

In the Matter of the Consolidated Appeals of:

M.L. WATTS,

C.A. WATTS,

C. WATTS AND

M. WATTS

) OTA Case Nos. 220710738, 220710739
)
)
)
)
)

OTA will grant a rehearing where one of the following grounds for a rehearing exists and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the appeal proceedings which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise, 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 Shanahan*, 2024-OTA-040P.)

“[A] taxpayer [] contesting [FTB’s] determination of unity . . . must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied on by [FTB] are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.” (*Appeal of Smith*, 2023-OTA-069P.) In the underlying appeal, appellants addressed the unitary connections relied on by FTB by presenting numerous arguments and supporting evidence. For the most part, FTB ignored these arguments and evidence entirely, neither acknowledging nor addressing them. Yet now, in its petition, FTB contends that the Opinion should have addressed arguments that FTB itself never raised or discussed in its briefing. Although FTB attempts to frame its petition as alleging insufficient evidence to justify the Opinion or that the Opinion is contrary to law, the substance of its request is unmistakable: FTB is attempting to introduce new arguments and legal theories that it could have raised before the Opinion issued, but did not.

For example, one central issue in the appeal is whether Sunstate’s use of an aircraft owned by WHI’s wholly owned subsidiary, Sunstate Aviation and Leasing, LLC’s (Aviation), constituted a substantial flow of value sufficient to support a finding that Sunstate and WHI were engaged in a unitary business. Appellants argued it did not, noting that the aircraft use represented less than 10 percent of Sunstate’s total expenditures, the use was limited and declining, and all transactions were conducted at arm’s length. In support, appellants submitted substantial evidence, including Sunstate’s unaudited 2012 financial statements, comprehensive flight logs with thousands of entries, a declaration from WHI’s CFO, C. Nute, and a declaration from Sunstate’s VP of Strategy and Finance, Y. Matsui.

In response, FTB did not address appellants’ arguments or even acknowledge the evidence submitted. Instead, FTB offered only three vague sentences lacking specificity and containing no citation to the record:

The aircraft owned by WHI was used by the Appellants for both personal and business (Sunstate) travel. When not used by Appellants, the aircraft was leased for use by others outside of Sunstate. The use of the aircraft demonstrates a flow of value from WHI to Appellants and Sunstate.

In the Opinion, OTA observed that “[d]espite appellants’ robust evidence on this issue, FTB did not address or provide OTA with a contrary characterization of appellants’ evidence.” Based on the record before it, OTA found that Sunstate’s use of Aviation’s aircraft did not constitute a substantial flow of value.

Now, in its petition, FTB expands its previously undeveloped three-sentence argument into three pages of new arguments asserting that the aircraft use was a substantial flow of value, and even relies on evidence that was not part of the record of the underlying appeal. These arguments could have been raised before issuance of the Opinion—but were not. Raising new arguments at this stage is not a valid ground for rehearing.

Parties appearing before OTA are generally responsible for presenting the facts and arguments supporting their positions. (See Cal. Code Regs., tit. 18, § 30102(i) [“‘Brief’ means a written document containing an argument or arguments concerning a party’s position”], (w) & (ff) [the record that an OTA panel shall consider in reaching a determination includes the parties’ arguments]; *United States v. Sineneng-Smith* (2020) 590 U.S. 371, 375–376 [as a general rule, parties “know what is best for them, and are responsible for advancing the facts and argument entitling them to relief”].) Because OTA is an independent and impartial tribunal, OTA cannot be an advocate for either party or for any particular outcome. (See Taxpayer Transparency and Fairness Act of 2017 (Stats. 2017, Ch. 16); *Appeal of Eric H. Liljestrand Irrevocable Trust*, 2019-OTA-012P.)

FTB’s dissatisfaction with the outcome of the appeal, and the attempt to reargue the same issues a second time, is not grounds for a rehearing. (*Appeal of Graham and Smith*, 2018-OTA-154P.) Where a party had ample opportunity to address an issue and discover and produce all relevant information, the “fact that it now wishes it had more fully explored the issue does not provide a basis for a rehearing.” (*Appeal of Nassco Holdings, Inc.* (2010-SBE-001) 2010 WL 5626976.)

A similar principle applies to alternative theories raised for the first time in a petition for rehearing. In the underlying appeal, FTB framed the sole issue in its brief as: “Whether WHI and Sunstate were unitary in the year of sale, 2012.” In the Opinion, OTA noted that “neither party made any alternative arguments in the event that the party loses its unitary argument. . . . Therefore, in this appeal, OTA will only address the unitary business issue.” (Opinion, p. 7, fn. 3.)

Despite this, FTB now argues in its petition that the Opinion failed to conduct a business-income analysis—namely, whether the income at issue constitutes business income under the transactional test (arising from transactions in the regular course of business) or the functional test (where the acquisition, management, and disposition of the property are integral to the taxpayer’s business operations). (See *Hoechst Celanese Corp. v. Franchise Tax Bd.* (2001) 25 Cal.4th 508, 520.)

But FTB never raised or discussed this theory in its briefing. “New theories that could have been raised, but were not, is not one of the causes that permits a new [hearing].” (*Insurance Co. of State of Pennsylvania v. American Safety Indemnity Co.* (2019) 32 Cal.App.5th 898, 922.)¹ When a party chooses not to argue in the alternative, OTA will not do so on its behalf. (See *Feigh v. Commissioner of Internal Revenue* (T.C. 2019) 152 T.C. 267, 277.) OTA’s role is to evaluate issues advanced by the parties, not to craft alternative arguments never raised. (See *ibid.*)²

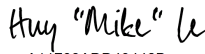
OTA declines to address the remaining new arguments FTB raises in its petition, as consideration of such arguments would inappropriately permit FTB to advance arguments it could—and should—have raised earlier.

OTA notes that FTB also advances arguments that mischaracterize or misstate the Opinion, effectively challenging positions the Opinion did not take. For example, FTB asserts that “the Opinion *relied exclusively* on evidence of a third party’s ownership of Sunstate” to conclude that WHI and Sunstate were not unitary. (*Italics added.*) But the Opinion did not rely exclusively on any single factor and expressly noted that the ownership requirement is disregarded under the three-unities test. Similarly, FTB claims the Opinion states “as a legal rule” that a complete overlap of officers is required to establish an integrated executive force. The Opinion contains no such rule. Rather, it found that the partial overlap of officers in this case was insufficient in light of the other arguments and evidence presented by appellants—arguments and evidence that FTB failed to address in the underlying appeal. Taken together, FTB’s assertions reflect a misreading of the Opinion rather than a substantive challenge to its actual reasoning.

¹ A rehearing may be granted where a party raise a new legal theory for the first time on a pure question of law to be applied to undisputed facts in the record. (*Hoffman-Haag v. Transamerica Ins. Co.* (1991) 1 Cal.App.4th 10, 15.) FTB’s business-income theory is not a pure question of law and the facts in the record are disputed.

² FTB further contends that appellants bear the burden of proving the income at issue is nonbusiness income. But appellants cannot be expected to present arguments or evidence on a theory FTB never raised in the underlying appeal.

Upon consideration of FTB's petition, OTA concludes that there is no basis for granting a new hearing. The petition is therefore denied.

DocuSigned by:

A11783ADD49442B...

Huy "Mike" Le
Administrative Law Judge

We concur:
Signed by:

CB1F7DA37831416...

Josh Lambert
Administrative Law Judge

DocuSigned by:

3AF5C32BB93B456...

Kenneth Gast
Administrative Law Judge

Date Issued: 7/14/2026