

Business Law

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CONTENTS

Summary of Developments	3
Featured Article	5
Developments	8
Contracts	8
Commercial Law	9
Federal Securities Law	10
California Taxation	11
Federal Taxation	11
Intellectual Property	13
Employers and Employees	14
Competitive Business Practices	20
Business Litigation	22
General Business	23
Table of Reported Cases	24

HIGHLIGHTS

Supreme Court Rules That State Law "Holder" Class Actions Are Precluded By SLUSA	5
Amanda M. Rose	
<i>In Merrill Lynch, Pierce, Fenner & Smith, Inc. v Dabit</i> , the Supreme Court held that state law securities fraud class actions are precluded by the Securities Litigation Uniform Standards Act of 1998, whether or not the plaintiffs would have standing to bring a federal Rule 10b-5 claim under the Court's decision in <i>Blue Chip Stamps</i> . In <i>Dabit's</i> wake, plaintiffs' lawyers are already devising—with mixed results—new theories for avoiding SLUSA preclusion. It is too soon to tell whether these theories will gain traction in the courts, or whether Congress's goal of concentrating all securities fraud class actions involving nationally traded securities in federal court will now be realized.	
Commercial Code Comments	9
Howard Foss	
UCC §2-717 permits a buyer to deduct damages suffered from the breach of a sales contract from the price still due under the <i>same</i> contract. But what about offsetting damages against money still owed by the buyer on <i>another</i> contract? In <i>AmerisourceBergen Corp. v Dialysist West, Inc.</i> , the Ninth Circuit said that was prohibited.	
Federal Taxation	11
Marilyn Barrett	
<i>Fargo v Commissioner</i> highlights the risk of submitting a very low offer in compromise. Taxpayers owing \$104,000 offered the IRS \$7500 in compromise. The IRS rejected this offer outright and refused further negotiations. The Ninth Circuit affirms that the IRS has no duty to negotiate.	
Competitive Business Practices	20
William J. "Zak" Taylor	
In <i>Kelton v Stravinski</i> , the court of appeal held that a covenant not to compete between two partners was unenforceable. More careful drafting could have avoided the whole problem.	

California Taxation

Franchise Tax Board

Taxpayers' failure to report increased tax liability resulting from an IRS audit authorized the FTB to mail a notice of proposed deficiency assessment at any time.

Ordlock v Franchise Tax Bd. (2006) 38 C4th 897, ___ CR3d ___

An IRS audit of the taxpayers' federal income tax return determined, more than 4 years after the taxpayers filed their federal and state returns, that they underreported income and owed additional federal income taxes. Although such a change increases the taxpayers' state tax income liability, the taxpayers failed to report the adjustments to the FTB as required by Rev & T C §18622. After receiving a notice of proposed assessment of additional state income tax, the taxpayers filed a timely protest. After an adverse ruling, the taxpayers paid the tax portion under protest and subsequently filed suit for a refund. The taxpayers argued that they were not required to report the changes (or pay the additional state taxes) because the 4-year period prescribed by Rev & T C §19057 for a notice of deficiency assessment expired before the IRS determination. Thus, the FTB was precluded from issuing the notice after the expiration of the 4-year term. The trial court granted summary judgment to the FTB. The appellate court reversed, agreeing with the taxpayers, and reasoning that Rev & T C §18622 neither revives nor sustains the FTB's authority to impose additional taxes after expiration of the 4-year term.

The California Supreme Court reversed and remanded. When a California taxpayer receives a final determination from the IRS changing or correcting his or her federal income tax return for a particular tax year, Rev & T C §18622 requires that the taxpayer report any federal adjustment that will increase the taxpayer's state tax liability for that year within 6 months of the determination. When the taxpayer properly reports the adjustment, the FTB must provide notice of any related deficiency assessment within 2 years. Rev & T C §19059. If the taxpayer fails to report the adjustment, the FTB may give notice of a deficiency assessment at any time. Rev & T C §19060. The court held that, because the taxpayers failed entirely to report a final federal determination that increased their federal tax liability (and consequently their state tax liability), the applicable limitations period was determined by Rev & T C §19060(a) rather than the general limitations period provided by Rev & T C §19057. The former statute permits the FTB to mail the notice of proposed deficiency assessment at any time.

Federal Taxation

Marilyn Barrett

Offers in Compromise

IRS did not abuse its discretion by rejecting taxpayers' \$7500 offer-in-compromise of \$104,000 interest owed on tax liabilities.

Fargo v Commissioner (9th Cir 2006) 447 F3d 706

The Fargos, who owned interests in the Jackson and Smith & Asher partnerships, claimed a loss of \$30,767 from Jackson in 1983, and losses of \$2749 from Jackson and \$28,996 from Smith & Asher in 1984. These partnerships were partners in other partnerships associated with a series of tax shelters, the Swanton Coal Programs, which were exposed as purely tax-motivated transactions in *Kelley v Commissioner* (1993) 66 TCM 1132. Although the 1993 ruling in *Kelley* affected the Fargos' 1983 and 1984 tax liabilities, determination of the final amount was delayed until 1999 due to the tiered partnership system and TEFRA procedures (Tax Equity and Fiscal Responsibility Act of 1982 (Pub L 97-248, 96 Stat 324)). The Commissioner had to negotiate with the limited partnerships' Tax Matter Partners (TMPs), and the delay led to an accumulation of penalties and interest in excess of \$127,000 assessed against the Fargos. The Fargos paid their back taxes of about \$24,000, but refused to pay interest of about \$104,000.

After the Commissioner sent notice of his intent to levy, the Fargos requested a collection due process hearing. Claiming economic hardship and exceptional circumstances under Treasury Regulations issued under IRC §7122, the Fargos submitted a \$7500 offer-in-compromise. The Commissioner rejected this offer outright and did not offer to negotiate. The Fargos petitioned the Tax Court, asserting that the Commissioner's failure to accept their \$7500 offer-in-compromise was an abuse of the Commissioner's discretion. The Tax Court ruled in favor of the Commissioner. The Fargos appealed the Tax Court's holding to the Ninth Circuit Court of Appeals on two grounds: (1) that they would suffer economic hardship if their offer-in-compromise was not accepted; and (2) that there were exceptional circumstances that should have compelled the Commissioner to accept the offer-in-compromise. The Ninth Circuit reviewed the case de novo and affirmed the Tax Court's decision.

First, the Ninth Circuit concluded that the Commissioner did not abuse his discretion in deciding that the Fargos would not experience economic hardship if their offer-in-compromise was rejected. Economic hardship is defined as the inability of the taxpayer to pay reasonable basic living expenses. Treas Reg §301.6343-1(b)(4)(i). The Fargos' current monthly medical expenses were \$288; their claimed future medical expenses of \$90,000