

**CALIFORNIA STATE BOARD OF EQUALIZATION**

**SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40**

In the Matter of the Appeal of:

**ALAN R. BRAYTON**

) Case No. 852168  
)  
) Oral hearing date: November 29, 2016<sup>1</sup>  
) Decision rendered: December 29, 2016  
) Publication due by: April 28, 2017  
)  
)

Representing the Parties:

For Appellant: Richard Carpenter, Attorney  
For Respondent: Anne Mazur, Specialist

Counsel for the Board of Equalization: John O. Johnson, Tax Counsel III

LEGAL ISSUE

Whether appellant has shown error in the Franchise Tax Board's (FTB or respondent) imposition of the accuracy-related penalty.

FINDINGS OF FACT

In 2004, appellant Alan R. Brayton, an experienced plaintiffs' attorney and founding partner of Brayton Purcell LLP (Law Firm), owned 99 percent of Brayton Purcell APC (S Corporation), an S corporation formed on May 3, 2004. All of the profits and losses of the Law Firm flowed through to the S Corporation, and 99 percent of the S Corporation's profits or losses were allocated to appellant.

After consulting tax and estate planning advisors, appellant engaged or purported to engage in a complex series of transactions beginning in July of 2004 which generated a reported \$49,450,000 in tax deductions. The transactions involved appellant's formation and control of six limited liability companies (LLCs) which each entered into service agreements with the Law Firm and the S Corporation resulting in total payments of \$49,450,000 for a service period of approximately six

<sup>1</sup> At the oral hearing, the Board voted unanimously to sustain the action of the Franchise Tax Board.

1 months. The LLCs did not file any tax returns or report any of the income. At the same time, appellant  
2 entered into agreements to provide the services to the LLCs for \$180,000, which was less than one-half  
3 of one percent of the amount charged to the Law Firm for the services. During the period at issue,  
4 appellant, his Law Firm, and his S Corporation also engaged or purported to engage in a complicated  
5 series of transactions involving currency-linked deposits, unitrusts, promissory notes, and the LLCs.  
6 However, appellant retained control of the LLCs. As discussed below, appellant claimed to have  
7 reasonably relied on a legal opinion regarding the series of transactions at the end of 2004, as well as  
8 advice from other professionals.

9 The S Corporation deducted the \$49,450,000 in payments to the LLCs as ordinary and  
10 necessary business expenses, which in turn substantially reduced appellant's taxable income from the  
11 S Corporation and reduced his personal taxable income by more than 75 percent. Respondent  
12 disallowed the claimed deduction at audit and issued a proposed assessment to appellant for additional  
13 tax and a 20 percent accuracy-related penalty. Appellant appealed respondent's assessment of the  
14 penalty.

15 LEGAL ANALYSIS AND DISPOSITION

16 Internal Revenue Code (IRC) section 6662, incorporated into California law by Revenue and  
17 Taxation Code section 19164, subdivision (a)(1)(A), generally provides that there shall be added to the  
18 tax an amount equal to 20 percent of the portion of an underpayment of tax required to be shown on a  
19 return. IRC section 6662(b) provides, in part, that the section will apply to any portion of the  
20 underpayment that is attributable to (1) negligence or to the disregard of rules or regulations or (2) any  
21 substantial understatement of income tax. IRC section 6662 provides that a substantial understatement  
22 of tax exists if the amount of the understatement exceeds the greater of 10 percent of the tax required to  
23 be shown on the return or \$5,000. (Int.Rev. Code, § 6662(d)(1).)

24 The taxpayer bears the burden of proving any defenses to the imposition of the accuracy-related  
25 penalty. (*Recovery Group, Inc. v. Comm'r*, T.C. Memo. 2010-76.) The accuracy-related penalty will  
26 not be imposed to the extent a taxpayer shows that a portion of the underpayment was due to reasonable  
27 cause and that he acted in good faith with respect to such portion of the underpayment. (Int.Rev. Code,  
28 § 6664(c)(1); Treas. Reg. §§ 1.6664-1(b)(2) & 1.6664-4.)

1 A determination of whether a taxpayer acted with reasonable cause and in good faith is made  
2 on a case-by-case basis and depends on all pertinent facts and circumstances, including his or her  
3 efforts to assess the proper tax liability, his or her knowledge and experience, and the extent to which  
4 he or she relied on the advice of a tax professional. Generally, the most important factor is the extent  
5 of the taxpayer's effort to assess his or her proper tax liability. (Treas. Reg. § 1.6664-4(b).) Reliance  
6 on the advice of an expert tax preparer may, but does not necessarily, demonstrate reasonable cause  
7 and good faith. (*Stolz v. Comm'r*, T.C. Memo. 1999-404; Treas. Reg. § 1.6664-4(c)(1).) Such  
8 reliance is not an absolute defense, but is a factor to be considered. (*Stolz, supra*; Treas. Reg.  
9 § 1.6664-4(c)(1).) A taxpayer claiming reliance on a professional must show that (1) the tax preparer  
10 was a competent professional who had sufficient expertise to justify reliance, (2) the tax preparer was  
11 supplied with the necessary and accurate information, and (3) the taxpayer actually relied in good faith  
12 on the advice. (*Neufeld v. Comm'r*, T.C. Memo. 2008-79.) Treasury Regulation section  
13 1.6664-4(c)(1)(i) further provides that “. . . the advice must take into account the taxpayer's purposes  
14 (and the relative weight of such purposes) for entering into a transaction and for structuring a  
15 transaction in a particular manner.”

16 Here, appellant has not contested that the additional tax is owed, and the understatement of tax  
17 on his tax return clearly constitutes a substantial understatement. Appellant contends, however, that  
18 the underpayment was due to reasonable cause and that he acted in good faith. Appellant's assertions  
19 rest on his alleged reliance on the use of tax professionals to structure the transactions and to prepare  
20 his tax return. However, the legal opinion did not provide advice regarding the legitimacy of the  
21 nearly \$50 million deduction. Any advice received from other advisors lacked credibility as appellant  
22 must have known it was inappropriate to claim a nearly \$50 million deduction by engaging in a paper  
23 transaction in which he caused his corporation to pay nearly \$50 million to controlled LLCs for  
24 services that he agreed to provide to the LLCs for \$180,000. Appellant essentially claimed a  
25 deduction for amounts he paid to himself. It does not take any special tax knowledge or experience to  
26 know that such a deduction is not likely to withstand scrutiny and at least should have been questioned  
27 aggressively.

28 The Texas law firm that organized the transactions received \$675,000 for its services and

1 therefore had a substantial interest in the transaction. It is not reasonable to rely on the advice of  
2 promoters who have a substantial financial interest in the transaction. (See, e.g., *106 Ltd. v. Comm'r*  
3 (D.C. Cir. 2012) 684 F.3d 84, 90-91.) There is no evidence that appellant's CPA received specific  
4 information about the fee payments to the LLCs or performed any analysis that could justify the  
5 \$49,450,000 in fees as a reasonable and necessary business expense.

6 Appellant has not shown that he acted reasonably and in good faith and he has not shown any  
7 other basis upon which the penalty might be abated. Accordingly, appellant has not shown error in  
8 respondent's imposition of the accuracy-related penalty for the 2004 tax year.

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ORDER

It is hereby ordered that the action of the FTB on appellant’s protest against the proposed assessment for 2004 be sustained. Adopted at Sacramento, California, this 28th day of March, 2017.

Diane L. Harkey \_\_\_\_\_, Chairwoman

George Runner \_\_\_\_\_, Member

Fiona Ma \_\_\_\_\_, Member

Jerome E. Horton \_\_\_\_\_, Member

Yvette Stowers \_\_\_\_\_, Member\*

\*For Betty T. Yee, pursuant to Government Code section 7.9.