

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Consolidated Appeals of: ) OTA Case No. 18073515  
**RANBIR SAHNI AND REKHA SAHNI** ) Date Issued: August 21, 2019  
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**OPINION ON REHEARING**

Representing the Parties:

For Appellants: Richard Suarez, Jr., Suarez Accountancy Corporation

For Respondent: Brandon S. Knoll, Tax Counsel III  
Michael Cornez, Attorney V

For Office of Tax Appeals (OTA): Josh Lambert, Tax Counsel<sup>1</sup>

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324, Ranbir Sahni and Rekha Sahni (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ claim for refund of \$52,056 for the 2003 tax year.

OTA Administrative Law Judges Sara A. Hosey, Teresa A. Stanley, and Michael F. Geary held an oral hearing for this matter in Los Angeles, California, on May 21, 2019. At the conclusion of the hearing, we closed the record and took the matter under submission.

**ISSUE**

Whether FTB’s calculation of appellants’ substituted bases in promissory notes included undisputed liabilities and closing costs.<sup>2</sup>

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<sup>1</sup> For purposes of this opinion, Josh Lambert represented the Office of Tax Appeals (OTA) in his former capacity as Tax Counsel. Effective June 3, 2019, Josh Lambert became an Administrative Law Judge at OTA.

<sup>2</sup> For Palmdale Gardens, the undisputed liabilities, which did not include the long-term mortgage, totaled \$91,794, and closing costs totaled \$8,920. For Tres Lomas, the undisputed liabilities, which did not include the long-term mortgage, totaled \$72,034 and closing costs totaled \$30,170.

## FACTUAL FINDINGS

1. Appellant-husband held a majority 99.99 percent interest in two limited partnerships (LPs), Palmdale Gardens and Tres Lomas, and each LP owned an apartment complex.
2. In early 2002, in separate real estate sale transactions, each LP sold its real property to the minority partner in each LP, the Continental Foundation. For Palmdale Gardens, the buyer paid \$1,885,000 in cash and executed a promissory note for \$1,315,000. For Tres Lomas, the buyer paid \$1,855,000 in cash and executed a promissory note for \$1,345,000.
3. Several months after the real estate sales transactions closed in 2002, each of the LPs were liquidated, and each LP assigned its rights in the promissory notes to appellant-husband.
4. In 2003, Continental Foundation paid the full amounts due on the promissory notes.
5. Appellants filed their original 2003 California tax return, which reported a substituted basis in the Palmdale Gardens promissory note of \$320,071, and a substituted basis in the Tres Lomas promissory note of \$332,888.
6. Appellants thereafter filed amended returns, which reported a substituted basis in the Palmdale Gardens promissory note of \$1,187,930. Appellants reported a substituted basis in the Tres Lomas promissory note of \$1,376,352. Appellants claimed that the amount of cash they received in the sales transactions was decreased by payment of outstanding mortgage liabilities, other liabilities, and closing costs well in excess of what the FTB allowed. FTB treated the amended return as a claim for refund of \$52,056.
7. During an examination of appellants' amended 2003 return, FTB requested that appellants provide evidence to substantiate appellant-husband's claim that he did not receive any cash distributions in 2002 that would reduce the "substituted basis" of the promissory notes he received in liquidation of the partnerships. Appellants did not reply.
8. FTB issued a refund claim denial letter on April 29, 2016, in effect, rejecting the claimed increase in appellants' substituted bases per their amended return.
9. The Board of Equalization (BOE) issued a summary decision on December 11, 2017, which sustained FTB's denial of the claim for refund.
10. Appellants filed a Petition for Rehearing on January 8, 2018, with OTA.

11. On June 27, 2018, OTA granted the petition on the limited question of whether FTB erroneously applied Internal Revenue Code (IRC) section 732(b) by not considering the undisputed liabilities and closing costs in calculating appellants' substituted bases in the promissory notes. Those undisputed items were outstanding liabilities totaling \$91,794 and \$8,920 of closing costs for the Palmdale Gardens property and outstanding liabilities totaling \$72,034 and \$30,170 of closings costs for the Tres Lomas property.

### DISCUSSION

As incorporated by R&TC section 17851, IRC sections 701 to 761 (Subchapter K) govern the taxation of partners in partnerships in California. Generally, partners are required to include their distributive shares of items of partnership income in their individual income, including capital gains and losses recognized by the partnership from the sale or exchange of capital assets. (IRC, § 702.) IRC section 705 provides that the adjusted basis of a partner's interest in a partnership is his original basis (as determined under IRC section 722) increased by subsequent contributions and the partner's distributable share of the income of the partnership, and decreased (but not below zero) by nonliquidating distributions to the partner and his distributable share of partnership losses and expenditures. (IRC, §§ 705(a), 722, 732(a).) 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 in the same transaction. (IRC, § 732(b).)

As stated above, the scope of this rehearing was specifically limited to the issue of whether FTB's calculation of appellants' substituted bases in the promissory notes included undisputed liabilities and closing costs of: (1) \$91,794 of liabilities and \$8,920 of closing costs for the Palmdale Gardens property; and (2) \$72,034 of liabilities and \$30,170 of closing costs for the Tres Lomas property.

In our Opinion on Petition for Rehearing, we found that BOE and FTB erroneously applied IRC section 732(b) because they should have adjusted the substituted bases in appellants' promissory notes to reflect the undisputed liabilities and closing costs. The decision to grant a rehearing was based on evidence that appeared to show FTB failed to correctly adjust appellants' substituted bases in the promissory notes to reflect the undisputed liabilities and closing costs. It now appears, from the evidence presented in connection with the rehearing, that FTB did take those liabilities and closing costs into consideration. FTB provided a copy of its

analysis of appellants’ claim for refund, which used amounts reported in the partnerships’ and appellants’ tax returns. FTB’s analysis shows that the undisputed liabilities and closing costs were properly accounted for in calculating the bases of the promissory notes. FTB used the documented, undisputed liabilities (\$91,794 for Palmdale Gardens and \$72,034 for Tres Lomas) in its balance sheet calculations and the undisputed closing costs (\$8,920 for Palmdale Gardens and \$30,170 for Tres Lomas) in its calculation of net cash available after the sales. Appellants admit as much in their opening brief on rehearing. They acknowledge that FTB allowed all mortgage liabilities and other liabilities as listed on the original returns. Those were the only undisputed liabilities and closing costs.<sup>3</sup>

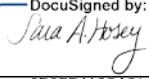
We conclude that FTB accurately accounted for the undisputed liabilities and closing costs in calculating the substituted bases of the promissory notes.

HOLDING

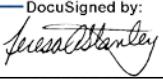
FTB’s calculation of appellants’ substituted bases in the promissory notes properly included the undisputed liabilities and closing costs.

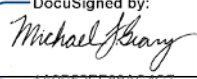
DISPOSITION

FTB’s action is sustained.

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Sara A. Hosey  
Administrative Law Judge

We concur:

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Michael F. Geary  
Administrative Law Judge

<sup>3</sup> Appellants have argued that these undisputed liabilities and closing costs were “obviously erroneous and understated.” However, their arguments have not adequately accounted for appellants’ receipt of substantial cash and their allegation of having incurred additional closing costs lacked any evidentiary support. Thus, those additional liabilities are not undisputed, and appellants’ arguments regarding them are beyond the scope of our rehearing.