

California Court of Appeal Upholds FTB's Disallowance Of Dividends Received Deduction, Imposition of Amnesty Penalty



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In 2004, the California Court of Appeal ruled, in *Farmer Brothers v. California Franch. Tax Bd.*, that California could not restrict its dividends received deduction (DRD) to dividends paid from income subject to tax in the state. Such a practice, the court held, was discriminatory under the U.S. Commerce Clause. Rather than authorize refunds to taxpayers that had been denied the deduction, the FTB determined that the proper remedy was to disallow the DRD for all taxpayers, regardless of the source of the income. This remedy was itself challenged as unconstitutional, in *River Garden Retirement Home v. California Franch. Tax Bd.* On July 15, 2010, the court of appeal issued its decision in *River Garden*, upholding the FTB's disallowance of the DRDs and affirming the imposition of an amnesty penalty on the taxpayer. In this article, authors Valerie C. Dickerson and Shirley Wei, of Deloitte Tax LLP, review this latest decision and assess its implications for other taxpayers.

California Court of Appeal Upholds FTB's Disallowance Of Dividends Received Deduction, Imposition of Amnesty Penalty

By VALERIE C. DICKERSON AND SHIRLEY WEI

INTRODUCTION

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On July 15, 2010, the California Court of Appeal, First Appellate District, issued its decision in *River Garden Retirement Home v. California Franch. Tax Bd.*² In *River Garden*, the Franchise Tax Board (FTB) disallowed a dividends received deduction (DRD) taken by the taxpayer under Cal. Rev. & Tax. Code §24402 for tax years 1999 and 2000 for dividends paid out of income that had been subject to California tax in the hands of the payors. The FTB also imposed an amnesty penalty on the taxpayer under §19777.5 for the

² *River Garden Retirement Home v. California Franch. Tax Bd.*, 186 Cal. App. 4th 922 (Cal. Ct. App. 2010).

same tax years. The court of appeal held in favor of the FTB on both issues, ultimately concluding that the FTB was correct both in its disallowance of the DRD and in the imposition of the amnesty penalty.

On Aug. 25, 2010, the taxpayer in *River Garden* timely filed a petition for review with the California Supreme Court. The outcome of the *River Garden* litigation may impact other taxpayers who are subject to an assessment for the amnesty penalty applicable to pre-2003 deficiencies.

This article provides an overview of related cases involving the DRD under §24402 that led up to *River Garden*, summarizes the appeals court opinion in *River Garden* with respect to the DRD and amnesty penalty issues, and briefly discusses cases in which the amnesty penalty under Cal. Rev. & Tax. Code §19777.5 was recently or is currently being litigated.

BACKGROUND: CASES PREDATING RIVER GARDEN

Pursuant to §24402, California permitted a deduction for dividends received from corporations outside the unitary combined reporting group to the extent the dividends were paid out of income previously taxed in California. In 2003, the California Court of Appeal, Second Appellate District, held in *Farmer Bros. Co. v. California Franch. Tax Bd.* (*Farmer Bros.*) that §24402 was facially discriminatory and, therefore, unconstitutional, because it granted a deduction for dividends declared from income included in the payor's California tax base, while no such deduction was afforded dividends from other income that was not subject to California tax.³

In response to the *Farmer Bros.* decision, in May of 2004, the FTB issued a memorandum stating its position that §24402 was unconstitutional in its entirety.⁴ Accordingly, the FTB determined that the proper remedy for open tax years (years ending on or after Dec. 1, 1999) was to disallow DRDs permitted under §24402 in their entirety, rather than to sever or reform the statute to allow DRDs with respect to dividends paid from income both subject to and not subject to California tax.⁵

The FTB determined that the proper remedy ... was to disallow DRDs permitted under §24402 in their entirety, rather than to sever or reform the statute.

In another case adjudicated before the California Court of Appeal, Second Appellate District, Abbott Laboratories (*Abbott Labs*) claimed an 80 percent DRD

³ *Farmer Bros. Co. v. California Franch. Tax Bd.*, 108 Cal. App. 4th 976 (2003), cert denied, 540 U.S. 1178 (2004).

⁴ Franchise Tax Bd. Memorandum, Departmental Procedures on Section 24402 Dividend Received Deduction (May 17, 2004).

⁵ *Id.*

(applicable to tax years 1999 and 2000) under §24402 for dividends received from TAP Pharmaceutical Products Inc. (TAP), a corporation that did business outside of California and in which Abbott Labs owned 50 percent of the outstanding common stock. A portion of TAP's income was subject to California tax while the remainder was not. On audit, the FTB had disallowed a DRD under §24402 for dividends that had been declared on income not previously subject to California tax.

On July 21, 2009, the appellate court issued its published decision in *Abbott Labs*,⁶ holding, *inter alia*, that the DRD under §24402 is invalid in its entirety for 1999 and subsequent years and that, contrary to Abbott Labs' contentions, rewriting or reforming the unconstitutional subdivision (§24402(a)) to sever its invalid portion would be inappropriate because it would be inconsistent with the California Legislature's intent and would contradict the purpose of the statute's enactment.

On Nov. 6, 2008, as *Abbott Labs* was proceeding through the appellate court, *River Garden* filed its own appeal. *River Garden*'s case involved the same issue as in *Abbott Labs*, but under a different factual context. Specifically, the court of appeal addressed two issues: First, whether §24402—which, as noted previously, was held unconstitutional in *Farmer Bros.* in 2003—could be severed or reformed by eliminating only the unconstitutional restriction and leaving the rest of the section in effect. Second, whether it was proper to impose the “amnesty penalty” on the taxpayer, which had failed to pay the deficiency by the March 31, 2005, deadline specified in California's amnesty program for tax years beginning before Jan. 1, 2003.⁸

California's 2005 tax amnesty program allowed taxpayers to satisfy unpaid California income and franchise tax liabilities (for tax years beginning before Jan. 1, 2003) by paying the amount due during the period from Feb. 1, 2005, through March 31, 2005. A taxpayer that was eligible to participate in the amnesty program, but did not (or did not participate as to the full amount due), was subject to an additional “amnesty penalty” of 50 percent of the interest accrued through the end of the amnesty period on unpaid tax amounts that were “due and payable” as of the end of March 31, 2005.⁹

As an amnesty eligible-taxpayer, *River Garden* had failed to pay the applicable deficiency by the March 31, 2005, amnesty deadline for tax years beginning before Jan. 1, 2003. As a result, the taxpayer now finds itself being held liable for repaying the DRDs it had legally claimed a decade ago.

The first issue—the DRD—is discussed immediately below; the second issue—the amnesty penalty—is discussed thereafter.

RIVER GARDEN DECISION: DRD UNDER §24402

River Garden, a California corporation, operated a retirement home in Lodi, Calif. *River Garden* received

⁶ *Abbott Laboratories v. California Franch. Tax Bd.*, 175 Cal. App. 4th 1346 (July 21, 2009), mod. 2009 Cal.App.LEXIS 1298 (Aug. 6, 2009).

⁸ Cal. Rev. & Tax. Code §19777.5.

⁹ Cal. Rev. & Tax. Code §19777.5(a).

dividends of \$46,271 in 1999 and \$55,025 in 2000 that, unlike the dividends at issue in *Abbott Labs*, were paid out of income that had been subject to California tax in the hands of the payors. Pursuant to §24402, River Garden deducted 80 percent of these dividends on its California franchise tax returns for 1999 and 2000. On audit, the FTB disallowed the deductions in their entirety based on its position that §24402, in its entirety, had been held unconstitutional.

After exhausting its administrative remedies, River Garden brought its case before a trial court, which sustained the FTB's demurrer to River Garden's challenge to the underlying tax issue and granted summary judgment in the FTB's favor on the challenge to the amnesty penalty. Subsequently, River Garden filed an appeal with the California Court of Appeal.

In its opening brief on appeal, River Garden initially argued that the court should preserve §24402 by severing the portion of the statute that unconstitutionally limits the DRD to those dividends paid from California sources.¹⁰ This argument was similar to the argument proffered by the taxpayer in *Abbott Labs*. Following the court of appeal's decision in *Abbott Labs*, River Garden conceded that §24402 was conclusively determined to be unconstitutional. River Garden then re-framed the question, arguing that severance was the appropriate remedy for curing the unconstitutionality of §24402.¹¹ On appeal, River Garden argued:

- that the demurrer was improper because the FTB did not establish that it had cured the discrimination for the years in question, *i.e.*, by showing that the favored and disfavored taxpayers in fact were treated equally during that period;

- that the language and legislative history of § 19393 (applicable to recomputations of tax if a provision is found to be invalid or discriminatory) indicated that the section applied only to national banks, and that because River Garden was not a national bank, the FTB lacked statutory authority to recompute its tax by disallowing the DRD at issue;¹²

- that the remedy of disallowing the DRD for tax years ending on or after Dec. 1, 1999, violated the prohibition set forth under the Due Process Clause of the U.S. Constitution against excessively retroactive tax increases; and

- that the FTB's decision to issue deficiency assessments to disallow the DRD for the years at issue results in a tax increase for corporate taxpayers that was not approved by a two-thirds vote of the California Legislature in breach of Cal. Const., art. XIII A, §3.¹³

As to River Garden's first contention, the court of appeal, citing the U.S. Supreme Court in *McKesson Corp. v. Florida Alcohol & Tobacco Div. (McKesson)*,¹⁴ stated that the FTB's duty was to provide a "clear and certain" remedy to rectify the discriminatory tax treatment, which, as viewed by the court, the FTB had done in this instance.¹⁵ Where the taxing authority chooses a remedial alternative that includes retroactive assessments, a "good-faith effort to administer and enforce such a [remedy] likely would constitute adequate relief."¹⁶ River Garden's suit for refund attacked the validity of the FTB's remedy, but did not allege that the FTB had failed to make a good faith effort to administer and enforce the remedy.¹⁷

River Garden's second assertion was that the language and legislative history of §19393 indicated that the section only applied to national banks, and because River Garden was not a national bank, the FTB lacked statutory authority to recompute its tax by disallowing the DRD at issue. In response, the court of appeal stated that where, as in the present case, the statute is clear and unambiguous on its face, the court will not resort to legislative history or other sources to ascertain the legislative intent of a statute.¹⁸ River Garden further asserted that Cal. Const., art. III, §3.5 proscribed the FTB, as an administrative agency, from determining the manner in which to implement California's tax laws in the face of *Farmer Bros.*¹⁹ The court of appeal responded that the courts in *Farmer Bros.* and *Abbott Labs* unequivocally established that §24402 is unconstitutional in its entirety, which is all that is required to enable the FTB to craft a remedy declining to enforce the statute for the years at issue. Further, §19393 specifically sanctions the FTB's actions, the court said.²⁰ Generally, §19393 authorizes the FTB to recompute tax for the taxable year in question if a provision is found to be invalid or discriminatory.²¹

¹⁰ *River Garden*, 186 Cal. App. 4th at 934.

¹¹ *Id.*

¹² Section 19393 provides:

For the purposes of the tax imposed under Chapter 2 (commencing with §23101) of Part 11, if any deduction, credit or exclusion provided for in Part 10 (commencing with Section 17001) of Part 11 (commencing with Section 23001) is finally adjudged discriminatory against a national banking association contrary to Section 548 of Title 12 of the United States Code, or if for any reason finally adjudged invalid, or discriminatory under the California Constitution, or the laws or the Constitution of the United States, the tax of the favored taxpayer shall be recomputed by the Franchise Tax Board for the taxable year in question, as of the time of allowance of the deduction, credit, or exclusion, by disallowing the deduction, credit, or exclusion, and any difference between the amount of the tax as recomputed and the amount of the tax as originally computed shall be subject to the provisions hereof relating to original computations.

¹³ *River Garden*, 186 Cal. App. 4th at 940-941.

¹⁴ *McKesson Corp. v. Florida Alcohol & Tobacco Div.*, 496 U.S. 18 (1990).

¹⁵ *River Garden*, 186 Cal. App. 4th at 940.

¹⁶ *Id.* (citing *McKesson*, 496 U.S. at 40-41).

¹⁷ *River Garden* 186 Cal. App. 4th at 940.

¹⁸ *Id.* at 942. However, the court of appeal noted that, contrary to River Garden's contentions, the legislative drafters wanted to emphasize the FTB's authority to recompute deductions, credits, or exclusions that are discriminatory against national banks contrary to 12 U.S.C. §548, while also more broadly recognizing that authority when a taxing provision fails under the state or federal constitutions or other federal law. *Id.*

¹⁹ Cal. Const., art. III, §3.5(a) provides, "[a]n administrative agency. . .has no power. . .[t]o declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional."

²⁰ *River Garden*, 186 Cal. App. 4th at 942-943.

²¹ See above, fn. 12.

The court of appeal concluded that ... the FTB had crafted a clear and certain remedy that afforded “meaningful backward-looking relief.”

In response to River Garden’s third contention—that the FTB’s remedy violated the Due Process Clause of the U.S. Constitution—the court of appeal cited the U.S. Supreme Court in *United States v. Carlton*²² and stated that the issue was whether the FTB’s four-year retroactive period was sufficiently “modest” as to pass constitutional muster. The court of appeal found that it was.²³ Therefore, the court of appeal concluded that, pursuant to the authority granted to the FTB under § 19393, the FTB had crafted a clear and certain remedy that afforded “meaningful backward-looking relief” and treated all taxpayers similarly for the years in question, as required under *McKesson*.²⁴ The court of appeal stated that “[d]eductions are a matter of legislative grace. Taxpayers have no vested right in the Internal Revenue Code nor, by analogy, to the California Revenue and Taxation Code and its dividends received deduction.”²⁵ In addition, the period of retroactivity coincided with the general four-year statute of limitations for issuing deficiency assessments, which supported the reasonableness of the remedy.²⁶ Moreover, the court of appeal concluded that the FTB acted promptly to develop the policy and procedures regarding the manner in which to apply *Farmer Bros*. Finally, the court of appeal found the FTB’s remedy did not “place new obligations on the taxpayer undermining the clarity or certainty of the remedy in a manner inconsistent with due process.”²⁷

Finally, the court of appeal addressed River Garden’s fourth argument—that the FTB’s remedy resulted in a violation of Cal. Const., art. XIII A, § 3, requiring that tax increases for corporate taxpayers must generally be approved by a two-thirds vote of the California Legislature.²⁸ The court of appeal found that the FTB did not enact any law and did not develop and implement the

²² *River Garden*, 186 Cal. App. 4th at 945, citing *United States v. Carlton*, 512 U.S. 26 (1994).

²³ *Id.* at 945. In *Carlton*, Congress amended a statute to rectify a mistake in the original tax law that applied retroactively to the enactment of the original statute, but had an actual retroactive effect of slightly more than a year. (*River Garden*, 186 Cal. App. 4th at 944.) The U.S. Supreme Court in *Carlton* found that the means to achieve that purpose was reasonable because Congress acted promptly and established only a modest period of retroactivity. *Id.*

²⁴ *Id.* at 949.

²⁵ *Id.*

²⁶ Pursuant to § 19057(a), the FTB must mail a notice of proposed deficiency assessment to the taxpayer within four years after the return was filed. § 19057(a). The FTB could not apply this remedy to tax years ending prior to Dec. 1, 1999, because the statute of limitations for mailing notices of proposed deficiency assessments to disallow § 24402 DRDs already claimed had expired. *River Garden*, 186 Cal. App. 4th at 940. However, it was still open for taxpayers who claimed the deduction for tax years ending on or after Dec. 1, 1999. *Id.*

²⁷ *Id.* at 949.

²⁸ Cal. Const., art. XIII A, § 3 provides:

policy of disallowing the DRD for the purpose of increasing revenues collected, but rather to rectify the Commerce Clause violations found in § 24402.²⁹ Thus, the court concluded that art. XIII A, § 3 had not been violated.

Based on the rationale stated above, the court of appeal held that:

- § 24402 cannot be saved by severance of the unconstitutional language nor by judicial reformation of the section;

- the FTB proceeded properly to remedy the constitutional violation by disallowing the DRD for tax years 1999 and 2000;

- this remedy did not violate the Due Process Clause of the U.S. Constitution against excessively retroactive tax increases; and

- the FTB’s decision to disallow the deductions for those years did not run afoul of Cal. Const., art. XIII A, § 3.³⁰

RIVER GARDEN DECISION: AMNESTY PENALTY UNDER § 19777.5

The second issue in *River Garden* was whether it was proper for the FTB to impose the “amnesty penalty” on River Garden.

California’s 2005 tax amnesty program, administered by the FTB, granted taxpayers with unpaid tax liabilities for tax years beginning before Jan. 1, 2003, an opportunity to apply for amnesty by filing an amnesty application and paying unpaid California income and franchise during the period from Feb. 1, 2005, through March 31, 2005. A taxpayer that participated in the program and fully complied with its requirements could, in exchange, avoid various penalties and possible criminal proceedings. A taxpayer that was eligible to participate in the tax amnesty program, but did not (or did not participate as to the full amount due), was subject to an additional “amnesty penalty” of 50 percent of the interest accrued through the end of the amnesty period on unpaid tax amounts that were “due and payable” as of the end of the amnesty period (March 31, 2005).³¹

In *River Garden*, the court of appeal upheld the FTB’s imposition of the amnesty penalty on the taxpayer, concluding that:

Any changes in state taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature.

²⁹ *River Garden*, 186 Cal. App. 4th at 950.

³⁰ *Id.* at 932. *River Garden* does not involve the taxpayer’s ability to eliminate or deduct dividends received under other sections of the code: (1) Cal. Rev. & Tax. Code § 25106 (elimination of dividends paid by and to members of the same combined group out of unitary business income of the group), (2) Cal. Rev. & Tax. Code § 24410 (dividends paid from insurance company affiliates), or (3) Cal. Rev. & Tax. Code § 24411 (dividends paid from a subsidiary excluded from the California combined group through a water’s-edge election).

³¹ § 19777.5(a).

■ the deficiency assessments issued by the FTB for tax years 1999 and 2000 were “due and payable” within the meaning of § 19777.5;³²

■ § 19777.5 did not operate retroactively, and thus imposition of the penalty did not raise concerns under the Due Process Clause of the U.S. Constitution; and

■ there was no statute of limitations that would bar imposition of the penalty for tax year 1999.³³

As part of the proceedings before the court of appeal, River Garden made the following arguments:

■ that it was not subject to an amnesty penalty because it paid in full the underlying tax deficiencies before they ever became “due and payable” within the meaning of §§ 19777.5(a) and 19049(a);³⁴

■ that § 19777.5, the amnesty penalty statute, violated substantive due process because it operated impermissibly for an indefinite and excessive period of retroactivity; and

■ that the four-year statute of limitations for assessing the amnesty penalty for tax year 1999 had already expired by the time § 19777.5 was enacted in August of 2004.³⁵

With respect to River Garden’s first contention, the court of appeal found that, although the amnesty penalty provisions in § 19777.5 did not define “due and payable,” the statute expressly stated that the general definition of “due and payable” contained in § 19049 did not apply. Specifically, § 19777.5(d) provides that “Article 3. . . (relating to deficiency assessments) [that commences with § 19031 and includes § 19049] shall not apply with respect to the assessment or collection of any penalty imposed [by this statute].”³⁶

The court of appeal also reviewed the legislative intent and concluded, *inter alia*, that the amnesty program “aimed to accelerate the collection of unreported and underreported tax liabilities.” The court found that the taxpayer’s argument that the liability was not “due and payable” until 15 days after the FTB’s “Corporation Formal Demand” would allow “a noncompliant taxpayer to escape the amnesty penalty by paying its tax liability following a final assessment issued years after the close of the amnesty period, but within 15 days of a notice and demand for payment.”³⁷ Based on this reasoning, the court determined that the assessment became final and was “due and payable” 30 days after the California State Board of Equalization issued its decision affirming the FTB’s notices of action issued to

³² § 19777.5(a)(2) provides:

For amounts that become due and payable after the last date of the amnesty period, [a penalty shall apply in] an amount equal to 50 percent of the interest computed under Section 19101 on any final amount, including final deficiencies and self-assessed amounts, for the period beginning on the last date prescribed by law for the payment of the tax for the year of the deficiency (determined without regard to extensions) and ending on the last day of the amnesty period specified in Section 19731.

³³ *River Garden*, 186 Cal. App. 4th at 932.

³⁴ Under § 19049(a), a “deficiency assessed is due and payable at the expiration of 15 days from the date of the notice and demand.” § 19049(a).

³⁵ *River Garden*, 186 Cal. App. 4th at 952-958.

³⁶ § 19777.5(d).

³⁷ *River Garden*, 186 Cal. App. 4th at 954.

River Garden.³⁸ The court then concluded that, because River Garden paid the tax deficiency several months after it became “due and payable,” the FTB properly imposed the amnesty penalty.

“River Garden seems to forget that this is an amnesty program—there are benefits to participating and adverse consequences for not participating.”

CALIFORNIA COURT OF APPEAL

River Garden argued that the FTB’s interpretation would lead to absurd consequences because taxpayers with “no known liabilities,” or who were contesting proposed tax liabilities as of March 31, 2005, that had no penalties asserted by the FTB in connection with them, might be subject to the amnesty penalty if the FTB later determined that there was a tax deficiency due.³⁹ However, the court of appeal declined to express any opinion about the “unknown liabilities” situation because the case did not involve a taxpayer with “no known liability.”⁴⁰ The court noted that “River Garden seems to forget that this is an amnesty program—there are benefits to participating and adverse consequences for not participating, which means the taxpayer can undertake a cost benefit analysis to determine if coming in under amnesty is worth it.”⁴¹ Moreover, the court of appeal noted that, even if § 19049(a) applied, River Garden did not pay within 15 days of notice and demand as required under § 19049(a).⁴²

Regarding River Garden’s second contention, the court of appeal concluded that the amnesty penalty did not violate Due Process because § 19777.5 did not in fact apply retroactively.⁴³ Section 19777.5 applied prospectively to assessments for amnesty-eligible years that remained unpaid or became final after March 31, 2005. Therefore, the court of appeal stated that it was a taxpayer’s current failure to discharge tax liabilities that subjected the taxpayer to increased consequences, such as the amnesty penalty (and not an increased underlying tax liability) for nonpayment of past due taxes.⁴⁴

In response to River Garden’s third contention—that the statute of limitations for assessing the 1999 penalty had expired by the time the legislature enacted § 19777.5—the court of appeal reasoned that the generally applicable statutory provision governing assessment and collection of penalties, interest, and additions to tax (*see* § 19036, providing that “any interest, penalty or addition to tax. . . may be assessed and collected in

³⁸ *Id.* at 953-954.

³⁹ *Id.* at 955.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* at 956. Following the State Board of Equalization’s decision, the FTB sent a series of three notices to River Garden demanding payment of the full amount due. The court of appeal considered the FTB’s first notice as a qualifying statutory notice and demand (and not the third notice as River Garden asserted).

⁴³ *Id.* at 956-957.

⁴⁴ *Id.*

the same manner as if it were a deficiency”) was “permissive” and not a mandatory limitation requiring the amnesty penalty to be assessed within the general statute of limitations.⁴⁵ In other words, the court of appeal determined that the language utilized in this section allowed the FTB the *option* of assessing and collecting the penalty in the same manner as if it was a deficiency, but did not require that it do so within those applicable time limits. In addition, the court of appeal held that this provision was explicitly not applicable because §19777.5 stated that the provisions containing §19036 did not apply.⁴⁶

OTHER PROCEEDINGS INVOLVING THE AMNESTY PENALTY

The court of appeal’s decision in *River Garden* is one of several cases in which the validity of the amnesty penalty was or is currently being litigated. Taxpayers considering their options with respect to the amnesty penalty under §19777.5 should note *River Garden* as well as the following cases:⁴⁷

- *Gribble v. California Franch. Tax Bd.*,⁴⁸
- *Cutler v. California Franch. Tax Bd.*,⁴⁹ and
- *Microsoft Corp. v. California Franch. Tax Bd.*⁵⁰

In *Gribble*, in its judgment filed Jan. 27, 2010, the Los Angeles Superior Court held in favor of the taxpayers for a refund of the previously paid amnesty penalty, finding that the penalty was improperly assessed in that case. In its Statement of Decision, dated Dec. 11, 2009, the superior court reasoned that if the FTB had expeditiously conducted the review (and not waited almost 10 years to deny the taxpayer’s protest), then the appeal would have been completed years before the amnesty penalty became due and payable.

⁴⁵ *Id.* at 957.

⁴⁶ *Id.*

⁴⁷ One case not listed, *Shaw v. California Franch. Tax Bd.*, No. BC378829 (Los Angeles Super. Ct., filed Oct. 10, 2007), was settled and no further proceedings are anticipated.

⁴⁸ *Gribble v. California Franch. Tax Bd.*, No. BC393360 (Los Angeles Super. Ct., Jan. 27, 2010).

⁴⁹ *Cutler v. Franchise Tax Board*, No. BC421864 (Los Angeles Super. Ct., filed Sept. 15, 2009).

⁵⁰ *Microsoft Corp. v. California Franch. Tax Bd.*, No. CGC-08-471260 (San Francisco Super. Ct., filed Jan. 22, 2008).

***River Garden* may well be the end of the road for taxpayers seeking to challenge the §24402 DRD.**

Additionally, the FTB did not present evidence that it sent an §19049 notice of assessment to the taxpayers and, thus, because there was no notice sent, the tax was not “due and payable.” This superior court decision is final, but not precedential, since only published appellate decisions may be cited as precedent. The significance of this case is thus limited, but may suggest that, under certain circumstances, there may be grounds for relief from the amnesty penalty that were not involved in *River Garden*.

In *Cutler*, the issue is whether the amnesty penalty violated the Due Process Clause of the U.S. and California Constitutions. Currently, this case is pending in Los Angeles Superior Court. Proceedings are set to begin in October 2010.

In *Microsoft*, the issues are whether there were any “due and payable” franchise tax liabilities to which the amnesty penalty could apply, under facts somewhat different from *River Garden*, and whether the amnesty penalty violated the Due Process Clause because of the procedure for imposition of the penalty and because of its retroactivity. Currently, this case is pending in San Francisco Superior Court.

CONCLUSION

In light of the court of appeal’s decision in *River Garden*, as well as *Farmer Bros.* and *Abbott Labs*, taxpayers may face substantial difficulty in challenging the constitutionality of the DRD under §24402 as well as the validity of the FTB’s remedy. *River Garden* may well be the end of the road for taxpayers seeking to challenge the §24402 DRD on that basis.

Furthermore, as this article demonstrates, if the California Supreme Court denies certiorari in *River Garden* (and, thus, the decision becomes final without further proceedings) or grants review and upholds the court of appeal’s decision, the case may negatively impact other taxpayers who are subject to an assessment for the amnesty penalty applicable to pre-2003 deficiencies.⁵¹ However, the validity of the amnesty penalty imposed on a taxpayer with “no known liabilities” as of March 21, 2005, could be subject to challenge as the court of appeal declined to express an opinion on this issue in *River Garden*.

⁵¹ *River Garden* timely filed a petition for review with the California Supreme Court on Aug. 25, 2010.

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