

ISSUES

1. Whether FTB's proposed assessments for the 2000 and 2001 tax years are valid.
2. If valid, whether appellants have shown error in FTB's proposed assessments for the 2000 and 2001 tax years, disallowing appellants' claimed Internal Revenue Code (IRC) section 988 losses in the amounts of \$3,002,413 and \$251,132, respectively.²

FACTUAL FINDINGS

Appellant-Powlen's Creation of Woodleaf Trust and Woodleaf Trust's California Tax Filings for the 2000 and 2001 Tax Years

1. Appellant-Powlen established Woodleaf Trust in 1999. Appellant-Powlen was the sole grantor and sole trustee of Woodleaf Trust throughout the 1999, 2000, and 2001 tax years, and the parties agree that Woodleaf Trust was a revocable inter-vivos (grantor) trust which was treated as a disregarded entity for federal and California income tax purposes during these tax years.
2. Woodleaf Trust filed California Fiduciary Income Tax Returns (Forms 541) for the 2000 and 2001 tax years. The 2000 and 2001 Forms 541 each contain a statement explaining: Woodleaf Trust was a grantor trust; all income was taxable to the grantor pursuant to R&TC section 17731; and a statement of income, deductions, and credits was attached.
3. For the 2000 tax year, the statement attached to the Form 541 identified appellant-Powlen as the grantor of the trust, and as relevant to this appeal, reported:

² The Minutes and Orders (M&Os) for this severed appeal previously identified a single issue for resolution: whether appellants have shown error in FTB's proposed assessments of additional tax for appellants' 2000 and 2001 tax years. Appellants objected to this issue statement contending that it is inadequate, and an over-simplification of the issues set for disposition. To better address the parties' briefing, OTA has added issue 1 as noted above and has retained (with slight modifications) the issue statement presented in the M&Os as issue 2. Appellants contend that the "issues before OTA at this time are not whether the FTB erred in its issuance of these [Notices of Proposed Assessment (NPAs)] or its evaluation of the protest. . . . The question before OTA . . . is whether the evidence is sufficient for OTA to affirm [] FTB's denial of [a]ppellants' protest of the two NPAs and sustain in full the proposed assessments of additional income tax for 2000 and 2001." OTA declines to adopt appellants' framing of the issue(s); however, OTA will address whether FTB's proposed assessments of additional tax should be sustained, including appellants' arguments regarding the applicable burden of proof in this appeal and whether that burden of proof has been met, in the discussion of the issues below.

- a. Passive income from partnerships of \$3,160,478; nonpassive (loss) from partnerships of (\$3,785); and
 - b. Ordinary loss from IRC section 988 transactions of (\$3,002,414).³ An accompanying footnote reported a “Date” of December 28, 2000, “Proceeds” of \$26,927, “Cost” of \$3,029,340, and a resulting “Loss” of (\$3,002,413) for the IRC section 988 transaction.⁴
4. For the 2001 tax year, the statement attached to the Form 541 again identified appellant-Powlen as the grantor of the trust, and as relevant to this appeal, reported:
- a. Passive income from partnerships of \$345,283; nonpassive (loss) from partnerships of (\$31,981); and
 - b. Ordinary loss from IRC section 988 transactions of (\$251,132). An accompanying footnote reported a “Date” of December 20, 2001, “Proceeds” of \$2,183, “Cost” of \$253,316, and a resulting “Loss” of (\$251,132) for the IRC section 988 transaction.
5. During the 1999, 2000, and 2001 tax years, Woodleaf Trust engaged in investment activities both directly and indirectly as a member of certain New York limited liability companies, which were taxed as partnerships (the New York LLCs).⁵ Some or all of the income and losses reflected in factual findings 3a. and 4a., above (and 7a. and 8a., below), related to passthrough income and losses from the New York LLCs.

³ IRC section 988 transactions are those involving the disposition of nonfunctional currency (i.e., foreign currency) or certain transactions which are denominated or determined in terms of nonfunctional currency.

⁴ There is a \$1 discrepancy between the loss reported per the statement and the loss reported per the footnote. This difference is not explained but is immaterial and may be due to rounding.

⁵ The identity of each of the New York LLCs in which Woodleaf Trust held a membership interest in, and received pass-through income and/or losses from, during the 2000 or 2001 tax years is not in the record. These LLCs may potentially include Azuma Trading Ventures, LLC; Shomrim, LLC; Shakti Advisors, LLC; New Vista, LLC; New Vista Investments, LLC; New Horizon Advisors, LLC; New Horizon Investments, LLC; Mazal Strategic Funds, LLC; Mazal Strategic Trading, LLC; Mazal Trading, LLC; Sentinel Investments, LLC; Sentinel Ventures, LLC; K2 Trading Ventures, LLC; and/or Everest Strategies, LLC. Appellant-Powlen describes these listed LLCs in his affidavit as “[t]he New York [LLCs] selected for examination by the IRS and New York for 1999, 2000, and 2001.”

Appellants' California Tax Filings for the 2000 and 2001 Tax Years

6. Appellants filed joint California Resident Income Tax Returns (Forms 540) for the 2000 and 2001 tax years.
7. Consistent with Woodleaf Trust's reporting above, appellants' 2000 Form 540 reported the following items from Woodleaf Trust:
 - a. Passive income of \$3,160,478; Ordinary (loss) of (\$3,785); and
 - b. Ordinary loss from IRC section 988 transactions of (\$3,002,413).
8. Also consistent with Woodleaf Trust's reporting above, appellants' 2001 Form 540 reported the following items from Woodleaf Trust:
 - a. Passive income of \$345,283; Ordinary loss of (\$31,981); and
 - b. Ordinary loss from IRC section 988 transactions of (\$251,132).

FTB's Audit

9. In early 2004, FTB opened an audit examination of appellants' 1999, 2000 and 2001 tax years.
10. From February 18, 2004, through August 18, 2004, FTB sent five information document requests (IDRs) to appellants for the 2000 and 2001 tax years, culminating in a formal demand (Demand) sent to appellants on April 7, 2005. The IDRs and Demand requested source documentation and information relating to appellants' claimed IRC section 988 losses, which were described in the Demand as: "a. Sale of Euros sold 12/28/00 for \$26,927 with basis of \$3,029,340 for a loss of \$(3,002,413)[; and] b. Ordinary Loss from Section 988 Transactions on Statement 3, CA Form 541 for 2001 in the amount of \$(251,132)."⁶
11. Appellants did not respond to FTB's IDRs or its Demand.
12. Consequently, on July 26, 2005, FTB issued Notices of Proposed Assessment (NPAs) to appellants disallowing appellants' claimed IRC section 988 losses for the 2000 and 2001

⁶ The IDRs and Demand also requested numerous other explanations, information, and documents, including tax returns for various partnerships/LLCs that appellants, Woodleaf Trust, or other related entities may have participated in during 2000 and/or 2001.

tax years.⁷ The NPAs proposed additional tax of \$282,576 and \$26,033 for the 2000 and 2001 tax years, respectively, plus penalties⁸ and interest.

13. The 2000 and 2001 NPAs each stated:

We are issuing this Notice of Proposed Assessment because you did not respond to our inquiries for requested documents dated February 18, 2004, March 25, 2004, April 30, 2004, June 25, 2004, August 18, 2004 and the demand [] dated April 7, 2005. We requested information from you to substantiate the flow-through losses reported on your [] personal income tax return from Woodleaf Trust. We do not have a record of receiving a reply to the requests. If you file a valid protest of this proposed assessment by the protest date and include the requested information in the protest, we may revise or withdraw the proposed assessment.⁹ [All caps omitted from original.]

14. During the audit, FTB also received information and documentation from the IRS and the New York State Department of Taxation and Finance (New York). The information and documentation received by FTB from the IRS and New York is listed and described in FTB's Audit Issue Paper dated May 3, 2005 (Audit Paper) but has not been provided as evidence in this appeal.

15. As relevant to this appeal, the Audit Paper also noted that "the auditor requested the [Individual Master File] from [FTB's] Disclosure Department and found that [appellants were] under Investigation by the IRS and [New York] for [t]ax [y]ear 1999." The Audit Paper further noted that the IRS was auditing appellant-Powlen, for his reported Son of

⁷ The NPAs did not make any adjustments to appellants' reported passthrough income and/or losses from the New York LLCs in which Woodleaf Trust was a member in during the 2000 and 2001 tax years.

⁸ The NPAs proposed demand penalties pursuant to R&TC section 19133, noneconomic substance transaction penalties pursuant to R&TC section 19774, and listed transactions interest-based penalties pursuant to R&TC section 19777. As noted below, FTB conceded these penalties in its Notices of Action for the 2000 and 2001 tax years, and these penalties are not at issue in this appeal.

⁹ FTB also issued an NPA to appellants for the 1999 tax year on October 14, 2004. The 1999 NPA disallowed appellants' claimed loss on the sale of Euros from Woodleaf Trust in the amount of \$4,966,031 and claimed losses on options from Woodleaf Trust in the amounts of \$3,006,080, \$4,000,000, and \$1,108,455. The NPA indicated that it was being issued because the statute of limitations was about to expire and similarly stated that FTB had requested information to substantiate the flow-through losses reported from Woodleaf Trust but did not receive a reply. Appellants failed to timely protest the 1999 NPA and it became final. (See R&TC, §§ 19041(a), 19042.) On appeal, appellants ask OTA to address/consider the 1999 NPA. OTA will address this request in the discussion below.

BOSS transactions¹⁰ and stated that “[t]he Transactions are being disallowed, however, there [h]as been no NPA issued by the IRS, to date.” Under the “Facts” section, the Audit Paper stated that FTB “[c]ontacted [appellants] on numerous occasions to initiate the audit . . . [appellants] did not respond to any of the IDR’s [sic] or Demand []. Based on the lack of response [appellants] will be assessed on the unsubstantiated items.” Under the “Analysis” section, the Audit Paper stated the following regarding the reasons for FTB’s issuance of the NPAs:

For [t]ax [y]ear[s] 2000 and 2001, the [t]axpayer was notified on February 18, 2004, March 25, 2004, April 30, 2004, June 25, 2004, August 18, 2004 and April 7, 2005 to provide substantiation to support the flow-thru losses reported on the 2000 and 2001 Personal Income Tax Return[s] from Woodleaf Trust.

The [t]axpayer has elected not to respond to the request for documents, therefore his flow through losses from the [IRC section] 988 [t]ransactions in the Woodleaf Trust in the amount of \$3,002,413 are being disallowed for [t]ax [y]ear 2000 and \$251,132 for [t]ax [y]ear 2001.

Income tax deductions are a matter of legislative grace and the burden is on the [t]axpayer to show by competent evidence that he is entitled to any deduction claimed, *Deputy v. du Pont*, 308 U.S. 488 (1940); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934). [Underlining omitted.]

Appellant-Powlen’s Protest of the 2000 and 2001 NPAs

16. Appellant-Powlen timely protested the 2000 and 2001 NPAs, disputing the proposed additional tax and penalties. In his protest letter, appellant-Powlen provided the following explanation for the claimed IRC section 988 losses:

In the spring of 1999, as part of his investment strategy for Woodleaf [Trust], [appellant-Powlen], in his capacity as trustee, acquired an interest in an investment partnership formed for the purpose of pooling funds to engage in certain foreign currency transactions, including the purchase and sale of Euros, then a new currency in the world market. Woodleaf [Trust] entered into a series of transactions involving the purchase of a Purchased Call Option for \$5 million and an obligation under a Sold Call Option of \$5 million. The Purchased Call Option was contributed to a partnership, which partnership engaged in foreign currency transactions, primarily involving Euros. In exchange for its contribution to the partnership,

¹⁰ Son of BOSS is a type of tax shelter designed and promoted by tax advisors in the early 1990s to generate losses which could be used to offset, and thereby reduce or eliminate, other income or gains from the sale of appreciated assets. Its informal name comes from the name of an earlier tax shelter, “BOSS” which is short for “Bond and Option Sales Strategy.”

Woodleaf [Trust] received an interest in the partnership and the partnership assumed Woodleaf[] [Trust's] obligation under the Sold Call Option. In late 1999, after disappointing results caused primarily by the weakness of the Euro at that [t]ime. Woodleaf [Trust] withdrew from the partnership and received a distribution of approximately \$50,000.00 in Euro currency in exchange for its partnership interest. In 2000, Woodleaf [Trust] sold some, but not all, of the distributed Euros and computed a loss with reference to its original basis in the partnership interest (\$5 million). In 2001, Woodleaf [Trust] again sold some, but not all, of the distributed Euros and computed a loss with reference to its original basis in the partnership interest (\$5 million). In addition to the IRC [section] 988 sales transactions reflected on the 2000 and 2001 tax returns, [appellants] reported appropriately the income, expenses, gains and losses from approximately ten other investment vehicles held in the name of Woodleaf Trust.

17. Appellant-Powlen's protest letter also indicated that the transactions at issue in the protest were "the subject of federal proceedings" and that the dispute with the IRS had (at the time the protest was filed) been placed on hold by agreement of the parties pending the outcome of federal litigation with the IRS in a "representative 'test' case" identified as *Jade Trading, LLC v. U.S.* (Fed.Cl. 2007) 80 Fed.Cl. 11 (*Jade Trading*). The protest letter requested that the FTB protest "be placed on hold in California as it will be economically onerous for [appellants] to respond to both taxing authorities simultaneously." FTB complied with appellant-Powlen's request in the protest letter and placed the protest on hold. In 2019, FTB determined that the federal matters had been concluded and reinstated the protest.¹¹
18. On March 2, 2021, FTB issued a preliminary protest determination letter (Preliminary Determination Letter). The Preliminary Determination Letter noted that FTB's determinations at audit must be upheld unless the taxpayer rebuts them with objective, uncontradicted and credible evidence as to the issue in dispute citing to *Appeal of Seltzer*, (80-SBE-154) 1982 WL 11930 and *Todd v. McColgan* (1949) 89 Cal.App.2d 509. FTB then concluded that appellant-Powlen had not provided credible evidence to support his claim that FTB erred by disallowing his 2000 and 2001 claimed IRC section 988 losses from Woodleaf Trust, noting in part:

¹¹ The Court of Federal Claims issued its decision in the identified "test" case, *Jade Trading*, in 2007. *Jade Trading* was subsequently affirmed in part and reversed in part in 2010 in *Jade Trading, LLC v. U.S.* (Fed. Cir. 2010) 598 F.3d 1372.

[Appellant-Powlen] has not provided copies of the options contracts or purchase agreements that gave rise to the losses. He has not submitted copies of bank records or brokerage statements for the periods at issue relating to the accounts where the investment strategy transactions occurred.....These and several other relevant documents were requested from [appellant-Powlen] several times, but were never provided. The Woodleaf Trust 2000 and 2001 currency transaction losses were properly disallowed because [appellant-Powlen] has not met his burden of proof and provided competent evidence that he is entitled to the deductions.

Next, the Preliminary Determination Letter noted that the transactions appellant-Powlen engaged in (or similar transactions) were litigated in federal court and found to lack economic substance in *K2 Trading Ventures, LLC v. U.S.* (Fed. Cl. 2011) 101 Fed. Cl. 365 (*K2 Trading*) and *Jade Trading, supra*, 80 Fed.Cl. 11. The Preliminary Determination Letter then analyzed the transactions and appellant-Powlen's/Woodleaf Trusts' asserted business purpose for engaging in the transactions as described in appellant-Powlen's protest letter, and concluded the transactions lacked both a valid business purpose other than tax avoidance and economic substance.¹²

19. In the May 26, 2021 final protest determination letter (Final Determination Letter), FTB stated that after considering the information and additional documentation provided during the protest hearing, the protest hearing officer's preliminary determination as explained in the earlier determination letters remained unchanged. It further stated:

No legal authority has been offered to support [appellant-Powlen's] argument that disallowing the flow-through loss deductions from the 2000 and 2001 Woodleaf Trust transactions requires that the gains from the same transactions be disregarded. [Appellant-Powlen] failed to establish that his flow-through ordinary losses from the IRC section 988 transactions from the Woodleaf Trust claimed in the 2000 and 2001 tax year[s] were incurred and deductible under any provision of the [IRC], including, but not limited to IRC sections 162 and 165.

20. FTB subsequently issued Notices of Action (NOAs) for the 2000 and 2001 tax years conceding the penalties but affirming the proposed additional tax per the NPAs, plus

¹² FTB cites numerous case authorities for its conclusions including, but not limited to: *Coltec Indus., Inc. v. U.S.* (Fed. Cir. 2006) 454 F.3d 1340; *Continental Oil Co. v. H.C. Jones* (10th Cir. 1940) 113 F.2d 557; *Casebeer v. Commissioner* (9th Cir. 1990) 909 F.2d 1360; *Appeal of Alyn*, (2009-SBE-001) 2009 WL 2340393; *Gilman v. Commissioner* (2nd Cir. 1991) 933 F.2d 143; *Knetsch v. U.S.* (1960) 364, U.S. 361; etc.

applicable interest. The NOAs stated the additional taxes per the NPAs were sustained in full as explained in the March 2, 2021, and May 26, 2021 determination letters.¹³

Appellants' Appeal

21. This timely appeal of the 2000 and 2001 NOAs followed.
22. On appeal, appellant-Powlen provided an affidavit signed under penalty of perjury dated December 28, 2022. In the affidavit, appellant-Powlen discusses: the filing of appellants' California Form 540s; the establishment of Woodleaf Trust; Woodleaf Trust's filing of its California Form 541s; Woodleaf Trusts' investment activities including its membership interests in the New York LLCs; the IRS's and New York's audits of the New York LLCs, Woodleaf Trust, and appellants; the New Yorks LLCs' existence as independent entities separate from their members, with each members' distributive share of reportable LLC items reported to the member on a Schedule K-1; appellant-Powlen's belief that the IRS notified FTB in 2003 that it had commenced examination of, and proposed deficiencies for, appellants' 1999, 2000, and 2001 returns relating to Woodleaf Trust's involvement as a member in the New York LLCs; FTB's audit examination of appellants' 1999, 2000, and 2001 tax returns including its issuance of IDRs; appellant-Powlen's assertion that these IDRs "requested the underlying business records and information and documentation relating to investment activities of [the New York LLCs] and their income tax reporting."¹⁴
23. On appeal, appellants provide IRS account transcripts dated August 10, 2020, for appellants' 1999, 2000 and 2001 tax years. For 1999, the account transcript indicates that the IRS has not finalized an assessment for appellants' 1999 tax year. For 2000, the account transcript indicates "[a]dditional tax assessed by examination" of \$417 on

¹³ The NOAs also reference a March 17, 2021 determination letter. The March 17, 2021 determination letter relates solely to appellant-Goldcamp's request for innocent spouse relief which will be decided by OTA in a separate Opinion.

¹⁴ In response to this affidavit, FTB submitted questions for appellant-Powlen on February 2, 2023, and appellant-Powlen submitted his response (under penalty of perjury) to these questions on February 17, 2023. The affidavit and response to FTB's questions are voluminous (seven and 16 pages, respectively). While appellant-Powlen's statements are not presented verbatim in this Opinion, they were expressly reviewed and considered by OTA in reaching the conclusions set forth in this Opinion. To the extent OTA does not adopt certain factual statements made by appellant-Powlen in the affidavit or his response to FTB's questions, OTA either found the statements to be inapplicable, unsupported assertions, or contradicted by other evidence in the record. "[OTA] need not accept appellants' self-serving contentions, especially in the absence of reliable corroborating evidence." (*Appeal of Johnson*, 2022-OTA-166P.)

January 3, 2005, and “[a]dditional tax assessed by examination – quick assessment” of \$3,742 on January 9, 2012. For 2001, the account transcript indicates “[a]dditional tax assess by examination – quick assessment” of \$10,634 on September 30, 2013.

DISCUSSION

Issue 1: Whether FTB’s proposed assessments for the 2000 and 2001 tax years are valid.

A. Applicable Law – FTB’s Duty to Examine at Audit and Reconsider at Protest

As soon as practicable after the return is filed, FTB shall examine the return and determine the correct amount of tax. (R&TC, § 19032.) If FTB determines that the tax disclosed by the taxpayer on an original or amended return is less than the tax disclosed by its examination, it shall mail notice to the taxpayer of the deficiency proposed to be assessed. (R&TC, § 19033(a).) In no case shall the deficiency determination be arbitrary or without foundation. (*Ibid.*) Except where a return or return data has been destroyed or cannot be located after reasonable effort and the taxpayer fails to provide FTB with a copy of the return within 30 days upon request, FTB, in connection with the determination described above, shall examine the original or amended return or related electronically stored return data. (R&TC, § 19033(b)(1)-(2).) R&TC section 19034(a) requires each deficiency notice issued by FTB to set forth the reasons for the proposed deficiency assessment and the computation thereof. R&TC section 19041 then permits a taxpayer to file a written protest against a proposed deficiency assessment within certain time limits, and R&TC section 19044 provides that if a protest is filed, FTB shall reconsider the assessment.

Appellants contend that FTB’s NPAs and/or actions in denying appellants’ protests of the NPAs for the 2000 and 2001 tax years were arbitrary, capricious, and/or lacking foundation in fact or in law. As a result, appellants assert (or imply) that FTB’s proposed deficiency assessments disallowing their claimed IRC section 988 losses for the 2000 and 2001 tax years are invalid. Appellants present several different arguments or theories for why they believe FTB’s actions were arbitrary, capricious, and/or lacking in foundation, each of which will be addressed below.

B. FTB's Alleged Failure Audit or Examine Appellants' Returns Pursuant to *Wertin*

Appellants first assert that FTB's actions were arbitrary and capricious (and therefore invalid) because FTB failed to properly audit appellants' returns. Appellants cite to and rely primarily upon *Wertin v. Franchise Tax Bd.* (1998) 68 Cal.App.4th 961 (*Wertin*) as support. *Wertin* involved a final federal adjustment which occurred years after FTB destroyed the taxpayer's California return due to the passage of time. FTB had six months from the date it was notified of the federal adjustment to issue an NPA to the taxpayer. FTB requested a copy of the taxpayer's California return so that it could compute the additional state tax due as a result of the federal adjustment but did not receive the requested return prior to this deadline. FTB therefore issued an NPA to the taxpayer, which stated that its deficiency determination was based on an estimate of the taxpayer's "net tax liability since we did not receive a copy of your return as requested."

The NPA was issued in 1993 pursuant to former R&TC section 18583 (repealed by Stats. 1993, ch. 877, § 20), which required FTB to examine, without exception, the taxpayer's return prior to issuing the NPA.¹⁵ In defense of its NPA, FTB argued that while it was unable to examine the taxpayer's return, it had nevertheless substantially complied with the requirements of R&TC section 18583 by examining the taxpayer's information which was available to it, including the federal adjustment. The court rejected this argument, holding instead that in failing to examine the taxpayer's return, FTB had "ignored statutory directives and computed [the] tax deficiency out of thin air. The arbitrariness and incorrectness of its determination are apparent from the fact it later had to correct its figures." (*Wertin, supra*, 68 Cal.App.4th, at p. 976.) The court concluded that FTB's NPA was procedurally defective because the FTB did not consult the taxpayer's California tax return, noting that "[t]he rationale for such a definitional constraint is to provide some grounding for [] FTB's calculation of the taxpayer's tax liabilities, and the plain meaning of these statutes is to build the taxpayer's tax return into the definition of deficiency to prevent the kind of haphazard resort to arbitrary outside sources and inaccurate deficiency computations . . ." (*Id.* at p. 974.)

¹⁵ Former R&TC section 18583 stated, "[i]f [FTB] determines that the *tax disclosed by the original return* is less than the tax disclosed by its examination . . . [italics added]" it may issue a deficiency assessment. The court found this language to required FTB "to consult the taxpayer's tax return before issuing a deficiency notice." Former R&TC section 18583 did not contain a similar exception to that provided in current R&TC section 19033(b)(1)-(2).

In response to *Wertin*, the legislature amended R&TC section 19033¹⁶ to “clarify the power of [FTB] to issue deficiency assessments.” (Stats. 2000, ch. 414, § 2.) The amendments, which were in effect at the time FTB issued the NPAs to appellants in 2005, specifically addressed FTB’s obligations prior to issuing an NPA where taxpayer returns were unavailable. Notably, these changes allowed FTB to, in certain instances, make deficiency determinations without an examination of the return so long as the determination is not arbitrary or without foundation. (R&TC, § 19033(a), (b)(1)-(2).)

Additionally, unlike the facts in *Wertin*, there is no indication, either on the face of the NPAs or in the evidentiary record, that appellants’ returns were unavailable to FTB¹⁷ or that FTB failed to examine those returns. To the contrary, FTB’s Demand references specific details from appellants’ 2000 and 2001 Forms 540s regarding their claimed IRC section 988 losses, including information reported by Woodleaf Trust on its Forms 541. This demonstrates that FTB did indeed examine those returns to obtain the information necessary to compute the asserted tax deficiency prior to issuing the NPAs. In other words, the IRC section 988 losses disallowed by FTB, and hence the resulting tax deficiencies, were not fabricated out of thin air or upon arbitrary outside sources, as was the case in *Wertin*. Accordingly, there is no basis for finding that FTB’s NPAs were procedurally defective and invalid due to a failure to examine appellants’ returns under *Wertin*.

C. FTB’s Alleged Failures at to Audit and Protest, Generally

In addition to their discussion of *Wertin*, appellants provide general assertions regarding FTB’s alleged failures to audit or examine the returns or other information during both the audit and protest. Appellants state that, they do “not question whether [] FTB looked at the Forms 540s,” but instead contend that “FTB conducted no audit.” Specifically, appellants contend:

[] FTB did not examine the Form 540s or the Form 541s filed by [appellants] for 1999, 2000 and 2001 let alone audit them..... [The Audit Paper] establishes that [] FTB relied on information it received from the IRS to issue NPAs to [appellants] for 1999, 2000 and 2001. FTB apparently issued the NPAs in issue based solely on the IRS advice to [] FTB that it had proposed deficiencies disallowing the IRC [section] 988 losses associated with [appellant-Powlen’s] involvement with abusive tax shelters.

¹⁶ Former R&TC section 18583 was renumbered to R&TC section 19033. (Stats. 1993, ch. 31, § 26.)

¹⁷ Even if this were the case, *Wertin* has been superseded by the above statutory amendments.

It is sophistry of [] FTB to contend it “reviewed [a]ppellant’s 2000 and 2001 tax returns during audit and protest.” The FTB conducted no audit. The FTB based its decisions on [appellant-Powlen’s] protests of the 2000 and 2001 NPAs on the obviously erroneous [Audit Paper]. [] FTB’s publication of the obviously erroneous [Audit Paper] establishes that [] FTB failed to critically examine the legal basis for the NPAs as stated by [appellants].

As discussed below, at each stage of the audit and protest, OTA finds no merit to appellants’ assertions that FTB: (1) conducted no audit/examination, (2) failed to meaningfully examine appellants’ Forms 540 or Woodleaf Trust’s Forms 541, (3) based its decisions at audit and/or protest disallowing the claimed IRC section 988 losses solely on the advice of the IRS, or (4) failed to critically examine the legal basis for its NPAs.

i. FTB’s Audit Examination

The record establishes that FTB opened an audit examination of appellants’ 2000 and 2001 returns in early 2004. In connection with this audit examination, FTB sent appellants five IDRs and a Demand requesting information relating to appellants’ claimed IRC section 988 losses. Subsequently, when appellants failed to respond, FTB issued NPAs for the 2000 and 2001 tax years disallowing the claimed IRC losses in the amounts of \$3,002,413 and \$251,132 (the amounts of the losses as reported on Woodleaf Trust’s Forms 541 and appellants’ Forms 540). As noted above, OTA finds that FTB properly examined appellants’ and Woodleaf Trust’s 2000 and 2001 returns to obtain the information necessary to compute the asserted tax deficiency prior to issuing the NPAs. Additionally, as required by R&TC 19034(a), the NPAs both provide the computation of the proposed deficiency assessment and set forth the reason for the assessments: appellants’ failure to respond to FTB’s numerous IDRs and the Demand requesting information and failure to substantiate the reported IRC section 988 losses from Woodleaf Trust. The NPAs make clear that appellants’ failure to substantiate their claimed losses was the primary reason for FTB’s disallowance of those losses.

The Audit Paper similarly noted that the claimed IRC section 988 losses were being disallowed because appellants failed to respond to FTB’s IDRs and Demand, and therefore failed to substantiate the losses claimed. While the Audit Paper also noted that FTB received various information and documents from the IRS and New York, the Audit Paper does not discuss, point

to, or rely on this information/documentation as the basis or primary reason for its disallowance of the claimed losses. Additionally, the Audit Paper also indicated that at the time FTB issued its NPAs, the IRS had not made any final assessments with respect to appellants' 1999, 2000 or 2001 tax years: "there [h]as been no NPA issued by the IRS, to date." Thus, there is nothing in the record to support appellants' assertion that "FTB apparently issued the NPAs in issue based solely on the IRS advice to [] FTB that it [the IRS] had proposed deficiencies disallowing the IRC [section] 988 losses. . . ." As such, OTA finds no merit to appellants' assertion that FTB "conducted no audit" of its own, based its assessment solely on advice received from the IRS, and failed to meaningfully examine appellants' Forms 540 or Woodleaf Trust's Forms 541. Appellants have little room to complain about the scope of FTB's audit examination when appellants failed to respond to FTB's five IDRs or Demand and failed to provide FTB with evidence or source documentation relating to the claimed loss transactions.

ii. FTB's Protest Reconsideration

In its Preliminary Determination Letter, FTB first noted that it was affirming its disallowance of the claimed IRC section 988 losses in the NPAs because of appellants' continued failure to substantiate the losses. FTB expressly pointed to appellants' failure (both during audit and protest) to provide source documentation such as copies of the option contracts or purchase agreements that gave rise to the losses, bank records or brokerage statements relating to the accounts where the investment strategies occurred, etc.

The Preliminary Determination Letter then noted the transactions Woodleaf Trust engaged in (or similar transactions) were litigated in federal court and found to lack economic substance in *K2 Trading, supra*, 101 Fed. Cl. 365, and *Jade Trading, supra*, 80 Fed. Cl. 11. The Preliminary Determination Letter analyzed the transactions as described in appellant-Powlen's protest letter, including appellant-Powlen's/Woodleaf Trusts' asserted business purpose for engaging in the transactions, and concluded that the transactions appeared to be Son of BOSS transactions that lacked both a valid business purpose other than tax avoidance and economic substance. FTB's analysis of the economic substance of the transactions and the purported business purpose as described by appellant-Powlen in his protest letter makes clear FTB properly reconsidered the assessments proposed in its NPAs at protest as required by R&TC section

19044.¹⁸ Thus, OTA also finds no merit to appellants' assertion that FTB "failed to critically examine the legal basis for the NPAs" at protest. Again, appellants have little room to complain about the scope of FTB's protest reconsideration when they once again failed to provide FTB with evidence or source documentation relating to the claimed loss transactions at protest.

D. Appellants' Assertion that FTB's Audit and/or Protest Determinations Lacked Foundation

Appellants note that any action of a governmental agency that is not reasonably supported by fact and law is arbitrary and capricious citing to *Scar v. Commissioner* (9th Cir. 1987) 814 F.2d 1363.¹⁹ Appellants assert or imply that FTB's actions and determinations at audit and/or protest are unsupported by fact and/or law and are therefore arbitrary, capricious, and invalid.

OTA disagrees. At both audit and protest, FTB points to its numerous requests for information and evidence from appellants to support and substantiate the claimed IRC section 988 losses, and appellants' failure to respond and provide source evidence or documentation as the reason for the disallowance. California Code of Regulations, title 18, (Regulation) section 19032 places on taxpayers the duty to maintain records and the duty to respond to FTB's requests for information. (Cal. Code Reg., tit. 18, § 19032(a)(3), (5).)²⁰ Additionally, as will be discussed in more detail in Issue section 2.A., below, the taxpayer generally bears the burden of proving a claimed loss (*Appeal of Rios*, 2021-OTA-341P; *Appeal of Vardell*, 2020-OTA-190P; *Hoover v. Commissioner*, T.C. Memo. 2006-82), including the basis in the property giving rise to the claimed loss. (*Hoover v. Commissioner*, *supra*; *Vaira v.*

¹⁸ The description of the transactions in the protest letter, and the IRS account transcripts (addressed in detail in Issue section 1.G. below) are the only additional evidence appellants point to as being provided to FTB during the protest.

¹⁹ *Scar v. Commissioner*, *supra*, 814 F.2d 1363 dealt with a similar issue as *Wertin*, *supra*, 68 Cal.App.4th 961, but related to a similarly worded federal statute. It was cited with approval in *Wertin*, *supra*.

²⁰ Regulation section 19032(a)(3) states, "A taxpayer, or the taxpayer's representative has a duty to make a timely response to request for information or documentation by [FTB] that are relevant and reasonable or provide an explanation as to why additional time is necessary to respond or state why the request is not relevant or reasonable." Regulation section 19032(a)(5) states, "Generally, it is the taxpayer who will be in possession or control of the necessary information, documents, books and records and who will have the knowledge regarding the circumstances of the relevant activities such that a determination of the correct tax can be made. The inability, or failure, of the taxpayer to supply requested relevant information in support of the tax return as filed may result in a [NPA] being issued. A taxpayer has a duty to maintain relevant records and documents"

Commissioner (3rd Cir. 1971) 444 F.2d 770, 774; *O'Neill v. Commissioner* (9th Cir. 1959) 271 F.2d 44, 50; *Moore v. Commissioner* (9th Cir. 1970) 425 F.2d 713, 715.)

Appellants had a duty to maintain records relating to the loss transactions performed by Woodleaf Trust (a disregarded entity) and had a duty to respond to FTB's IDRs and Demand. Appellants also have the burden of establishing that they are entitled to the losses claimed, including the burden of proving their claimed basis amounts of \$3,029,340 and \$253,316 which gave rise to these losses. As appellants provided no source documentation to FTB (at audit or protest) to substantiate either the Euro currency sales or exchanges reported as occurring on December 28, 2000, and December 20, 2001, or the claimed basis amounts, FTB's disallowance of the claimed losses for lack of substantiation is supported by both the facts²¹ and the law.²² Thus, FTB's determination (at both audit and protest) to disallow the losses based on a lack of substantiation, is not without foundation.

Additionally, at protest, FTB also analyzed the transactions as described by appellant-Powlen in the protest letter and found the described transactions to lack economic substance and a valid business purpose. In making this determination, FTB analyzed and applied numerous case authorities relating to Son of BOSS transactions, economic substance, and business purpose. Again, OTA finds FTB's conclusions regarding the lack of economic substance or a valid business purpose to be supported by the facts²³ and the law.²⁴ Thus, OTA finds no merit to appellants' assertion that FTB's actions or determinations at audit or protest were arbitrary and capricious, on the basis that they were unsupported by fact or law or without foundation.

E. FTB's Purported Errors at Audit and/or Protest

Appellants take issue with FTB's statements in the Audit Paper and in its briefing in this appeal, that income tax deductions are a matter of legislative grace and the burden is on taxpayers to show by competent evidence that they are entitled to any deduction claimed, and

²¹ FTB's IDRs and Demand, and appellants' failure to respond or provide any source documentation or evidence relating to the transactions.

²² The taxpayer's duty to maintain records and respond to FTB's requests, and the taxpayer's burden of establishing the claimed loss and basis amounts (as established by the authorities set forth in the preceding paragraph).

²³ Appellants' description of the transactions as provided in appellant-Powlen's protest letter.

²⁴ The numerous case authorities cited and applied by FTB in the Preliminary Determination Letter. (See factual finding 18 and footnote 12 above for details.)

citation to deduction cases such as *Deputy v. Du Pont*, *supra* 308 U.S. 488, and *New Colonial Ice Co. v. Helvering*, *supra*, 292 U.S. 435. Appellants contend that while this is an accurate statement of income tax law with respect to income tax deductions, it has “no application to the Son of BOSS transactions” at issue here which do not involve income tax deductions, but instead involves losses which are recognized under IRC section 61. Appellants similarly take issue with the Final Determination Letter’s use of the terms “loss deductions” and “deductible” losses and its citations to IRC section 162, relating to ordinary and necessary business expenses, and IRC section 165, relating to certain types of losses such as wagering losses, theft losses, capital losses, worthless security losses, casualty losses, etc. Appellants note that “[f]undamental principles of income tax law treat ‘losses’ and ‘deductions’ as entirely different types of transactions for California and federal income tax reporting purposes.” Appellants further note that “[s]ales and exchanges of property create gains and losses” and “[s]uch gains and losses from sales and exchanges of property are reportable for income tax purposes in most instances.”

However, OTA does not find FTB’s actions disallowing the claimed IRC section 988 losses at either audit or protest to be arbitrary or capricious (or without foundation) due to FTB’s citation to legal authorities relating to a taxpayer’s duty to substantiate deductions rather than losses. As discussed above in Issue section 1.D. (and as will be discussed in more detail in Issue section 2.A. below), taxpayers also have the burden of proving a claimed loss, including the claimed basis giving rise to the claimed loss. Appellants failed to meet this burden when they failed to provide any information or source documentation relating to the transactions at audit and/or protest and failed to establish that the transactions had economic substance. As discussed in detail above, FTB’s conclusions at audit and protest are supported both by the facts and by the relevant and applicable law, notwithstanding FTB’s purported errors in the Audit Paper and the Final Determination Letter.

Appellants also assert the erroneous statement in the Final Determination Letter is the sole reason or basis provided by FTB for its denial of appellants’ protest in the NOAs. However, this simply is not the case. The NOAs expressly stated that the proposed assessments were sustained in full based on both the March 2, 2021, and May 26, 2021 letters (i.e., based on both the Preliminary Determination Letter and the Final Determination Letter). Additionally, the Final Determination Letter, itself, expressly noted that “the protest hearing officer’s preliminary determination as explained in the earlier determination letters remained unchanged.” Appellants’

focus exclusively on FTB's statements relating to deductions entirely ignores the remaining analysis and reasons provided for the disallowance of the losses in the Preliminary Determination Letter. Specifically, appellants' continued failure to provide source documentation substantiating the claimed losses (citing to a taxpayer's duty to show error in FTB's audit determination as set forth in *Appeal of Seltzer, supra* and *Todd v. McColgan, supra*, 89 Cal.App.2d 509), and appellants' failure to establish that the loss transactions had economic substance and a valid business purpose and citation to numerous case authorities relating to the economic substance doctrine generally and Son of BOSS transactions specifically.²⁵

F. FTB's Purported Failure to Carefully Review and/or Understand the Information Received from the IRS and New York

Appellants contend that FTB received "most" or "substantially all" of the information and documents it requested from appellants in its IDRs and Demand from either the IRS and/or New York and assert, "[i]t is quite possible FTB employees never carefully examined, or perhaps did not understand, the information and documentation [] FTB received from the IRS and New York in 2005. . ." Appellants further assert that "FTB failed to carefully examine the underlying factual information and documentation it received relating to the income tax returns of entities from which items were passed through to the joint Form 540s of [appellants] for 1999, 2000, and 2001." Appellants thus assert or imply that it was arbitrary, capricious and improper for FTB to disallow (or to continue to disallow at protest) the claimed losses when it received documentation relating to the transactions or the New York LLCs from the IRS and New York.

OTA disagrees. OTA finds no evidence to support appellants' assertion that FTB received "most" or "substantially all" of the information it requested from appellants in its IDRs and Demand from the IRS and/or New York or that the information FTB received was sufficient

²⁵ Appellants also assert that FTB relied solely on the Audit Paper in its denial of appellant-Powlen's protest: "it is inexcusable to rely on an obviously erroneous [Audit Paper] prepared over fifteen years ago as the sole foundation for the denial of [appellant-Powlen's] protest of the 2000 and 2001 NPAs." Appellants further assert that FTB's citation to legal authorities relating to deductions rather than losses, establishes that FTB did not have a proper understanding of the Son of BOSS transactions at issue at protest. OTA finds no merit either of these assertions. As previously noted, the Preliminary Determination Letter thoroughly examined the loss transactions as described by appellant-Powlen in the protest letter (including the asserted business purpose for the transactions). FTB's analysis makes clear that FTB understood appellant-Powlen's description of the transactions in the protest letter and disallowed appellants' claimed IRC section 988 losses because: (1) appellants failed to substantiate the losses, and (2) FTB concluded that the transactions lacked a valid business purpose and economic substance. FTB's citation to legal authorities relating to deductions rather than losses in its Audit Paper, Final Determination Letter, and briefing indicates that FTB believed the cited authorities to be applicable to the losses at issue, not that it did not properly understand the transactions.

to substantiate the claimed losses or establish the economic substance of the loss transactions. The information and documentation FTB received from the IRS and New York is not in the record of this appeal. However, a review of the documents FTB listed as received from the IRS and New York in the Audit Paper suggests that FTB received only a small portion of the information and documentation it had requested from appellants.

Much of the source documentation relating to the reported losses, including the reported basis amounts in the Euros sold or exchanged in 2000 and 2001 do not appear to be included in the list of items described as received by FTB. Specifically, the documentation FTB lists as received from the IRS and New York does not appear to include the relevant bank and/or brokerage statements, the option contracts for the Purchased Call Option and the Sold Call Option acquired by Woodleaf Trust in 1999, documentation evidencing Woodleaf Trust's contribution of the Purchased Call Option and Sold Call Option to the LLC(s) in 1999, and documentation evidencing Woodleaf Trust's withdrawal from the LLC(s) later in 1999 in exchange for \$50,000 in Euros.

Similarly, many of the items that FTB requested to substantiate the economic substance and/or business purpose for the transactions also do not appear to be included in the list of items described as received by FTB. Specifically, the documentation FTB lists as received from the IRS and New York does not appear to include the offering, prospectus, or other literature received by the appellants regarding the transactions, copies of the legal or tax opinion, agreements entered into with other parties relating to the transactions, the amount of fees or commissions paid, etc.

Thus, FTB's actions and/or determinations at audit and/or protest are not arbitrary or capricious on the basis that FTB failed to consider or understand documents it received from the IRS and/or New York. To the extent appellants believe documents FTB received from the IRS and/or New York support their claimed IRC section 988 losses, appellants were free to provide

this documentation as evidence in this appeal.²⁶ Instead, appellant-Powlen states that he “will not produce any documents already in the hands of FTB,” and asserts that “all of the relevant material facts that are necessary for decision on the two severed issues . . . are [] contained in the record.”

G. FTB’s Purported Failure to Consider the IRS’s Purported Change in Position

Appellants next contend that FTB based its proposed assessments on information that the IRS was auditing appellants’ federal income tax returns but then failed to then consider that the IRS later changed its position with regard to appellants’ 1999, 2000, and 2001 returns in 2006. Appellants contend that in 2006, the IRS accepted appellants’ 1999, 2000, and 2001 federal income tax returns as filed (with the exception of some minor computational adjustments), and that the IRS’s acceptance of these returns is reflected in the IRS account transcripts for these tax years. Appellants contend that they provided FTB with the transcripts during the protest, that FTB disregarded the change in position by the IRS in 2006, and that it was arbitrary and capricious for FTB to continue disallowing the claimed losses “in the absence of both evidence and law to support a different tax treatment of the losses . . . for California income tax purposes from the treatment of these same losses for federal income tax purposes.”

Again, OTA disagrees. While appellants provided federal account transcripts for the 2000 and 2001 tax years showing that the “additional tax assessed by examination” was \$417 and \$0, respectively, and the “[a]dditional tax assessed by examination – quick assessment” was \$3,742 and \$10,634, respectively, this information does not conclusively demonstrate that the IRS changed its position and specifically determined or concluded that appellants’ claimed IRC section 988 losses for the 2000 and 2001 tax years should be allowed as appellants contend. As discussed further below in Issue section 2.D., there is evidence which suggests that these losses may have stemmed from a Son of BOSS tax shelter involving at least one of the New York LLCs, and that the losses were examined and disallowed by the IRS at the partnership level.

²⁶ Appellants requested and received the FTB audit/protest files from FTB by January 23, 2023. While appellants contend that FTB initially produced documents that “had not been properly redacted,” appellants acknowledge that FTB produced “properly redacted documents [on] January 23, 2023” and that they “secure[d] copies of the vast majority of the information and document that [] FTB requested in its IDRs” Appellants also contend that there “are a couple of outstanding discovery issues,” but do not specifically identify any remaining discovery issue(s) beyond FTB’s purported failure to produce properly redacted documents until January 23, 2023. In any event, OTA does not have jurisdiction over whether FTB’s redaction of or failure to produce documents violated the Information Practices Act, the California Public Records Act, or any similar provision of the law. (Cal. Code Regs., tit. 18, § 30104(c).)

(See *K2 Trading, supra*, 101 Fed. Cl. 365 discussing *Asuma Trading Ventures, LLC v. Commissioner* (Docket No. 26772-06.) (*Asuma Trading*)). It is unclear why the IRS has not assessed any additional tax with respect to appellants' claimed IRC section 988 losses for the 2000 and 2001 tax years despite this partnership level determination in *Asuma Trading*, and appellants have not provided any evidence (such as IRS audit workpapers or IRS no-change letters) to establish that the IRS has expressly determined that appellants' claimed IRC section 988 losses should be allowed or that appellants' 2000 and 2001 returns were accepted as filed.²⁷

In any event, regardless of the outcome of the IRS audit, it is well established that FTB is not bound by the determinations of the IRS. (*Appeal of Der Wienerschnitzel International, Inc.* (79-SBE-063) 1979 WL 4104 (*Der Wienerschnitzel*)). In *Der Wienerschnitzel*, the taxpayer argued that a final IRS determination in its favor was controlling on FTB. OTA's predecessor, the Board of Equalization, disagreed, noting that while R&TC section 25432²⁸ created a rebuttable presumption in FTB's favor when FTB bases its actions on a federal determination, neither that section nor any other binds FTB to follow IRS decisions which it believes to be erroneous. FTB has no obligation to follow an IRS assessment, and it has no duty or obligation to provide evidence and law to support a different treatment of claimed loss transactions for California income tax purposes as appellants contend.

Appellants also assert or imply that it was improper for FTB to defer the protest based on the federal proceedings, reactivate the case years later, and then fail to follow the IRS's purported change in position in 2006. OTA also finds no merit to this argument. FTB agreed to defer the protest proceedings at appellants' request because appellants asserted it would be "economically onerous for [appellants] to respond to both taxing authorities simultaneously." In acquiescing to appellants' request, FTB did not thereby agree to and/or obligate itself to follow the IRS's determination – especially, whereas here, the reason for the IRS's failure to assess additional tax is unclear and unknown. Thus, OTA does not find FTB's action at protest

²⁷ In their April 18, 2022 additional brief, appellants appear to acknowledge that the IRS may still make adjustments to appellants' 1999 through 2001 tax year accounts stating "FTB might well have followed the lead of the IRS in 2006 . . . and accepted the returns for all three years as filed subject, of course to any adjustments required as a consequence of a final decision in the one [t]ax [c]ourt case involving [appellant-Powlen] that remains pending *Asuma Trading* []." The fact that the IRS may still make adjustments to appellants' federal tax accounts for these tax years pending the outcome of this litigation suggests that the IRS has not, in fact, accepted appellants' returns as filed as appellants contend or concluded that the claimed IRC section 988 losses should be allowed.

²⁸ See R&TC section 18622(a) for the similar rule applicable to personal income taxpayers.

to be arbitrary or capricious because of the alleged failure to follow the IRS's purported change in position in 2006.

H. Appellants' Assertion that OTA May Review or Address the 1999 NPA

Appellants acknowledge that OTA “does not have jurisdiction over this [1999] year based on the appeals relating to 2000 and 2001.” Nevertheless, appellants “invite[] OTA to address the 1999 tax year,” contending that “[a]n understanding of the activities of [the LLCs] in 1999 is essential to an understanding of the proper tax treatment of flow-through items from the [LLCs] in 2000 and 2001.” Appellants assert that the 1999 NPA “was issued based solely on a notification from the IRS relating to that year;” “FTB received the information it requested from [appellants] relating to all three years, 1999, 2000 and 2001 [from the IRS], before the NPAs were issued for 2000 and 2001;” and FTB was “arbitrary and capricious in defaulting [appellants] for [their] failure to timely protest the NPA for 1999.” Appellants assert that if “FTB had not defaulted [appellants'] protest for 1999 as untimely, [] FTB might well have followed the lead of the IRS in 2006 as to all three years and accepted the returns for all three years as filed”

Appellants' arguments do not provide OTA with jurisdiction to review or “address” FTB's NPA or proposed assessment for the 1999 tax year. R&TC section 19041(a) provides that within 60 days after the mailing of a proposed deficiency assessment, the taxpayer may file with FTB a written protest against the NPA. R&TC section 19042 provides that if no protest is filed, the amount of the proposed deficiency assessment becomes final upon the expiration of the 60-day period provided in R&TC section 19041. FTB issued an NPA to appellants for the 1999 tax year on October 14, 2004. Appellants failed to protest that NPA within 60 days, and the NPA became final upon the expiration of the 60-day period on or about December 13, 2004. As the 60-day time period required for filing a protest is expressly provided by statute (see R&TC, §§ 14041(a), 19042), FTB was not “arbitrary and capricious in defaulting [appellants] for [their] failure to timely protest the NPA for 1999” as appellants contend.

R&TC section 19042's use of the word “final” means an appeal to OTA under R&TC section 19045 is foreclosed. (See *Appeal of Lopez* (83-SBE-046) 1983 WL 15496.) Thus, OTA does not have jurisdiction over FTB's proposed assessment for the 1999 tax year. (See also Cal. Code Regs., tit. 18, section 30104(g) [providing that OTA does not have jurisdiction over a taxpayer's appeal from an NPA].) Because OTA does not have jurisdiction over this proposed

assessment, OTA does not have jurisdiction to consider appellants' arguments that the 1999 NPA was invalid, or otherwise incorrect or erroneous.

Appellants also contend that OTA should consider and address the 1999 tax year in connection with appellants' appeal for the 2000 and 2001 tax year, because "these three years are inextricably intertwined both procedurally and factually." OTA has considered information relating the 1999 tax year to the extent it impacts the correctness of FTB's proposed assessments for the 2000 and 2001 tax years.²⁹ However, OTA does not have jurisdiction to consider the correctness of the proposed assessment for 1999.

Issue 2: If valid, whether appellants have shown error in FTB's proposed assessments for the 2000 and 2001 tax years disallowing appellants' claimed IRC section 988 losses in the amounts of \$3,002,413 and \$251,132, respectively.

Because OTA concludes that the proposed assessments for the 2000 and 2001 tax years are valid, OTA will now consider whether appellants has shown error in the proposed assessments.

A. Applicable Law – Presumption of Correctness and Burden of Proof

FTB's determinations are generally presumed correct, and the taxpayer bears the burden of proving otherwise. (*Appeal of Vardell, supra*.)³⁰ Additionally, the taxpayer generally bears the burden of proving a claimed loss. (*Appeal of Rios, supra*; see also *Hoover v. Commissioner, supra*, T.C. Memo. 2006-82.)³¹ A loss cannot be properly computed where the taxpayer does not prove basis. (*Hoover v. Commissioner, supra*), and it is well settled that establishing a

²⁹ OTA has already addressed appellants' arguments that FTB acted arbitrarily and capriciously in failing to consider the IRS's purported change in position in 2006 in Issue Section 1.G., above. The information appellants provide with respect to the 1999 tax year does not alter or change OTA's analysis or conclusion above.

³⁰ Some cases impose an initial burden on FTB to establish that its proposed assessment is reasonable and rational before this presumption of correctness applies. (See *Appeal of Bindley*, 2019-OTA-179P; *Todd v. McColgan, supra*, 89 Cal. App.2d at 514. To the extent FTB has such a burden, OTA expressly finds FTB's 2000 and 2001 proposed assessments to be reasonable and rational. (See Issue section 1.D. concluding that FTB's audit and protest determinations were supported by fact and law and were not lacking foundation). Thus, FTB's initial burden (if applicable), has been met, and the presumption of correctness applies to the 2000 and 2001 proposed assessments.

³¹ *Hoover v. Commissioner, supra*, applies Tax Court Rule 142(a) which provides that in proceedings before the tax court, the burden of proof shall be upon the petitioner, except as otherwise provided by statute or determined by the tax court. A similar rule is provided for proceedings before OTA in Regulation section 30219(a), which is set forth in detail below.

taxpayer's cost basis is a factual matter. (*Vaira v. Commissioner, supra*, 444 F.2d at p. 774.) "Proof of basis is a specific fact which the taxpayer has the burden of proving." (*O'Neill v. Commissioner, supra*, 271 F.2d at p. 50; see also *Moore v. Commissioner, supra* 425 F.2d at p. 715 ["[t]he taxpayer bears the burden of establishing the cost basis of property".]) In proceedings before OTA, the burden of proof is on appellants as to all issues of fact, except as otherwise specifically provided by law, and the burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(a), (b).)

Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Vardell, supra*.) A taxpayer's failure to introduce evidence that is within his or her control gives rise to the presumption that the evidence, if provided, would be unfavorable to the taxpayer's position. (*Ibid.*) Additionally, a taxpayer's burden of proof is not relieved because it may be difficult or impossible to substantiate a claimed loss. (*Appeal of Giese* (86-SBE-016) 1986 WL 22687; *Burnet v. Houston* (1931) 283 U.S. 223, 227-228.)

FTB disallowed appellants' claimed IRC section 988 losses for the 2000 and 2001 tax years because it concluded: (1) both at audit and protest, that appellants had failed to substantiate the losses claimed, and (2) at protest, that the transactions as described in appellant-Powlen's protest letter were Son of BOSS transactions that lacked both economic substance and a valid business purpose. Thus, in order to prevail in this appeal, appellants need to establish error in both of these determinations by FTB.

B. Appellants' Assertions Regarding the Burden of Proof and What They Need to Establish to Succeed on Appeal

Appellants contend, "In this appeal[,], [a]ppellants must plead and introduce evidence sufficient to establish a *prima facie* case that FTB erred in its denial of the protest of the proposed additional assessments of income tax for 2000 and 2001," and that "[t]his threshold is quite low." Appellants acknowledge that FTB's proposed assessments are presumed correct, but contend that this "presumption of correctness . . . imposes on [a]ppellants the burden of presenting a legally supportable claim and sufficient supporting information and documentation that OTA could decide in favor of [a]ppellants." Appellants contend that "[t]his minimal burden is fully met by [a]ppellants' statement of the severed issued coupled with the FTB's statement of the basis for its decision in the Final Determination Letter. . . ." Appellants further assert that "[t]hese two statements standing alone establish a *prima facie* case in favor of [a]ppellants."

OTA disagrees with appellants regarding their applicable burden of proof in this appeal. Appellants do not provide any legal authority for their assertions that they need only establish a “legally supportable claim” or a “*prima facie* case” in their favor.³² Instead, because OTA has expressly concluded that FTB’s proposed assessments are valid, the remaining issue in this appeal is the correctness of FTB’s proposed assessments disallowing appellants’ claimed IRC section 988 losses in the amounts of \$3,002,413 and \$251,132. FTB’s determinations are presumed correct, and appellants have the burden of proving otherwise. (*Appeal of Vardell, supra.*) Thus, to prevail in this appeal, appellants need to show that FTB’s disallowance of the claimed IRC section 988 losses was incorrect or erroneous.

Establishing error in FTB’s disallowance of the claimed IRC section 998 losses requires appellants to establish, by a preponderance of the evidence, that they are entitled to the losses claimed. (*Appeal of Rios, supra; Hoover v. Commissioner, supra; Cal. Code Regs., tit. 18, section 30219(a), (b).*) To meet this evidentiary standard, appellants must establish by documentation or other evidence that the circumstances they assert are more likely than not to be correct. (*Appeal of Belcher, 2021-OTA-284P*). Thus, it is not enough for appellants to merely point to various purported errors (in fact and/or law) in FTB’s Audit Paper and/or protest determination letters, without also establishing by a preponderance of the evidence that the claimed IRC section 988 losses: (1) were incurred in the amounts and tax years claimed, and (2) the loss transactions had economic substance and were therefore allowable. For the reasons discussed in more detail below, OTA concludes that appellants failed to establish by a preponderance of the evidence that: (1) the losses were incurred in the amounts and/or tax years claimed, and (2) the loss transactions had economic substance and were therefore allowable.

C. Appellants’ Failure to Substantiate the Claimed Losses

On appeal, appellants fail to provide any source documentation relating to the IRC section 988 losses claimed for the 2000 and 2001 tax years. While Woodleaf Trust reported that these losses related to currency sales or exchanges occurring on December 28, 2000, and

³² *Prima facie* is a Latin term meaning “‘at first sight’ or ‘at first look.’ This refers to the standard of proof under which the party with the burden of proof need only present enough evidence to create a rebuttable presumption that the matter asserted is true. A *prima facie* standard of proof is relatively low. It is far less demanding than the preponderance of the evidence, clear and convincing evidence, and beyond a reasonable doubt standards that are also commonly used.” (Thomson Reuters Practical Law Glossary, 2024, available at [https://www.westlaw.com/2-518-8779?transitionType=Default&contextData=\(sc.Default\)&VR=3.0&RS=cblt1.0](https://www.westlaw.com/2-518-8779?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0).)

December 20, 2001, which generated “proceeds” of \$26,927 and \$2,183, respectively, appellants have failed to provide any bank records, brokerage statements or other corroborating evidence establishing that they sold or exchanged currency (Euros) on the dates reported and that these sales/exchanges generated the proceeds reported.

Additionally, while Woodleaf Trust reported basis of \$3,029,340 and \$253,316 in the Euros purportedly sold or exchanged on December 28, 2000, and December 20, 2001, respectively, appellants again provide no evidence or source documentation to support or substantiate the claimed basis amounts. Instead, to date, appellants have only provided a general description of the transactions which purportedly created the claimed basis amounts. This description is contained in appellant-Powlen’s protest letter.³³

The protest letter explained that in 1999 Woodleaf Trust purchased a “Purchased Call Option” for \$5 million and had an obligation under a “Sold Call Option” of \$5 million, both of which were contributed to a “partnership” which is not named or identified by appellants. The protest letter further explained that Woodleaf Trust received an interest in the partnership in exchange for the contribution and that the partnership assumed Woodleaf Trust’s obligation under the “Sold Call Option.” The protest letter stated that in late 1999, Woodleaf Trust withdrew from the partnership and received a distribution of approximately \$50,000 in Euros in exchange for its partnership interest. The protest letter further stated that Woodleaf Trust sold some but not all of the distributed Euros in 2000 and 2001 and “computed a loss [for each year] with reference to its original basis in the partnership interest (\$5 million).”

While appellants provide a general description of the transactions generating the reported basis amounts, appellants have failed to provide any evidence or source documents relating to the transactions described. For example, appellants have not provided any evidence of: (1) Woodleaf Trust’s purchase of a \$5 million “Purchased Call Option” and its obligation under a \$5 million “Sold Call Option;” (2) Woodleaf Trust’s contribution of the “Purchase Call Option” to a partnership and the partnership’s assumption of Woodleaf Trust’s obligation under the “Sold Call Option” in 1999; or (3) Woodleaf Trust’s subsequent withdrawal from the partnership in late 1999 in exchange for approximately \$50,000 in Euros. A loss cannot be properly computed where the taxpayer does not prove basis. (*Hoover v. Commissioner, supra*; T.C. Memo. 2006-

³³ Appellants briefing in this appeal fails to provide a detailed description of the transactions giving rise to the claimed IRC section 988 losses for the 2000 and 2001 tax years. Thus, the only evidence in the record describing the claimed transactions giving rise to the losses is appellant-Powlen’s protest letter.

82.) Thus, appellants have also failed to substantiate the reported basis in the Euros purportedly sold/exchanged in 2000 and 2001, and have therefore, failed to substantiate their claimed losses for these tax years. (*Appeal of Rios, supra; Hoover v. Commissioner, supra; O’Neill v. Commissioner, supra*, 271 F.2d at p. 50; *Moore v. Commissioner, supra*, 425 F.2d at p. 715.)

i. Evidence Offered by Appellants

Appellants contend that their income tax returns “as well as the income tax returns of Woodleaf Trust are admissible as evidence in a court of law,” note that “[t]hese documents were signed under penalty of perjury” and contend that in comparison to this evidence submitted by appellants, “[t]here is no evidence to which [] FTB can point that indicates the reporting of any of the items passed-through from Woodleaf Trust to the income tax returns of [a]ppellants for 2000 and 2001 was erroneous.” Beyond these tax returns, the only other evidence offered by appellants to support the claimed IRC section 988 losses is: (1) appellant-Powlen’s statements in the affidavit and in the responses to FTB’s questions that the IRS and New York had concluded their audits and ultimately allowed appellants’ claimed IRC section 988 losses for the 2000 and 2001 tax years,³⁴ and (2) appellants’ federal account transcripts for 1999, 2000, and 2001 reflecting minor or no federal income tax adjustments for each year.

OTA expressly finds this evidence insufficient to meet appellants’ burden of establishing by a preponderance of the evidence that they are entitled to the losses claimed (i.e., that the losses were incurred in the amounts and tax years reported and had economic substance). It is well settled that a filed tax return does not establish the truth of the facts stated therein. (*Lawinger v. Commissioner*, 103 T.C. 428, 238 citing *Wilkinson v. Commissioner*, 71 T.C. 633, 639; see also *Kennedy v. Commissioner*, T.C. Memo 2009-57 and *Hoover v. Commissioner, supra*.) OTA does not find appellants’ or Woodleaf Trust’s 2000 and 2001 tax returns to be credible evidence that appellants incurred and are entitled to the IRC section 988 losses claimed thereon.

³⁴ In the responses to FTB’s questions, appellant-Powlen stated under penalty of perjury that he was informed by the firms that represented him in the IRS and New York audits that: “the reporting in the income tax returns of each of the New York [LLCs] that the IRS had identified as abusive tax shelters had been accepted as filed by both the IRS and New York subject only to legal questions regarding the reporting of specific transactions involving certain specific members”; “Woodleaf Trust was not one of the specific members of the New York [LLCs] that engaged in a transaction that was subject to question by the IRS or New York”; and “the income tax returns filed by each of the New York [LLCs] in which Woodleaf Trust was a member had been accepted as filed, specifically including the K-1s issued to Woodleaf Trust by each of the entities in which Woodleaf Trust held an interest.”

Additionally, OTA need not accept appellant-Powlen's self-serving contentions, especially in the absence of reliable corroborating evidence. (*Appeal of Johnson*, 2022-OTA-166P; see also *Geiger v. Commissioner* (9th Cir. 1971) 440 F. 2d 688, 689-90 (per curiam), cert. den. (1971) 404 U.S. 851 [taxpayer's testimony, even though uncontradicted, found insufficient to sustain her burden of proof].) The only evidence offered as support for appellants' statements are appellants' and Woodleaf Trust's 2000 and 2001 tax returns and the IRS account transcripts. As noted in Issue section 1.G. above, the IRS account transcripts only indicate that the IRS has not yet made final adjustments disallowing appellants' claimed IRC section 988 losses for the 2000 and 2001 tax years. They do not establish that the IRS expressly concluded that the losses should be allowed as appellants contend. The reason or basis for the IRS's actions with respect to appellants' 2000 and 2001 tax years is unknown, and even if appellants were to establish that the claimed losses were expressly allowed by the IRS, California is not bound by, and is not required to follow, this federal determination. (*Der Wienerschnitzel*, *supra*.)

ii. Appellants' Alleged Difficulty Obtaining Information

Appellants also contend that “[a] substantial portion of the information and documentation that [] FTB requested in [the] IDRs it issued to [appellants] was confidential tax return information of third parties” and that “[m]ost, if not all, of the information and documentation . . . was not available to [] [a]ppellants.” OTA finds no merit to this assertion.

While the IDRs and Demand did request information and tax returns related to certain LLCs and partnerships,³⁵ FTB also expressly requested source documentation and information relating to the claimed IRC section 988 losses, which were described in the Demand as: “a. Sale of Euros sold 12/28/00 for \$26,927 with basis of \$3,029,340 for a loss of \$(3,002,413)[; and] b. Ordinary Loss from Section 988 Transactions on Statement 3, CA Form 541 for 2001 in the amount of \$(251,132).”³⁶ The claimed IRC section 988 losses resulted from purported currency sales or exchanges performed by Woodleaf Trust. These were direct transactions by Woodleaf

³⁵ This is reflected in request number 15 per the Demand.

³⁶ This is reflected in request number 1 per the Demand. Additionally, the remaining items reflected in request numbers 2 through 14 of the Demand also appear to largely related to: actions of appellant-Powlen individually or as grantor and trustee of Woodleaf Trust; source documentation relating to currency transactions performed directly Woodleaf Trust; tax opinions received by appellants and/or Woodleaf Trust; fees or commissions paid by appellants and/or Woodleaf Trust and; agreements in which Woodleaf Trust and/or appellant-Powlen likely would have been a party.

Trust, not pass-through items from partnerships or LLCs as appellants suggest or imply. Appellant-Powlen was the sole grantor and trustee of Woodleaf Trust, which was a disregarded entity. Appellants fail to explain why they are unable to obtain and provide evidence or source documentation relating to the purported currency sales or exchanges performed by Woodleaf Trust on December 28, 2000, and December 20, 2001; Woodleaf Trust's purchase of a "Purchased Call Option" and obligation under a Sold Call Option" in 1999; Woodleaf Trust's contribution to, and the LLC's/partnership's assumption of, these options in 1999, and Woodleaf Trust's redemption of its LLC/partnership interest in late 1999 in exchange for approximately \$50,000 in Euros. Given Woodleaf Trust's direct involvement in each of these transactions, OTA fails to understand why appellant-Powlen did not have or could not have obtained the relevant information and finds little merit to appellants' assertion that they did not have most of the information requested by FTB in its IDRs and Demand.

Appellants contend it is "quite likely [appellant-Powlen] did not have many of the documents FTB requested" and instead assert that these documents were likely held by "the money managers, accountants and lawyers who organized and operated the entities that engaged in the Son of BOSS financial transactions." However, appellants do not describe and do not provide any evidence establishing any efforts made by them to obtain the relevant information from these third parties, or evidence establishing that they were unable to obtain the information despite their efforts. Appellants also do not identify or provide any alternative evidence or source documentation to substantiate the claimed losses. In any event, appellants' burden of proof to substantiate the claimed IRC section 988 losses is not relieved because it may be difficult or impossible to substantiate the losses claimed. (*Appeal of Giesea, supra; Burnet v. Houston, supra*, 283 U.S. at p. 227-228.) Appellants failed to respond to FTB's IDRs and Demand, failed to provide any source documentation or evidence relating to the claimed IRC section 988 losses during the FTB audit and protest, and fail to provide such source documentation or other evidence in this appeal. While this alone is sufficient to affirm FTB's disallowance of appellants' claimed IRC section 988 losses, OTA also finds that appellants have failed to substantiate the transactions giving rise to the claimed losses had economic substance.

D. Appellants' Failure to Establish Economic Substance

As noted above, FTB also disallowed the claimed IRC section 988 losses because it determined at protest that the transactions which gave rise to the losses were likely Son of BOSS transactions which lacked economic substance and a valid business purpose beyond the creation of tax benefits.³⁷ FTB's determinations are generally presumed correct, and the taxpayer bears the burden of proving otherwise. (*Appeal of Vardell, supra.*) Additionally, the taxpayer generally has the burden of proving that a transaction has economic substance. (*Jade Trading, supra*, 80 Fed.Cl. at pp.13-14.)

Appellants argue that FTB's proposed assessments for 2000 and 2001 are erroneous, because FTB failed to audit the relevant transactions giving rise to appellants' claimed IRC section 988 losses, including those occurring in 1999 which appellants contend are integral to understanding these losses. Appellants assert that, in disallowing these losses, FTB erroneously assumed all the transactions engaged in by Woodleaf Trust and the New York LLCs were sham transactions, when in fact, the artificial losses resulting from the Son of BOSS transactions involving the New York LLCs occurred solely in the 1999 tax year. Appellants maintain that for the 2000 and 2001 tax years, the New York LLCs were engaged in legitimate investment activities and the losses from such activities should be allowed. Appellants assert that the IRS "concluded the investment activities of the [LLC] that were deemed to constitute sham transactions had not been utilized in 2000 and 2001." For the reasons discussed below, OTA finds that appellants have failed to establish that the transactions giving rise to the claimed IRC section 988 losses had economic substance.

As noted above, appellant-Powlen's protest letter described the transactions giving rise to the claimed IRC section 988 losses and explained that appellants' 1999 through 2001 federal income tax liabilities were, at that time, being disputed with the IRS, and that those proceedings had been placed on hold pending the outcome of federal litigation with the IRS in a "representative 'test' case" challenging the validity of the loss deductions arising from a Son of BOSS tax shelter (identified as *Jade Trading, supra*, 80 Fed.Cl. 11). In *Jade Trading*, the court

³⁷ The purpose of the economic substance doctrine is "to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." (*Coltec Indus., Inc. v. U.S., supra*, 454 F.3d at p. 1353-1354.)

concluded that the foreign currency spread transaction pursuant to which an option spread was contributed to a partnership lacked economic substance and was disregarded for tax purposes.³⁸

Additionally, relevant information concerning Woodleaf Trust's investment activities for the 1999 through 2001 tax years may also be gleaned from the court's findings of fact in *K2 Trading, supra*, 101 Fed. Cl. 365. In *K2 Trading*, the court found that for the 1999 tax year, Woodleaf Trust contributed a spread position to Asuma Trading Ventures, LLC (Asuma) in exchange for a partnership interest and then subsequently withdrew from the partnership.³⁹ (*Id.* at p. 368.) In addition, the court found:

During the 1999, 2000, and 2001 tax years, the Asuma partners [including Woodleaf Trust] sold a portion of the assets received upon exiting the partnership, calculating the basis of these assets with respect to the purchased options only. By disregarding the sold options as contingent obligations, some or all of the Asuma partners claimed losses during the 1999, 2000, and 2001 tax years totaling over \$36 million dollars. The IRS subsequently issued to Asuma [a Final Partnership Administrative Adjustment] with respect to Asuma's 1999 taxable year, which is currently the subject of litigation pending in the United States Tax Court [in *Asuma Trading Ventures, LLC v. Commissioner*] (Docket No. 26772-06).

(*Ibid*; Internal citations omitted.)

For the 2000 tax year, the court in *K2 Trading* found that Woodleaf Trust had also contributed spread positions to K2 Trading Ventures, LLC (K2) in exchange for a partnership interest. (*K2 Trading, supra*, 101 Fed. Cl. at pp. 369-370, 372.) On May 8, 2001, K2 "closed out all of the spread positions that the Participants [including Woodleaf Trust] had contributed to K2." (*Id.* at p. 373.) "Upon withdrawal, the Participants [including Woodleaf Trust] received stock and/or currency in exchange for their interest in K2." (*Ibid.*) As of the issuance of the court's opinion in *K2 Trading*, Woodleaf Trust had not yet disposed of any assets it had received from the liquidation of K2. (*Id.* at p. 374)

³⁸ *Jade Trading* was affirmed in part and reversed on other grounds in *Jade Trading, LLC v. U.S.* (Fed. Cir. 2010) 598 F.3d 1372.

³⁹ A spread transaction "involves the purchase and sale of foreign currency options, creating a spread position, which is contributed to a partnership. When the investor exits the partnership, a marketable asset is received which has a high-basis and low value, the sale of which generates a loss." (*K2 Trading, supra*, 101 Fed. Cl. at p. 368 [citing *Jade Trading, supra* 80 Fed.Cl. at p. 18].)

Given the similarities, OTA finds it reasonable to conclude that the IRC section 988 loss transactions described in appellant-Powlen's protest letter are the same as (or substantially similar to) the spread transactions entered into by Woodleaf Trust and contributed to Asuma in 1999, as described in *K2 Trading*. The U.S. Tax Court has yet to issue a final ruling on the validity of any losses arising from these transactions.⁴⁰ However, it appears that the steps taken by Woodleaf Trust in 1999 are analogous to those typically taken in a Son of BOSS tax shelter and were "designed to produce noneconomic tax losses by artificially overstating basis in partnership interests." (IRS Notice 2000-44, 2000-36 I.R.B. 255, (Notice 2000-44) [identifying Son of BOSS transactions as "listed transactions"].)⁴¹

Although complicated in execution, the premise behind a Son of BOSS transaction is relatively simple. Artificial losses are generated by purchasing and writing option contracts with offsetting premium amounts, transferring them to a partnership in exchange for an interest in the partnership, and claiming an outside basis which:

is increased by the cost of the purchased call options but is not reduced under [IRC section] 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the written call options. Therefore, disregarding additional amounts contributed to the partnership, transaction costs, and any income realized and expenses incurred at the partnership level, the taxpayer purports to have a basis in the partnership interest equal to the cost of the purchased call options ... even though the taxpayer's net economic outlay to acquire the partnership interest and the value of the partnership interest are nominal or zero."

(Notice 2000-44.)

The federal courts have, on numerous occasions, held that the artificial losses resulting from Son of BOSS transactions should be disregarded for lack of economic substance. (*K2 Trading, supra*, 101 Fed. Cl. 365; *Jade Trading, supra*, 80 Fed. Cl. 11; see also *Stobie Creek Investments LLC v. U.S.* (Fed. Cir. 2010) 608 F.3d 1366.)

While review of the relevant source documentation relating to the transactions would be the ideal method of verifying whether appellants are entitled to their claimed IRC section 988

⁴⁰ At the time this Opinion was issued a decision had not yet been issued by the tax court in *Asuma Trading Ventures, LLC v. Commissioner* (Docket No. 26772-06), and the matter was still pending before the tax court.

⁴¹ A listed transaction is one which the IRS has identified as a tax avoidance transaction or substantially similar transactions, subject to various heightened reporting requirements. (See IRC, § 6011; Treas. Reg. § 1.6011-4.)

losses for the 2000 and 2001 tax years, appellants have failed to provide any source documentation as evidence in this appeal. Consequently, OTA cannot ascertain what, if any, portion of appellants' claimed IRC section 988 losses stemmed from legitimate investment activities, as opposed to Son of BOSS tax shelter transactions.⁴² At a fundamental level, as noted above, because appellants have failed to provide any relevant source documentation relating to the transactions, appellants have failed to establish the loss transactions occurred, and generated losses in the amounts and tax years claimed. Thus, appellants have failed to establish that the transactions giving rise to the claimed IRC section 988 had economic substance and a valid business purpose and have failed to establish error in FTB's proposed assessments disallowing these losses. (*Jade Trading, supra; Appeal of Vardell, supra.*)

i. Appellants' Alternative Argument that the Pass-Through Income from the New York LLCs Must also be Eliminated

Alternatively, appellants argue that “[i]f investments activities are classified as sham transactions that lack business purpose and economic substance, all of the separately reported tax items from such investment activities must be eliminated from the income tax reporting.” However, the mere fact that Woodleaf, Asuma, K2, or any of the New York LLCs had engaged in Son of BOSS transactions for the purpose of creating fictitious losses, is insufficient to show that the flow-through *income* generated by those same entities, or any of the other New York LLCs, was similarly fictitious.

The court in *K2 Trading* found that K2 “has not met its burden of proving that the spread transactions contributed to [it] had economic substance by a preponderance of the evidence.” (*K2 Trading, supra*, 101 Fed. Cl. at p. 379.) Importantly, the court did not conclude that the LLCs (Asuma or K2) themselves were shams or conducted no legitimate investment or business activities in addition to the Son of BOSS transactions which were found to lack economic substance. Similarly, FTB concluded that the Son of BOSS transactions lacked economic substance. The creation of fictitious losses and the receipt of actual income are not mutually

⁴² Given the similarities between appellants' description of the transactions in the protest letter and the Son of BOSS tax shelter transactions described in Notice 2000-44, *Jade Trading, supra*, 80 Fed. Cl. 11, and *K2 Trading, supra*, 101 Fed. Cl. 365, this Opinion will not further discuss the economic substance doctrine. Because appellants have failed to provide any source documentation from which an examination may be conducted, OTA will not discuss or apply the two-part test economic substance test adopted by the Ninth Circuit in *Casebeer v. Commissioner, supra*, 909 F.2d 1360 and applied by OTA in *Appeal of La Rosa Capital Resources, Inc.*, 2020-OTA-220P.)

exclusive. OTA concurs with appellants' observation in their reply brief that "Son of BOSS transactions involved the creation of paper losses to offset *real gains* for selected partners."⁴³ (Italics added.) Therefore, appellants have not established that the relevant income-producing transactions lacked economic substance or that the resulting income was fictitious.

Based on the foregoing, OTA finds that appellants have not shown error in FTB's proposed assessments for the 2000 and 2001 tax years.⁴⁴

⁴³ See also footnote 34 above, where appellant-Powlen appears to acknowledge that the IRS only challenged some (not all) of the transactions performed by the New York LLCs and/or certain members of those LLCs. Appellant-Powlen expressly states that the pass-through items reported by the New York LLCs were accepted as filed by IRS: "[T]he income tax returns filed by each of the New York [LLCs] in which Woodleaf Trust was a member had been accepted as filed, specifically including the K-1s issued to Woodleaf Trust by each of the entities in which Woodleaf Trust held an interest." Appellant-Powlen's protest letter similarly states, "In addition to the IRC [section] 988 sales transactions reflected on the 2000 and 2001 returns, [appellants] reported appropriately the income, expenses, gains and losses from approximately ten other investment vehicles held in the name of Woodleaf Trust."

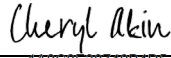
⁴⁴ The briefing in this case was voluminous. To the extent appellants raise arguments OTA has not directly addressed in this Opinion, OTA has considered them and found them to be without merit.

HOLDINGS

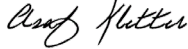
1. FTB’s proposed assessments for the 2000 and 2001 tax years are valid.
2. Appellants have not shown error in FTB’s proposed assessments for the 2000 and 2001 tax years, disallowing appellants’ claimed IRC section 988 losses in the amounts of \$3,002,413 and \$251,132, respectively.


DISPOSITION

FTB’s actions are sustained.

DocuSigned by:

 Cheryl L. Akin
 Administrative Law Judge

We concur:

DocuSigned by:

 Asaf Kletter
 Administrative Law Judge

DocuSigned by:

 Amanda Vassigh
 Administrative Law Judge

Date Issued: 8/9/2024