

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of:	)	OTA Case No. 18012099
	)	
<b>ERNEST P. GRAHAM AND</b>	)	Date Issued: November 28, 2018
<b>JANICE P. SMITH</b>	)	
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**OPINION ON PETITION FOR REHEARING**

Representing the Parties:

For Appellants:	Daniel J. Leer
For Respondent:	Renel A. Sapiandante, Tax Counsel IV
For Office of Tax Appeals:	Linda Frenklak, Tax Counsel IV

J. JOHNSON, Administrative Law Judge: On August 31, 2017, the California State Board of Equalization (BOE) issued a decision in which it sustained the Franchise Tax Board’s (respondent) proposed assessments of taxes and penalties in the respective amounts of \$141,774.00 and \$211,611.53 for 2001; \$112,623.00 and \$22,524.60 for 2003; and \$1,280,646.00 and \$532,919.25 for 2005.<sup>1</sup> Appellants then filed a petition for rehearing pursuant to section 19048 of the Revenue and Taxation Code (R&TC). Upon consideration of the petition for rehearing, we conclude that the grounds set forth therein do not constitute good cause for a new hearing, as required by the *Appeal of Wilson Development, Inc.*, 94-SBE-007, October 5, 1994 (*Wilson Development*).<sup>2</sup> (See also, *Appeal of Do*, 2018-OTA-002P, Mar. 22, 2018.)

Among the grounds listed for granting a new hearing, the BOE in *Wilson Development* determined that good cause for a new hearing may be shown where the rights of the complaining party are materially affected, and there exists an insufficiency of the evidence to justify the

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<sup>1</sup> On appeal, respondent indicated that it will: abate the interest-based penalty for the 2001 tax year; withdraw its assessment regarding the “Bombay Digital” like-kind exchange for the 2003 tax year; and abate the tax on the pension distribution rollover for the 2005 tax year.

<sup>2</sup> BOE opinions are generally available for viewing on the BOE’s website: <[www.boe.ca.gov/legal/legalopcont.htm](http://www.boe.ca.gov/legal/legalopcont.htm)>.

decision or the decision is against law, or an irregularity in the proceedings by which the party was prevented from having a fair consideration of its case. (See also Cal. Code Regs., tit. 18, section 30602(c)(5).)

In their petition for rehearing, appellants argue that the BOE's decision was against law and was based on misunderstandings of fact that created an irregularity in the proceedings that prevented a fair consideration of their appeal. The following discussion addresses the specific contentions set forth by appellants in their request for a new hearing.

*Internal Revenue Code (IRC) section 1231 Gain*

Appellants contend that the BOE's reliance on the duty of consistency to sustain respondent's determination that they received gain in the 2001 tax year in the amount of \$1,719,031 pursuant to IRC section 1231 was a mistake of law that precluded a fair consideration of their appeal. Appellants reassert their argument provided on appeal that the transaction that gave rise to the gain occurred in 1999 and therefore the proposed assessment was barred pursuant to the four-year statute of limitations set forth in R&TC section 19057. They also reassert that appellant-husband did not receive any taxable income during 2001 for which he claimed tax treatment that was inconsistent with his position for the 1999 tax year.

The issue of the gain related to IRC section 1231 was argued extensively by the parties throughout the appeal, including appellants' contention that assessments relating to the 1999 tax year are barred by the statute of limitations. The reasoning of the BOE in its decision to sustain respondent on this issue is supported by the facts presented by the parties and by settled law. We find no ground for a rehearing based on this assertion.

*Charitable Contribution Deduction*

Appellants contend that, based on a misunderstanding of the facts, the BOE improperly sustained respondent's determination to disallow a charitable contribution deduction in the amount of \$834,707 that was carried over to the 2002 through 2006 tax years. Appellants assert that the BOE erroneously found that appellants failed to comply with IRC section 170 and Treasury Regulations section 1.170A-13(b), and contend that they provided the documents on appeal showing that they "complied in all respects with the instructions to Schedule A of Form 1040 and Form 8283 and, thus, with [Treasury Regulations] Section 1.170A-13(b)." Appellants state that the BOE "apparently overlooked these documents and thus misunderstood the facts."

To the contrary, the BOE's decision explicitly addresses the documentation, facts, and legal argument provided by both parties, including the purported appraisal, and reasonably concluded that the claimed charitable contribution deduction carryover was properly denied. Appellants' attempt to reargue this issue does not qualify as grounds for granting a rehearing.

*Statute of Limitations for Tax Year 2001*

Appellants contend that the BOE improperly sustained the proposed assessment for the 2001 tax year in its entirety or, alternatively, the disallowed charitable contribution deduction, based on the erroneous application of the eight-year statute of limitations set forth in R&TC section 19755. In addition to arguments already considered and rejected on appeal,<sup>3</sup> appellants argue that the BOE improperly based its finding that the trust was an "abusive tax avoidance transaction" on the definition contained in R&TC section 19753(c), which appellants contend does not apply to R&TC section 19755.<sup>4</sup> Appellants assert that the burden of proof as to what defines an abusive tax avoidance transaction shifted to respondent.

The BOE's decision analyzed the underlying transactions relating to the 2001 proposed assessment, and found that they constituted a plan or arrangement devised for the principle purpose of avoiding tax. The BOE looked to the appropriate definition of an "abusive tax avoidance transaction," and the decision is well-founded and not the result of an inappropriate application of facts or law. Appellants are merely continuing arguments that were fully briefed and considered previously on appeal, and therefore no rehearing is warranted under this contention.

*IRC Section 1031 Like-Kind Exchange*

Appellants contend that the BOE improperly sustained respondent's determination to disallow IRC section 1031 like-kind exchange transactions resulting in additional gain in the amount of \$1,197,624 for the 2003 tax year. They argue that the BOE incorrectly interpreted

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<sup>3</sup> For example, appellants argue that the eight-year statute of limitations, if it applies, applies only to items on the return that relate to the abusive tax avoidance transaction (i.e., the private annuity transaction), and therefore respondent cannot review the charitable contribution deduction, which appellants contend was not related to the abusive tax avoidance transaction. Appellants provide no legal authority for their position. In any event, the facts show that the trust from which the alleged charitable contribution arose was involved in the abusive tax avoidance transaction, and therefore clearly subject to the eight-year statute of limitations.

<sup>4</sup> Appellants assert that the definition contained in R&TC section 19753 does not apply to R&TC section 19755 because it is in a different article of the code; however, for the tax years at issue, the two sections were in the same article, and therefore the definition does apply.

case law, which was not controlling in this appeal, and thereby “caused an error in its analysis of [appellants’] case.” The case law at issue had been argued on appeal, and discussed between the parties as far back as respondent’s audit issue presentation sheets during the audit. The BOE’s discussion is based on an extensive and reasonable analysis of the applicable law, and appellants’ desire to continue the legal discussion does not constitute a valid ground for granting a rehearing.

Appellants also contend that the BOE incorrectly found that appellants owned the Carmel property at the time of the transaction. However, the BOE’s finding as to the owner of the property at the time of the transaction is based on applicable case law, an appropriate analysis of the benefits and burdens of ownership factors, and reference to Revenue Procedure 2004-51 as persuasive authority wherein it states that, “[a]n exchange of real estate owned by a taxpayer for improvements on land owned by the same taxpayer does not meet the requirements of [IRC section] 1031.” Lastly, appellants state that “even if [appellants] failed to timely identify an exchange parcel[,] this would taint only the home office exchange.” The BOE considered appellants’ arguments on appeal, and appellants’ reassertions of their arguments on petition for rehearing do not show an insufficiency of the evidence to justify the decision or that the decision is against law.

#### *Gain from the Disposition of Interest in WWCI and WWCII*

Appellants contend that the BOE improperly sustained respondent’s determination that an additional gain in the amount of \$5,449,542 resulted from the disposition of interests in WWCI and WWCII for the 2005 tax year. First, appellants argue that the BOE incorrectly determined that the trust as successor to the annuities should be disregarded and that gain from the partnership’s sale should be attributed to appellant-husband. Appellants contend that the BOE’s analysis of this issue is flawed. However, as noted by appellants, this issue relies heavily on legal analysis and the determinations of the fact-finder. The BOE is the fact-finder for the purposes of the decision, and, despite appellants’ assertions, BOE’s determinations as to law and facts regarding this issue are well-founded. There is ample evidence supporting the determination that these structured transactions were a sham implemented solely for tax avoidance purposes.

Alternatively, appellants argue that the BOE acknowledged but erroneously disregarded appellants’ evidence of the value of the property appellant-husband transferred to the partnership to receive his interest. Appellants also argue that the BOE improperly found “that the Trust and

the antecedent annuities were part of a scheme known as a BOB [bogus optional basis] ‘for the purpose of artificially increasing the [partnerships’] bases by triggering the application of [IRC] sections 754 and 743(b).’ ” According to appellants, respondent failed to meet its burden of producing evidence showing that the partnerships made an election to increase inside basis. As noted above, the BOE is the finder of fact, and appellants’ desire for the BOE to have found differently does not refute the fact that the BOE’s decision is based on reasonable findings of facts and interpretation of the law. Such a desire does not satisfy the grounds necessary to grant a rehearing.

#### *Long-Term Capital Loss Carryover*

Appellants contend that the BOE improperly sustained respondent’s determination to disallow a long-term capital loss carryover in the amount of \$531,077 and a short-term loss carryover in the amount of \$1,688 for the 2005 tax year. They state that the disallowance of this carryover amount is based on respondent’s disallowance of appellants’ IRC section 1031 like-kind exchanges. As indicated by appellants, they have already provided their arguments on this topic “in detail in [their] Petition, Reply Brief and [Supplemental] Brief.” The desire to revisit that challenge is not grounds for a rehearing.<sup>5</sup>

#### *Casualty Loss Deduction*

Appellants contend that the BOE improperly sustained respondent’s determination to disallow a casualty loss deduction in the amount of \$149,957 for the 2005 tax year. Appellants repeat the same arguments they provided on appeal, and argue that the BOE improperly found that *Bailey v. Commissioner*, T.C. Memo. 1983-685, was controlling in this appeal. The BOE’s decision considered appellants’ assertions in its decision, as well as respondent’s, and determined that the factually similar decision in *Bailey* provided sufficient legal support for sustaining respondent’s position. This reasonable analysis and conclusion does not represent a mistake of law or a misunderstanding of fact justifying a rehearing.

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<sup>5</sup> While the BOE decision indicated that appellants did not specifically discuss the disallowance of these claimed carryover losses, as stated by appellants, they are the result of and dependent upon the finding that appellants’ asserted IRC section 1031 like-kind transactions were not valid.

*Irregularity in the Proceedings / Pension Rollover*

Lastly, appellants contend that there was an irregularity in the proceedings because the BOE failed to consider the issue of whether respondent erred in the disallowance of rolled-over distributions from the E.P. Graham & Company Profit Sharing Plan. According to appellants, the BOE's decision acknowledges but fails to resolve this issue. As confirmed in respondent's reply to the petition for rehearing, this item was no longer at issue when the BOE made its decision because respondent conceded in its supplemental brief that appellants substantiated that they were entitled to tax-free treatment of the 2005 rolled-over distributions, and the resulting adjustments to tax and penalties for that year. Accordingly, a rehearing cannot be granted based on this assertion, as the issue was conceded by respondent and any alleged irregularity or omitted discussion by the BOE did not materially affect appellant's rights.


*Summation and Holding*

The question of whether a decision is contrary to law is not one that involves a weighing of the evidence, but instead requires a finding that the decision is "unsupported by any substantial evidence." (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906.) In their petition, appellants set forth arguments and facts that they previously made to the BOE. These arguments, discussed above, were already considered at length and decided upon in a written decision. The decision gave appropriate consideration to the evidence and arguments presented by appellants on appeal in reaching its conclusions. Appellants' dissatisfaction with the outcome of their appeal, and the attempt to reargue the same issues a second time, is not grounds for a rehearing. As the BOE found in the decision on appeal, appellants' contentions fail to show error in respondent's position, and they do not show that the decision created an "injustice based on a mistake of law or misunderstanding of facts." (*Appeal of NASSCO Holdings, Inc.*, 2010-SBE-001, Nov. 17, 2010 [discussing *In re Jessup* (1889) 81 Cal. 408, 471-472].) Appellants have not demonstrated that there was insufficient evidence to justify the BOE's decision or that the BOE's decision is contrary to law.

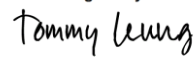
By arguing that there was an irregularity in the proceedings because the BOE's decision was against law and was based on misunderstandings of fact, appellants have confused these separate grounds for a rehearing under *Wilson Development*. Courts have defined an irregularity in the proceedings as "[a]ny departure by the court from the due and orderly method of

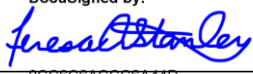
disposition of an action by which the substantial rights of a party have been materially affected.”  
(*Gay v. Torrance* (1904) 145 Cal. 144, 149.) Appellants have not shown that there was any irregularity in the processing of their appeal. To the contrary, the parties in this appeal were offered ample opportunity to submit briefs and exhibits, and, as noted above, a lengthy written decision was issued which addressed each of the parties’ contentions and the evidence provided. Accordingly, appellants have not demonstrated irregularity in the proceedings that prevented them from having a fair consideration of their appeal, and appellants have not established good cause for a new hearing under any grounds set forth in *Wilson Development*.

For the foregoing reasons, appellants’ petition is hereby denied.

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John O. Johnson  
Administrative Law Judge

We concur:

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Tommy Leung  
Administrative Law Judge

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Teresa A. Stanley  
Administrative Law Judge