

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19095263
M. GELMAN AND)
R. GELMAN)
_____)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellants: M. Gelman
R. Gelman
For Respondent: Paul L. Kim, Attorney

V. LONG, Administrative Law Judge: On February 21, 2024, the Office of Tax Appeals (OTA) issued an Opinion sustaining the action of respondent Franchise Tax Board (FTB) proposing an assessment of tax of \$424,251, and applicable interest, for the 2011 tax year.

In the Opinion, OTA held that M. Gelman and R. Gelman (appellants) had not demonstrated error in FTB’s disallowance of appellants’ flow-through capital losses from Enhanced Affordable Development Company, LLC (EADC) resulting from EADC’s disposition of its interest in South River Road Associates (South River). Appellants timely filed a petition for rehearing (petition) under Revenue and Taxation Code (R&TC) section 19048. Upon consideration of appellants’ petition, OTA concludes they have not established a basis for rehearing.

OTA may grant a rehearing where one of the following grounds is met 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, occurring 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 party could not have reasonably discovered and

provided prior to issuance of the Opinion; (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); *Appeal of Do*, 2018-OTA-002P.)

Appellants' petition contends that there was an irregularity in the proceedings that prevented the fair consideration of the appeal, that there was insufficient evidence to justify the written Opinion; that the Opinion is contrary to law; and that an error in law that occurred during the appeals hearing or proceeding.

1. Irregularity in the Proceedings

An irregularity in the proceedings warranting a rehearing would generally include any departure by OTA from the due and orderly method of conducting appeal proceedings by which the substantial rights of a party (here, appellants) have been materially affected. (*Appeal of Graham and Smith*, 2018-OTA-154P; see also *Jacoby v. Feldman* (1978) 81 Cal.App.3d 432, 446.) Courts have found that an irregularity in the proceeding is “any act that: (1) violates the right of a party to a fair [hearing] and (2) which a party ‘cannot fully present by exceptions taken during the progress of the [hearing] . . .’ [citation].” (*Montoya v. Barragan* (2013) 220 Cal.App.4th 1215, 1230.) Included in the classification of irregularities is an “overt act of the [tribunal] . . . or adverse party, violative of the right to a fair and impartial [hearing]. . . .” (*Russell v. Dopp* (1995) 36 Cal.App.4th 765, 780.) Examples of irregularities include the absence of a [panel member] from the [hearing room] during a portion of the [hearing], and [panel member] threatening to prejudge testimony unless a witness is withdrawn. (See *O’Callaghan v. Bode* (1890) 84 Cal. 489, 495; see also *Pratt v. Pratt* (1903) 141 Cal. 247, 252.)

In an appeal before OTA, the grounds for a rehearing pursuant to California Code of Regulations, title 18, (Regulation) section 30604 can exist both where an oral hearing is held and where an appeal is submitted for an Opinion based upon the written record.

Appellants contend that an irregularity in the proceedings took place when OTA requested additional briefing from the parties after an oral hearing was held in the appeal. Appellants cite to Regulation section 30421(c) for the proposition that OTA may not request additional briefing after the date of hearing. However, appellants' citation to Regulation section 30421(c) is misplaced. Regulation section 30421(c) discusses some actions, pertaining to motions that a Panel Member may take prior to or at an oral hearing. While the record is generally closed at the conclusion of an oral hearing pursuant to Regulation section 30412, a

Panel may reopen the record pursuant to Regulation section 30213 and request additional briefing pursuant to Regulation section 30304. Accordingly, OTA's decision to reopen the record did not constitute a departure from the due and orderly method of conducting appeal proceedings. In addition, OTA's order requesting additional briefing gave each party 30 days to submit their additional briefs and allowed appellants 30 days to respond to FTB's additional brief. Appellants were provided with the opportunity to file an additional brief and to respond to FTB's additional brief, and they in fact filed such briefs. Accordingly, appellants have not demonstrated that OTA's decision to request additional briefing was unfair or violative of appellants' rights.

2. Insufficient Evidence to Justify the Opinion or Opinion is Contrary to Law

Regulation sections 30604(a)(4) and (a)(5) provide that a rehearing may be granted on two distinct grounds: - insufficiency of the evidence to justify the opinion, or the opinion is contrary to law. (*Bray v. Rosen* (1959) 167 Cal.App.2d 680, 683.) To find that there is an insufficiency of evidence to justify the Opinion, OTA must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, the panel clearly should have reached a different opinion. (Code Civ. Proc. § 657; *Bray v. Rosen, supra*, 167 Cal.App.2d at p. 684.) To find that the Opinion is against (or contrary to) law, OTA must determine whether the opinion is “unsupported by any substantial evidence.” (*Appeal of Graham and Smith*, 2018-OTA-154P, 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.) In OTA's review, it considers the evidence in the light most favorable to the prevailing party (here, FTB). (*Sanchez-Corea, supra*, 38 Cal.3d at p. 907.)

Appellants assert that the “preponderance of the evidence” standard applied by the panel as set forth in Regulation section 30219¹ is not the correct legal standard, but that even if it were, appellants contend that they have met that burden, and, alternatively, the standard was

¹ OTA acknowledges that the Opinion erroneously cites to subdivision (c) of Regulation 30219 instead of subdivision (b). Regulation 30219 was renumbered effective June 30, 2023, which resulted in this error. Accordingly, OTA will make an errata change to the Opinion correcting the citation pursuant to Regulation 30506(b).

incorrectly applied. Appellants assert that the proper test is found in the California Civil Code, which provides that in civil penalty matters where the taxpayer's knowledge or intention is critical to the imposition of the penalty, the standard is "clear and convincing evidence." Appellants contend that the burden of demonstrating clear and convincing evidence rests with FTB. Appellants point to Internal Revenue Code (IRC) section 7491, which shifts the burden of proof in tax court proceedings to the IRS if a taxpayer introduces sufficient credible evidence in its favor. Appellants contend that California Civil Code section 1636, which requires contracts to be interpreted so as to give effect to mutual intention of the parties, prevents OTA from setting aside appellants' contract.

Regulation section 30219 provides that, except as otherwise provided by law, the burden of proof is on the appellants as to all issues of fact and that, except in cases involving fraud or intent to evade tax, the burden of proof requires proof by a preponderance of the evidence. Appellants asserts that a higher legal standard, that of clear and convincing evidence, should apply. In addition, appellants argue that the burden of proof should shift to FTB pursuant to IRC section 7491; however, California does not conform to this section of the IRC.

Appellants contend they proved by a preponderance of the evidence that the effective date of the Partnership Agreement was July 1, 2010, although it is undisputed that the Agreement was executed after this date. Appellants contend they met their burden by providing: the Agreement dated July 1, 2010; oral testimony and email communications; and a letter from the City of San Luis Obispo acknowledging the effective date of the agreement as of July 1, 2010.

To find that the Opinion is against or contrary to law, OTA must determine whether the Opinion is "unsupported by any substantial evidence." (*Appeal of Graham and Smith, supra*, citing *Sanchez-Corea, supra*.) A review of the Opinion shows that it evaluated evidence, including: the Partnership Agreement dated July 1, 2010; the letter from the City of San Luis Obispo acknowledging this date; and the August 25, 2010 Letter of Intent (LOI) setting forth the terms of a future partnership agreement. The Opinion held that appellants had not demonstrated that the Partnership Agreement had an effective date of July 1, 2010, because the August 25, 2010 LOI contemplated a future agreement under certain terms, which were the same terms entered into by the Partnership Agreement. Accordingly, the Opinion held that the evidence showed that the LOI negotiated the terms of the Partnership Agreement, and accordingly, the Partnership Agreement could not be found to predate the LOI.

Appellants additionally contend that California Civil Code section 1636 prevents OTA from setting aside appellants' contract. Civil Code section 1636 states that a "contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." In its review, the Opinion evaluated whether appellants demonstrated that the Agreement reduced to writing a prior oral understanding between the parties. As discussed above, the Opinion reviewed the evidence in the appeal and determined that appellants did not demonstrate that the parties had a prior oral understanding before the August 25, 2010 LOI. Accordingly, appellants have not established that the Opinion was unsupported by substantial evidence.

3. Error in Law

A rehearing may be granted where an error in law occurred during the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(6).) A procedural "error in law" means an error in the OTA appeals hearing or proceeding, other than a legal error in the Opinion. (Cal. Code Regs., tit. 18, § 30604(b).) For example, the erroneous admission of evidence subject to attorney-client privilege, over the objection of the party petitioning for a rehearing, might be a basis for a rehearing due to an error in law if the error was material. (*Ibid.*)

Appellants assert that there was insufficient evidence to justify the Opinion because documents submitted by FTB lacked foundation and therefore should not have been admitted as evidence. Appellants also request that OTA stipulate to reversing the Opinion if a state court should determine that the LOI is inadmissible as a matter of law.

The California Evidence Code does not apply to proceedings before OTA, but OTA may use the California Evidence Code in evaluating the weight to give evidence presented in a proceeding. (Cal. Code Regs., tit. 18, § 30214(f).) Any party may provide argument on the relevant weight that should be given to an item of evidence. (*Ibid.*) While appellants are correct in that OTA may apply the California Evidence Code to weigh evidence, appellants had ample opportunity during briefing and the oral hearing to provide argument on the relevant weight that should be given to the evidence; that would have been the appropriate time to raise concerns regarding the foundation of documents presented by FTB and allow FTB the opportunity to respond. Given that appellants failed to raise such arguments in a timely manner, appellants have not demonstrated that an error in law occurred. To the extent appellants request that OTA

stipulate to reversing the Opinion in the event that the LOI is determined inadmissible by a court, OTA declines to do so.

Signed by:
Veronica I. Long
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Veronica I. Long
Administrative Law Judge

We concur:

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Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

Signed by:
Seth Elsom
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Seth Elsom
Hearing Officer

Date Issued: 11/6/2024