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered evidence, material to the appeal, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion;[1] (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law in the OTA appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6).)

[1] Although appellant provided new evidence with his petition, appellant is not arguing a rehearing is warranted based on newly discovered evidence.

Here, appellant argues grounds for a rehearing exist based on the following:

1. FTB did not produce of a copy of the Notice of Proposed Assessment (NPA); and
2. OTA erred in weighing the evidence supporting appellant's argument that Anderson Audio Visual, Inc. (AAV) functioned as appellant's incorporated pocketbook and in weighing the evidence of appellant's repayments of purported loans; and
3. OTA's Opinion is contrary to the law on the incorporated pocketbook theory and back-to-back loans.

Upon consideration of appellant's petition, OTA concludes appellant has not established a basis for rehearing. OTA addresses each of appellant's arguments in turn.

FTB did not produce a copy of the NPA.

Appellant argues that the lack of a copy of FTB's NPA in the record is grounds for a rehearing, although appellants do not specifically state which of the grounds they allege are implicated here. Rather, this argument is a new argument appellants raise for the first time in their petition. Appellants' attempt to bring forth a new argument requiring the submission of additional facts and evidence through a PFR is improper. Moreover, there is no provision that would permit a new hearing on a new legal theory appellants failed to raise and provide prior to the issuance of the Opinion.

Notwithstanding, OTA disagrees with appellants' contention that FTB's NPA was untimely. FTB's Notice of Action and appellants' protest letter both indicate FTB issued the NPA in January 2014, and FTB provided a statute of limitations waiver in response to appellants' petition that shows the parties agreed to extend the time for FTB to issue a proposed assessment to May 26, 2014. Thus, the record shows appellants' contention is without merit.

OTA erred in weighing the evidence such that there was insufficient evidence to justify the Opinion.

To find that there is insufficient evidence to justify the Opinion, OTA must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, OTA clearly should have reached a different Opinion. (Code Civ. Proc., § 657; *Appeals of Swat-Fame Inc., et al.*, 2020-OTA-045P.) OTA considers the evidence in the light most favorable to the prevailing party (here, FTB). (*Appeals of Swat-Fame Inc., et al., supra*.)

First, appellant contends OTA erred in weighing the evidence supporting appellant's argument that AAV functioned as appellant's incorporated pocketbook because OTA concluded that AAV was not in the practice of habitually paying appellant's personal expenses. In his petition, appellant argues OTA "committed clear error" by not giving proper weight to "the contemporaneous documentary books and records" provided to FTB and to the testimony of Mr. Matranga at the hearing. Specifically, Mr. Matranga testified to appellant's line of credit and the alleged ability of AAV to make payments on behalf of appellant. Appellant also points to AAV's disbursements for payments of appellant's personal expenses and "personal loans to entities in which he invested, including the two partnerships at issue here."

AAV's books and records indicate a number of transactions showing that AAV disbursed funds to appellant to allegedly pay appellant's personal expenses. However, of all the disbursements, appellant identifies only the taxing authorities as payees on appellant's behalf (two payments to each of the taxing authorities in 2008 and three payments in 2009.) AAV's disbursements to appellant do not demonstrate that the other payments were for appellant's personal expenses. Appellant doesn't identify the payee and the expense; rather, appellant's list of disbursements, other than those paid to tax authorities, appears to be distributions directly to appellant. Moreover, Mr. Matranga testified at the hearing that AAV made payments "on behalf of and for the benefit of [appellant]." However, Mr. Matranga does not point to specific transactions in the record, and appellant's petition includes records of disbursements *to appellant* that do not indicate that AAV made payments for appellant's personal expenses or personal loans *to other entities*.

Additionally, although AAV may have made direct payments to the taxing authorities for appellant's estimated tax payments, such payments do not on their own demonstrate AAV was in the practice of habitually paying appellant's personal expenses. (See *Broz v. Commissioner* (2011) 137 T.C. 46, affd., 727 F.3d 621 (6th Cir. 2013) [taxpayer's wholly-owned S corporation made tax payments for taxpayer's federal tax liability, but the Tax Court found the S corporation did not habitually pay taxpayer's expenses, and so, was not an incorporated pocketbook].) Based on the evidence provided with the petition and during the appeal, it is not clear that OTA should have reached a different conclusion on the incorporated pocketbook issue.

Second, appellant also contends that OTA erred in weighing the evidence of appellant's repayments of purported loans. Appellant executed his purported repayment in 2016 through

adjusted journal entries prior to the sale, and OTA found such purported repayments were insufficient to demonstrate appellant intended repayment at the time the purported loans were made. OTA's analysis utilized the *Alterman* factors to conclude appellant had not shown a bona fide loan existed between appellant and AAV. (See *Alterman Foods Inc. v. U.S.* (5th Cir. 1974) 505 F.2d 873.) Specifically, OTA concluded that, while appellant's purported repayment in 2016 should be considered, it does not outweigh the factors indicating AAV did not make bona fide loans to appellant in 2008 and 2009.

In appellant's petition, appellant reiterates the argument he made during the appeal. Appellant pointedly argues OTA discounts the purported repayment of amounts AAV distributed to appellant. However, OTA heard and considered this argument during the appeal, and OTA found the adjusted journal entries in 2016 do not demonstrate AAV made bona fide loans to appellant in 2008. Appellant's petition does not demonstrate OTA's Opinion was based on insufficient evidence given the factors against a bona fide loan. Thus, this argument, which was considered and rejected in the Opinion, does not constitute grounds for a rehearing. (See *Appeal of Graham and Smith*, 2018-OTA-154P.)

Thus, based on the foregoing, appellant has failed to show OTA clearly should have reached a different Opinion.

OTA's Opinion is contrary to the law on the incorporated pocketbook theory and back-to-back loans.

The contrary to law standard of review involves reviewing the Opinion for consistency with the law. (Cal. Code Regs., tit. 18, § 30604(b).) To find that the Opinion is against (or contrary to) law, we must determine whether the Opinion is "unsupported by any substantial evidence." (*Appeal of Graham and Smith, supra.*, citing *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906 (*Sanchez-Corea*).) This requires a review of the Opinion to indulge "in all legitimate and reasonable inferences" to uphold the Opinion. (*Sanchez-Corea, supra*, 38 Cal.3d at p. 907.) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Appeal of NASSCO Holdings, Inc*. (2010-SBE-001) 2010 WL 5626976.)

Appellant argues OTA's Opinion is contrary to law because the Opinion ignored the analysis and regulatory history of Treasury Regulation 1.1366-2. Appellant argues the incorporated pocketbook theory and back-to-back loans are "blessed" in the Preamble to the

Treasury Regulation, and OTA's Opinion did not "take into account the specific language in the Regulation and the extensive Regulatory history and analyze same in this case."

OTA disagrees. OTA's Opinion does not disregard the regulatory history or deny that a taxpayer may use a corporation as the taxpayer's incorporated pocketbook. OTA's analysis concluded appellant did not show AAV was an incorporated pocketbook as interpreted consistently by the courts. (See *Meruelo v. Commissioner*, T.C. Memo. 2018-16, affd. (11th Cir. 2019) 923 F.3d 938; see also *Messina v. Commissioner*, T.C. Memo. 2017-213.) Notably, the example cited in appellant's Reply Brief dated May 11, 2023 states bona fide indebtedness "is determined under general Federal tax principles and depends upon all of the facts and circumstances." (Treas. Reg. § 1.1366-2(a)(2)(i).) As stated above and in the Opinion, the facts and circumstances here show AAV was not appellant's incorporated pocketbook.

Lastly, appellant argues OTA shows bias in its reliance on *Bergersen v. Commissioner*, T.C. Memo. 1995-424. In *Bergersen*, the Tax Court analyzed whether bona fide loans existed, and OTA's Opinion similarly analyzed whether disbursements from AAV to appellant constituted bona fide loans. Again, the question of whether a bona fide loan exists depends on all the facts and circumstances, and OTA determined that, based on *all* the facts and circumstances, appellant had not shown bona fide loans. The Tax Court in *Bergersen* considered the fact that the taxpayer made interest payments which had significant tax benefits including "current interest payment deductions and future tax-free distributions from their corporation." (*Ibid.*) Thus, the court concluded, the weight afforded these interest payments as a factor in determining whether a bona fide loan existed was undercut by those tax benefits. Similarly, OTA's Opinion found the weight afforded to appellant's purported repayment, as one factor of many, was undercut by the significant tax benefits to appellant. As such, appellant has not shown OTA's Opinion cannot be valid according to the law.

Accordingly, OTA finds appellant is not entitled to a rehearing, and as such, denies appellant's petition.

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Richard Tay
Administrative Law Judge

We concur:

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Asaf Kletter
Administrative Law Judge

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Amanda Vassigh
Administrative Law Judge

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