

COURTS: NEVADA SUPREME COURT RULES THAT FTB COMMITTED FRAUD AGAINST INVENTOR GIL HYATT, BUT REVERSES JURY'S AWARD OF PUNITIVE DAMAGES

The Nevada Supreme Court ruled September 18 that the Franchise Tax Board committed fraud against inventor Gilbert Hyatt during residency audits in the 1990s, and must pay damages for the fraud and intentional infliction of emotional distress, but reversed a jury's award of punitive damages and damages for invasion of privacy.

The decision in [Franchise Tax Board of the State of California v. Gilbert P. Hyatt](#), issued more than two years after the Silver State's high court heard two rounds of oral arguments, validated Mr. Hyatt's argument that the FTB engaged in unscrupulous behavior during its audits, but also upheld several FTB arguments and significantly reduced the amount of damages the jury had awarded after hearing testimony in a lengthy trial – including \$250 million (plus interest) in punitive damages.

Upholding the fraud damages, the court wrote:

"The evidence presented sufficiently showed FTB's improper motives in conducting Hyatt's audits, and a reasonable mind could conclude that FTB made fraudulent representations, that it knew the representations were false, and that it intended for Hyatt to rely on the representations. What's more, the jury could reasonably conclude that Hyatt relied on FTB's representations to act and participate in the audits in a manner different than he would have otherwise, which resulted in damages. Based on this evidence, we conclude that substantial evidence supports each of the fraud elements."

The court also stated:

"FTB represented to Hyatt that it would protect his confidential information and treat him courteously. At trial, Hyatt presented evidence that FTB disclosed his social security number and home address to numerous people and entities and that FTB revealed to third parties that Hyatt was being audited. In addition, FTB sent letters concerning the 1991 audit to several doctors with the same last name, based on its belief that one of those doctors provided Hyatt treatment, but without first determining which doctor actually treated Hyatt before sending the correspondence. Furthermore, Hyatt showed that FTB took 11 years to resolve Hyatt's protests of the two audits. Hyatt alleged that this delay resulted in \$8,000 in interest per day accruing against him for the outstanding taxes owed to California. Also at trial, Hyatt presented evidence through Candace Les, a former FTB auditor and friend of the main auditor on Hyatt's audit, Sheila Cox, that Cox had made disparaging comments about Hyatt and his religion, that Cox essentially was intent on imposing an assessment against Hyatt, and that FTB promoted a culture in which tax assessments were the end goal whenever an audit was undertaken."

The court rejected FTB's argument that Mr. Hyatt should not have been awarded damages for intentional infliction of emotional distress, and also rejected the claim that such an award is subject to a cap, but said "evidentiary and jury instruction errors

committed by the district court” require reversal of the damages, and a new trial to determine the amount of such damages. The jury had awarded \$82 million to Mr. Hyatt for emotional distress.

Information presented at the new trial to determine the amount of damages may be much different from the first trial, in light of the court’s ruling that Mr. Hyatt is precluded from presenting some arguments that the court said violated a restriction against asking the jury to consider the audits’ conclusions. On the other side of the dispute, the court said the FTB will be allowed to present previously excluded arguments that a federal audit and business-related issues were to blame for some of Mr. Hyatt’s distress.

The court made it clear, however, that it believed Mr. Hyatt had proven that the FTB’s behavior affected him emotionally and physically. The court wrote:

“Hyatt suffered extreme treatment from FTB. As explained above in discussing the fraud claim, FTB disclosed personal information that it promised to keep confidential and delayed resolution of Hyatt’s protests for 11 years, resulting in a daily interest charge of \$8,000. Further, Hyatt presented testimony that the auditor who conducted the majority of his two audits made disparaging remarks about Hyatt and his religion, was determined to impose tax assessments against him, and that FTB fostered an environment in which the imposition of tax assessments was the objective whenever an audit was undertaken. These facts support the conclusion that this case is at the more extreme end of the scale, and therefore less in the way of proof as to emotional distress suffered by Hyatt is necessary.”

On the issue of punitive damages, the court ruled that under the doctrine of comity, a California tax agency could not be ordered to pay such damages, because a Nevada resident would not be allowed to seek such damages from a Nevada tax agency. The FTB attempted to persuade the court that comity also requires a cap on damages for emotional distress, but the court found that “Nevada’s policy interest in providing adequate redress to its citizens outweighs providing FTB a statutory cap on damages under comity.”

In an email announcing the court’s ruling, FTB spokeswoman Susan Maples focused on the dollar amounts of the awards, writing: “We are pleased to report today’s Nevada Supreme Court decision regarding Hyatt that dramatically reduces the original judgment against FTB. ... The original judgment with interest was over \$600 million and has been reduced to \$1.08 million plus post judgment interest along with an undecided amount for emotional distress that has been remanded back to the lower court. FTB is still reviewing the 68 page decision that covers many technical issues of law. We will be determining next steps in the days ahead.”

In his *Taxable Talk* blog, enrolled agent Russ Fox of Clayton Financial and Tax wrote September 18 that the decision is about the FTB’s treatment of taxpayers, not just the amount of money that the agency eventually will be ordered to pay the inventor. The decision “is definitely a win for the FTB as far as damages,” he wrote, and then added: “If I as a tax professional were to conduct myself in the manner that the FTB did, I would

almost certainly be liable for truckloads of damages and would lose my license. Consider that the Nevada Supreme Court called the conduct of the FTB ‘extreme.’ Consider also that at trial the FTB called its conduct typical. ... The FTB should look at this result and realize the egg on their face ... but probably won’t.”

Observers said the court’s decision – which can be cited by other taxpayers – may send a signal to other states not to come into Nevada and commit torts, as the state will not provide comity, and will allow its residents to try the torts.

The decision was signed by six of the court’s seven justices. The remaining justice recused herself from the case more than two years ago, and did not participate in oral arguments or in writing the opinion.