

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:)	OTA Case No. 18022337
)	
RANBIR SAHNI AND)	Date Issued: June 27, 2018
)	
REKHA SAHNI)	
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DECISION ON PETITION FOR REHEARING

Representing the Parties:

For Appellants: Richard Suarez, Jr., CPA

For Respondent: Brandon S. Knoll, Tax Counsel¹

For Office of Tax Appeals: Josh Lambert, Tax Counsel

S. HOSEY, Administrative Law Judge: On December 11, 2017, the California State Board of Equalization (BOE) issued a decision in which it sustained the action by the Franchise Tax Board (FTB or respondent) denying Ranbir and Rekha Sahni’s (appellants) claim for refund in the amount of \$52,056 for the 2003 tax year.² By letter dated January 8, 2018, appellants petitioned for a rehearing on the ground that the BOE’s decision is contrary to law. Upon consideration of appellants’ petition according to the standards expressed in *Appeal of Wilson Development, Inc.*, 94-SBE-007, October 5, 1994,³ we conclude that appellants have shown good

¹ Alberto T. Rosas, one of the administrative law judges for the Office of Tax Appeals (OTA), previously represented the Franchise Tax Board in this case while he was employed with that agency. However, Mr. Rosas has been excluded from having any involvement in any aspect of the OTA’s consideration of this matter.

² Pursuant to Assembly Bill 102, The Taxpayer Transparency and Fairness Act of 2017, and Assembly Bill 131 (2017-18 Reg. Sess.), the duty of resolving administrative appeals for personal income tax matters has been transferred from the BOE to the newly created Office of Tax Appeals.

³ Pursuant to the Office of Tax Appeals Rules for Tax Appeals, California Code of Regulations, tit. 18, § 30501(d)(3), precedential opinions of the State Board of Equalization (BOE) that were adopted prior to January 1, 2018, may be cited as precedential authority to the Office of Tax Appeals unless a panel removes, in whole or in part, the precedential status of the opinion. BOE’s precedential opinions are available for viewing on the BOE’s website: <http://www.boe.ca.gov/legal/legalopcont.htm>.

cause for a new hearing, but only on the limited issue of calculation of substituted basis under Internal Revenue Code (IRC) § 732(b).

In *Appeal of Wilson Development, Inc., supra*, the BOE determined that good cause for a new hearing may be shown where one of the following grounds exists and the rights of the complaining party are materially affected: 1) irregularity in the proceedings by which the party was prevented from having a fair consideration of its appeal; 2) accident or surprise, which ordinary prudence could not have guarded against; 3) newly discovered evidence, material for the party making the petition for rehearing, which the party could not, with reasonable diligence, have discovered and produced prior to the decision of the appeal; 4) insufficiency of the evidence to justify the decision, or the decision is against the law; or 5) the decision is contrary to law. (See also Cal Code Regs., tit. 18, § 30602(c)(5)(A-D); *Appeal of Sjofinar Do*, 2018-OTA-002P, Mar. 22, 2018.)

Appellants allege that the decision is contrary to law. The issue before the BOE was whether appellants properly reported the amount of capital gain from the sale of real estate. Appellant-husband (hereafter, appellant) held a majority 99.99 percent interest in two limited partnerships (LPs), Palmdale Gardens (Palmdale) and Tres Lomas Garden Apartments (Tres Lomas), and each LP owned an apartment complex. The LPs sold each apartment complex for cash and a promissory note. Several months after the sales, the LPs liquidated and assigned the promissory notes to appellant. The only factual dispute was the amount of cash appellant received from the sales of the properties. In this regard, it appears that the specific amounts in dispute were the amounts the LPs paid for sales commissions and other costs of sale. Appellant argued that the commissions and other costs of sale totaled \$320,000 per property, but provided no supporting evidence. FTB, on the other hand, argued that the commissions and other costs of sale totaled \$8,920 for Palmdale and \$30,170 for Tres Lomas, as shown on the LPs' returns. It also argued that appellant received sufficient cash (\$994,996 from the Palmdale sale and \$1,012,133 from the Tres Lomas sale) to reduce appellant's basis in both notes to zero.⁴ FTB persuaded BOE that the amounts reported on appellants' original return should be accepted as accurate, at least in part because they were consistent with the LPs' returns, and that the amounts

⁴ FTB states that "[s]ome of the proceeds related to this sale [Palmdale] were used to pay off the mortgage of approximately \$1,304,365 ... paying off other liability estimated at \$91,794 ... and closing costs of \$8,920." FTB also states that "[s]ome of the proceeds related to this sale [Tres Lomas] were used to pay off the mortgage of approximately \$952,386 ... paying off other liability estimated at \$72,034 ... and closing costs of \$30,170." These amounts are also reflected on Form 6252, "Installment Sale Income," of the LPs' returns.

reported on appellants' amended individual return should be rejected because they were inconsistent with the LPs' returns and were not supported by adequate evidence. On that basis, BOE denied the refund. The BOE's decision focused upon the fact that appellant did not provide copies of escrow settlement statements or other evidence to establish how much cash was received from the proceeds of the sales of the properties.

As the BOE decision states, California Revenue and Taxation Code (R&TC) § 17851 incorporates IRC §§ 701 to 761 (subchapter K) governing the taxation of partners in partnerships in California. IRC § 732(b) states that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed to the partner in the same transaction. Therefore, the net cash distributed to appellant must be deducted from appellant's adjusted basis in the partnerships to calculate the substituted basis for the promissory notes. Both parties and the BOE agreed that IRC § 732(b) applied.

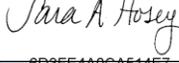
We note that neither the LPs' returns nor appellants' original return applied IRC § 732(b). The fact that the original return filed by appellants agreed with the LPs' returns should not work against appellants; they argue that the LPs' returns were in fact wrong and they based their individual return on the incorrect information therein. The fact that appellants' original return agreed with the LPs' returns, while appellants' amended return did not agree with the LPs' returns, is entirely consistent with appellants' argument. The LPs' returns were wrong because they (and appellants' original return) did not calculate a substituted basis for the promissory notes as required by IRC § 732(b). But more importantly, BOE agreed that appellant's basis in the promissory notes should have been adjusted pursuant to IRC § 732(b), but it did not make the adjustment warranted by the undisputed evidence. FTB should have adjusted the substituted basis in appellant's promissory notes to reflect the *undisputed* liabilities and costs of sale.⁵

Accordingly, we find that appellants have shown good cause for a new hearing due to the BOE's erroneous application of IRC § 732(b) and failure to correctly calculate appellant's substituted bases in the promissory notes. On that basis, we grant the petition. Because appellants have based their petition solely on the BOE's alleged erroneous application of IRC § 732(b) and have not provided new evidence to support their other assertions (that commissions and other costs of sale were more than amounts reported by the LPs), the rehearing shall be

⁵ See footnote 4, above.

limited to consideration of the undisputed liabilities and costs of sale to calculate appellant's substituted basis in the promissory notes.

For the foregoing reasons, appellants' petition is hereby granted, and the issue on rehearing shall be limited to the calculation of appellant's substituted basis in the promissory notes.

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Sara A. Hosey
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

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Michael F. Geary
Administrative Law Judge