

## California - Trial court awards attorney fees, FTB's assertion of commercial domicile not substantially justified

June 27, 2013

### In brief

On June 14, 2013, a trial court ordered the California Franchise Tax Board to pay a taxpayer nearly \$1.2 million in attorney fees regarding a twelve year matter concerning a corporation's commercial domicile. The order serves as a good reminder to California taxpayers of the state's persistent and sometime intrusive audit practices and the importance of documenting tax positions such as commercial domicile. [*Daniel V, Inc., v. Franchise Tax Board*, Los Angeles County Superior Court, No. BC457301 (6/14/13 hearing)]

### In detail

#### **Corporate domicile and Franchise Tax Board's position**

At issue was a determination of where a corporation was commercially domiciled, California or Nevada, impacting where certain income would be sourced, e.g., portfolio and investment income. The taxpayer offered evidence that the corporation maintained its corporate office, bank accounts, brokerage accounts, and books and records in Nevada. The California Franchise Tax Board (FTB) raised a 1998 filing that was electronically signed by the corporation's president, presumably in California. The FTB asked the court to draw the

inference that a California shareholder managed and directed the corporation from California. The court found that FTB's case consisted entirely of circumstantial evidence and that the evidence was insufficient to draw any such inference, especially in the face of contrary direct evidence.

#### **Award of attorney fees**

California generally allows the award of reasonable litigation costs to a prevailing party in a civil proceeding brought by the FTB in connection with the determination of any tax, interest, or penalty if the state's position is not 'substantially justified.' During a June 14, 2013, hearing on the taxpayer's motion for attorney fees, the

trial court judge awarded the taxpayers nearly \$1.2 million in fees. The judge noted that he found "the position taken by the Franchise Tax Board in this matter was not substantially justified. . . the evidence was surprisingly weak in terms of a case that's gone on for . . . 12 years or so. And all we've got is some speculation, some supposition but evidence just wasn't there. . . . the conduct of the Franchise Tax Board just was not doing the right thing. . . . all we really had was some speculation because the corporation has their CPAs in California, that's not enough."

### ***The takeaway***

The judge's award of litigation costs in this decision highlights the persistent nature of some state audits in the face of limited facts and documentation. Although the standard applied in this

case is generally applicable to most proceedings brought by the FTB, it is particularly relevant for taxpayers with a similar commercial domicile issue. The case serves as a good reminder that maintaining adequate,

contemporaneous documentation to substantiate domicile is a best practice to help defend against contrary state assertions.

### ***Let's talk***

For more information regarding the *Daniel V* decision, please contact:

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