

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
MORRIS DAVIS AND )  
JUDY A. HUNTER-DAVIS ) OTA NO. 18063330  
 )  
 ) APPELLANT. )  
 )  
 )  
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, December 17, 2019

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Cerritos, California, 90703,  
commencing at 11:47 a.m. and concluding  
at 1:43 p.m. on Tuesday, December 17, 2019,  
reported by Ernalyne M. Alonzo, Hearing Reporter,  
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ JOSHUA LAMBERT

Panel Members: ALJ DANIEL CHO  
ALJ JOHN JOHNSON

For the Appellant: TIM A. TARTER, ATTORNEY

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
By: NATHAN HALL  
PETER KWOK

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I N D E X

E X H I B I T S

(Appellant's Exhibits were received at page 7.)  
(Department's Exhibits were received at 7.)

OPENING STATEMENT

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By Mr. Hall	45

APPELLANT'S WITNESSES:

	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
Judy A. Hunter-Davis	10			
Brent Cooper	24			

DEPARTMENT'S WITNESSES:

(None offered)

REBUTTAL STATEMENT

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1 Cerritos, California; Tuesday, December 17, 2019

2 11:47 a.m.

3

4 JUDGE LAMBERT: We're now on the record in the  
5 Office of Tax Appeals oral hearing in the appeal of Morris  
6 Davis and Judy Hunter-Davis, Case Number 18063330. We're  
7 in Cerritos, California. The date is Tuesday,  
8 December 17th, 2019, and the time is approximately  
9 12:47 -- 11:47 a.m.

10 My name is Josh Lambert, and I'm the lead  
11 Administrative Law Judge for this hearing and my  
12 co-panelists for today are John Johnson and Daniel Cho.

13 Appellants, can you please identify yourselves  
14 for the record.

15 MR. TARTER: This is Tim Tarter. I'm an attorney  
16 representing Appellant Dr. Hunter-Davis. She prefers  
17 Dr. Hunter for purposes of this proceeding. Also here in  
18 attendance for Appellant is Witness Brent Cooper who has  
19 been Dr. Hunter's long-time tax accountant and who  
20 prepared the returns at issue.

21 JUDGE LAMBERT: Thank you.

22 FTB, can you please identify yourself?

23 MR. HALL: For Respondent, the Franchise Tax  
24 Board, my name is Nathan Hall, and I'm here with Peter  
25 Kwok.

1 JUDGE LAMBERT: Thank you.

2 The issue in this appeal: Is whether the  
3 reported distributive share of capital gains totaling  
4 \$9,461,508.00 from Bay Shores Investment, LLC, may be  
5 reduced by \$4.25 million, which is Appellant's claimed  
6 basis.

7 Appellants, do you agree this is the issue?

8 MR. TARTER: Your Honor, Tim Tarter for  
9 Appellants, with one exception. When the protest was  
10 filed on June 8th, 2018, with the Office of Tax Appeal,  
11 OTA, we submitted with that request for appeal hearing a  
12 calculation showing that the amount claimed on the return,  
13 \$4,250,000, was actually low. It should be \$4,804,429.  
14 And Mr. Cooper will explain how he corrected -- how he  
15 calculated that corrected basis number for purposes of  
16 this appeal.

17 JUDGE LAMBERT: Okay. We will take that into  
18 account. The \$4.25 million amount is based on the  
19 original assessment?

20 MR. TARTER: That's correct.

21 JUDGE LAMBERT: So that's why we'll state -- we  
22 will state that is the overall issue. And after he gives  
23 his testimony and from the arguments you gave in your  
24 briefing, we'll take into consideration your revised  
25 calculation of basis.

1 MR. TARTER: Thank you, Your Honor.

2 JUDGE LAMBERT: So you agree that is the issue?

3 MR. TARTER: Yes.

4 JUDGE LAMBERT: Okay. Thank you.

5 FTB, do you agree that this is the issue?

6 MR. HALL: Yes.

7 JUDGE LAMBERT: Thanks.

8 The parties to the admission into evidence of  
9 Appellants' Exhibits 1 through 17, and FTB's Exhibits A  
10 through O. And neither party had any objection to the  
11 admission of these exhibits.

12 Appellants, is this correct that you have no  
13 objections?

14 MR. TARTER: No objection, Your Honor.

15 JUDGE LAMBERT: And FTB, is this correct that you  
16 have no objection?

17 MR. HALL: It is correct.

18 JUDGE LAMBERT: Thank you.

19 So I hereby admit those exhibits into evidence.

20 (Appellant's Exhibits 1-17 were received  
21 in evidence by the Administrative Law Judge.)\*\*\*

22 (Department's Exhibits A-O were received in  
23 evidence by the Administrative Law Judge.) \*\*\*

24 JUDGE LAMBERT: First, we'll begin with  
25 Appellants' argument, which should not exceed 60 minutes.

1 FTB may ask questions of the witnesses, and then the  
2 Judges will then be allowed to ask questions if they wish.  
3 FTB may make its presentation not to exceed 30 minutes,  
4 and the Judges will then be allowed to ask questions, if  
5 we wish. Appellants will then be allowed 15 minutes  
6 rebuttal after that.

7 Appellants, Mr. Tarter, this is your  
8 opportunity -- and Dr. Hunter -- to explain your position.  
9 You'll have 60 minutes. You may begin.

10

11 OPENING STATEMENT\*\*\*

12 MR. TARTER: Thank you. I appreciate the  
13 opportunity to appeal this matter on behalf of my client,  
14 Dr. Hunter, to the Office of Tax Appeals. Also as a  
15 former government attorney myself, I appreciate the  
16 service of Franchise Tax Board in supplying counsel in  
17 today's hearing as well. Welcome.

18 We have a fairly comprehensive set of exhibits,  
19 so I'm going to -- that have been admitted. And so the  
20 extent that I can, I'll mention on the record where I'm  
21 reading. That may be somewhat awkward or slow, but I  
22 think it does complete the record, and it makes it easier  
23 if you guys -- if the panel needs to revisit anything  
24 about the argument previously.

25 The facts in this case, thankfully, do not appear



1 to be in dispute, at least nothing of major significance.  
2 Certainly, there's a legal dispute. But I do want to read  
3 into the record the general outline of the facts. And  
4 then also, before I move on, get a little testimony from  
5 Dr. Hunter on that since she's here.

6 I'm reading from Exhibit 2, page 1 of 5. This is  
7 the State's February 15, 2018, protest determination. And  
8 the only reason I'm reading from the FTB is just to  
9 eliminate any concern that I'm misstating the facts.  
10 Starting on page 1, the State provided as follows: That  
11 Dr. Hunter has approximately a 2.2 percent, 2. -- yeah --  
12 about 2.2 percent, or did have a 2.2 percent interest in a  
13 partnership called Bay Shores Investment, LLC. Bay  
14 Shores.

15 Bay Shores directly owned about a 20 percent  
16 interest in an entity called HealthCare Partners Holding.  
17 So just for purposes of brevity, I'll refer to Bay Shores  
18 as short for Bay Shores Investment and HealthCare for  
19 short for HealthCare Partners Holdings. I think that's  
20 also consistent to how the State referenced those two  
21 entities.

22 According to the State, which is not in dispute,  
23 on May 20th, 2012, DaVita HealthCare Partners, Inc., here  
24 I'll refer to as DaVita, acquired HealthCare. Membership  
25 interest in HealthCare converted into the right of the

1 holders to receive merger consideration. The total merger  
2 consideration paid by DaVita to HealthCare was  
3 approximately \$3.7 billion in cash and 9.3 million shares  
4 of DaVita HealthCare Partners Inc. common stock.

5 If the panel could take judicial notice, DaVita  
6 is a publicly traded company. I looked it up today. Its  
7 largest owner is Brookshire Hathaway, which owns about  
8 23 percent of DaVita.

9 I'd like to swear in Dr. Davis.

10 JUDGE LAMBERT: Sure.

11 MR. TARTER: Judge Lambert, I think you do that.  
12 Just so I can get a few comments from her.

13 JUDGE LAMBERT: Dr. Hunter, could you please  
14 stand up and raise your right hand.

15

16 JUDY A. HUNTER-DAVIS\*\*\*

17 produced as a witness, and having been first duly sworn by  
18 the Administrative Law Judge, was examined and testified  
19 as follows:

20

21 JUDGE LAMBERT: Thank you. You can sit.

22

23 DIRECT EXAMINATION\*\*\*

24 BY MR. TARTER:

25 Q Dr. Hunter, just a few questions. Do you recall

1 when you first started working for Bay Shores?

2 A Yes. It was in October of 1991.

3 Q Okay. And about when did you become a partner  
4 there?

5 A I believe it was sometime in 1994.

6 Q 1994. Okay. And we have some basis calculations  
7 in the record already, so we can confirm that. So what  
8 did Bay Shores do, let's say, as of 2011? What was Bay  
9 Shores doing as its business?

10 A We were seeing patients and providing health  
11 care.

12 THE STENOGRAPHER: Can I please ask you to bring  
13 the microphone closer to you. Thank you.

14 BY MR. TARTER:

15 Q Why don't you repeat that answer. What was Bay  
16 Shores' business, and let's say, in the year -- just to  
17 make sure it hasn't changed much -- around 2011, the year  
18 before the transactions at issue.

19 JUDGE LAMBERT: And also could you, so that the  
20 court reporter can transcribe everything, speak slowly so  
21 she can properly get everything you say.

22 THE WITNESS: Oh, certainly. Basically, we  
23 provided health care to patients.

24 BY MR. TARTER:

25 Q Okay. In 2020 -- you already heard me read into

1 the record -- DaVita came in and purchased HealthCare and  
2 there's a dispute between the parties that Bay Shores was  
3 approximately a 20 percent owner in HealthCare Partners.

4 A Correct. So we were providing health care as  
5 HealthCare partners, yes.

6 Q And Bay Shores was under the HealthCare umbrella  
7 in 2011?

8 A Yes.

9 Q Okay. So what happened in 2012? Again, there's  
10 no dispute that on May 20th, 2012, DaVita HealthCare  
11 Partners -- and again for the record, I'm just reading  
12 from Exhibit 2, page 1 -- DaVita HealthCare Partners,  
13 DaVita acquired HealthCare. So what happened after that  
14 acquisition?

15 A I became an employee of DaVita Medical Group.

16 Q Okay. And so, literally, that was the name on  
17 your check?

18 A Yes, that is true.

19 Q Okay. Was that effective on May 20th of 2012 or  
20 January 1st of 2013?

21 A I believe it was January of 2013.

22 Q Okay. So you finished in the year 2012 as a Bay  
23 Shores doctor, essentially?

24 A Yes, under the HealthCare Partners as well.

25 Q What happened -- from your perspective, what

1 happened to Bay Shores as of January 1st, 2013?

2 A It no longer existed as a medical group.

3 Q And why do you say that?

4 A Because we became employees of DaVita HealthCare  
5 Partners -- DaVita Medical Group. Sorry.

6 Q You became an employee?

7 A I became an employee of DaVita Medical Group.

8 Q Okay. Now, it's also already -- it's also  
9 stipulated, again, from Exhibit 2 that all the partners  
10 received some shares of DaVita. You received some shares  
11 of DaVita?

12 A Yes.

13 Q Okay. And so for a period of time, you were a  
14 shareholder of DaVita?

15 A Yes.

16 Q Okay. As of January 1st, 2013, the first day  
17 following the year at issue here before the panel, who  
18 issued your checks that you received as an employee?

19 A As of January 2013?

20 Q Correct.

21 A Yes, DaVita Medical Group.

22 Q Okay. Did you meet with partners of Bay Shores,  
23 your former partners, in any type of formal meetings after  
24 January 1st of '13? Partnership meetings, did those  
25 occur?

1 A No.

2 Q Okay. Any partnership activity at all,  
3 January 1st, 2013 forward?

4 A Other than letters.

5 Q Letters explaining what?

6 A Explaining the fact that we had been purchased by  
7 DaVita and that we no longer existed as a medical group.

8 Q Okay. All right. Thank you.

9 MR. TARTER: I'm going to pause. I wasn't clear  
10 if she answers questions now or later, but I'm done with  
11 my direct.

12 JUDGE LAMBERT: Yeah, that's fine you can  
13 proceed.

14 MR. TARTER: Oh, I can proceed. Thank you.  
15 Thank you.

16 THE WITNESS: Thank you.

17 MR. TARTER: Don't go anywhere. I may have some  
18 follow-up questions.

19 THE WITNESS: All right.

20

21 OPENING STATEMENT\*\*\*

22 MR. TARTER: I believe in the state's papers  
23 there's no dispute that federal law controls with respect  
24 to the issues that we have here. Primarily, you know, we  
25 refer to the partnership provision sometimes as

1 Subchapter K provisions. The primary one at issue here is  
2 Internal Revenue Code Section 731. Now, normally I just  
3 say tax -- Federal Tax Code Section. But, technically,  
4 the long legal cite is Title 26 USC 731.

5 If it's all right with you, Judge Lambert, all  
6 the code sections or regulation sections that I reference  
7 are either to the federal tax code or to the federal tax  
8 regulations. Is that fair?

9 JUDGE LAMBERT: That's fine.

10 MR. TARTER: Okay. Title 26 USC can be a  
11 mouthful, and so I want to avoid that if possible.

12 As mentioned previously on the record by  
13 Judge Lambert, the petitioner reported on her return --  
14 and I am now looking at Exhibit 2, page 2 of 5. So  
15 Exhibit 2, page 2. Again, this is still part of the  
16 State's document. Again, I'm using the State's document  
17 to avoid any question of accuracy.

18 There's no dispute that Dr. Hunter reported  
19 \$9,461,508 as long-term capital gain -- as gross,  
20 long-term capital gain. She also claimed a basis  
21 reduction to that number on her original file return of  
22 \$4,250,000. These numbers can be found -- or calculated  
23 would be more correct -- at Exhibit 4. Exhibit 4 is the  
24 2012 Schedule K-1, California K-1, issued to Dr. Hunter by  
25 Bay Shores.

1           On page 1 of Exhibit 4, toward the bottom on the  
2 right-hand column, which is the California column, you'll  
3 see the numbers \$9,460,005, which is the net long-term  
4 capital gain. And on line 9 and line 8, net short-term  
5 capital gain of 1,503. You add those two numbers together  
6 and you get the number on Exhibit 2, page 2, \$9,461,508.

7           Turning to the second page of Exhibit 4, at  
8 line 19, the partnership reported distributions of money,  
9 paren, cash of marketable securities to Dr. Hunter of  
10 \$9,202,271. They also reported distributions of property  
11 other than money, which is line 19(b) of Exhibit 4, page  
12 2, of \$1,331,971. I want to fact -- focus on the  
13 \$9,000,202.

14           There should be no dispute that the \$9,000,202  
15 that was distributed to Dr. Hunter in '12 by the Bay  
16 Shores Partnership, consist of -- entirely consistent of  
17 the net long-term capital gain that was reported on page 1  
18 of the K-1. In other words, she received proceeds  
19 classified as long-term capital gain from the merger  
20 between DaVita and HealthCare Partners.

21           Code Section -- Tax Code Section 731 is titled  
22 "Extent of Recognition of Gain or Loss on Distribution."  
23 731(a) says in the case of a distribution by a partnership  
24 to a partnership, which we clearly have here. 731(a)(1)  
25 then goes on to say gain shall not be recognized to such



1 partner except to the extent that any money distributed  
2 exceeds the adjusted basis of such partner's interest in  
3 the partnership immediately before the distribution.

4 The reason, in my opinion, the K-1 on page 2 --  
5 or any K-1 for that matter -- has a separate line for  
6 distributions of money is so that a partner can track the  
7 meaning or the effect, I should say, of 731(a)(1). In  
8 other words, if you go to Treasury Regulation 1.731(a)(1),  
9 Recognition of Gain, the Treasury Regulation puts a little  
10 more meat on the bones.

11 That regulation states that where money is  
12 distributed by a partnership to a partner and according to  
13 the -- again, according to the K-1 money or cash  
14 marketable securities of \$9.2 million was distributed to  
15 Dr. Hunter. No gain shall be recognized to the partner  
16 except to the extent that the amount of money distributed  
17 exceeds the adjusted basis of the partner's interest in  
18 the partnership. Well, clearly \$9,000,202 exceeded  
19 Dr. Hunter's basis.

20 If we just go to the government's calculation  
21 basis at Exhibit 13, this is the far-right column, bottom  
22 right. At the start of 2012, the State calculated  
23 Dr. Hunter's basis at 3 -- roughly \$3.5 million. There  
24 can be really no reasonable dispute that \$9,000,202  
25 exceeds \$3.5. So how did this -- how did 731 get reported

1 on the tax return? In other words, as we all know, tax  
2 returns sometimes are very clear, but usually they're not.  
3 As a former tax preparer, I think I can say that.

4 So Appellant's -- Dr. Hunter's tax accountant was  
5 faced with a dilemma. How do you report the long-term  
6 capital gain of 9 point -- roughly, \$5 million? And then  
7 how do you reduce that gross long-term capital gain from  
8 the proceeds? How do you show that on a tax return?  
9 There's no dispute that the amount is correct, the  
10 \$9,461,508. There's also no dispute that the \$9,461,508  
11 is long-term capital gain between the partners.

12 So in hindsight, maybe the tax accountant would  
13 been done something different. But if you turn to  
14 Exhibit 11, I think that Dr. Hunter's accountant, Brent  
15 Cooper, I think -- I think he did about as good of a job  
16 as he could with the form available to him. But I think  
17 because of the presentation, somehow this case has gotten  
18 off track. Let me explain.

19 Exhibit 11, which is a single page, is the  
20 California capital gain or loss adjustment worksheet on  
21 the tax return. It's not a worksheet. It's an actual  
22 term, part of the Schedule D of the California State  
23 individual return. And he puts on there to try to be very  
24 clear -- and I'm looking at column one(a). The tax  
25 accountant reports Bay Shores Investment, LLC, basis in

1 Bay Shores' K-1 calculation.

2 And he reports on column C, in cost or other  
3 basis, \$4,250,000. And notice he doesn't put anything in  
4 sales price because Dr. Hunter wasn't selling her  
5 interest. That had been sold upstream from her, and it  
6 probably wasn't deemed a sale. More of an exchange is the  
7 term the parties have used consistently. So this form  
8 didn't really work. Regardless, it was the form that was  
9 provided for reporting capital gain or net capital gain.

10 And so the CPA doctor -- or excuse me -- the tax  
11 return preparer, Brent Cooper, Mr. Cooper put zero in  
12 sales price. When I first looked at this form I thought,  
13 you know, in hindsight I think I would have put the  
14 \$9,461,508 in column (b). Then everything would have  
15 worked out perfectly. There would not have been, quote,  
16 end quote, loss reported in Schedule D.

17 But then on close examination, I was wrong.  
18 Although the pressures of tax return deadlines can be  
19 onerous, in hindsight, I think Mr. Cooper got it right.  
20 Because on line 2 of the form, it says net gain or loss  
21 shown on California K-1. So Mr. Cooper really had no  
22 choice. If he had put the 9,461 number underneath sales  
23 price, one, it wasn't a sale, per say. And the proper  
24 place for that number was on line 2.

25 I think I speculate. I wasn't around then, but

1       there has been a lot of discussion in the papers about  
2       this idea of loss and whether or not there has to be a  
3       liquidation of loss.  And I'll get to those arguments in a  
4       moment, but I think it's important to note -- very  
5       important to note that although the form self-populated  
6       column D with a, quote, end quote, loss of 4.25 million  
7       because there was nothing inserted on column B, sales  
8       price, if you go down to line 10, Dr. Hunter did not claim  
9       a loss from this transaction.

10               To the contrary, \$5,274,737 gain was reported  
11       from this transaction.  True, the form forced the tax  
12       preparer to populate schedule or column D.  But that,  
13       certainly, was not the determination that she should be --  
14       that Dr. Hunter should be bound by.  That's simply the  
15       effect of the fact of the form.  If there -- if there's a  
16       form to properly reflect a 731 transaction, i.e. gain  
17       distributed -- or excuse me -- cash distribution in excess  
18       of basis, I'm not aware of it.  I think Mr. Cooper did the  
19       best he could with the form he had.

20               But I'm hopeful that the State doesn't continue  
21       to focus on this particular number in the loss column.  I  
22       don't think that was -- that clearly was not the intent,  
23       and it certainly does not reflect the transaction.  The  
24       transaction, as you read down through lines 5 down to 10,  
25       it was the only way that Mr. Cooper could come to the

1 correct number while reporting the \$9,461,000. It's been  
2 my experience that if you don't report every line of a K-1  
3 you get audited.

4 Clearly here, Mr. Cooper could have just put in a  
5 net number. But he did everything he could to fully  
6 disclose what was going on starting with the column -- at  
7 column 1, Bay Shores investment basis. He clearly  
8 identified what he was deducting or reducing, the  
9 long-term capital gain from the K-1 aligned to.

10 The State will likely today, as it has in its  
11 papers, will talk about 731(a)(2). And so although I do  
12 have a rebuttal period, I think it's worth, kind of,  
13 putting this all in context now. 731(a)(2) talks about a  
14 loss from a distribution. Because remember 731 is titled  
15 "Extent of Recognition of Gain or Loss in Distribution".

16 So 731(a)(2) talks about losses. Loss shall not  
17 be recognized to such partner except that upon a  
18 distribution and liquidation of a partner's interest. The  
19 State today I'm sure and its papers filed with this panel,  
20 with the OTA, focuses on liquidation. When do we have a  
21 liquidation? Their position -- the State's position is we  
22 don't have liquidation until the actual Bay Shores  
23 partnership is final, maybe dissolved, and the State looks  
24 at the 2012 K-1 and there's -- there's -- the final box is  
25 not checked in 2012.

1           And in fact, it's stipulated that the final box  
2 was not checked until 2018. And you have a copy of that  
3 K-1 if you want to see where that little box is. It took  
4 me a while to find it, but it's on the top, toward the top  
5 of the K-1. And so the State's position is that no loss  
6 can be recognized until Bay Shores submits its final  
7 return to the State. My primary position -- the  
8 Appellant's primary position is we're not talking about a  
9 loss. I've made that point clear. We're not talking  
10 about a loss. We're just talking about a reduction of the  
11 gain that was recognized based upon the cash distributed  
12 in 2012 to the Appellant.

13           The Treasury Regulation provides a little bit  
14 more meat to that bone. The Treasury Regulation of  
15 1.731(a)(1), Recognition of Gain -- I'm speaking from  
16 1.731-1(a)(1) little (i). And, again, this is laid out  
17 pretty well in my June 8th, 2018, request for appeal  
18 hearing submitted to the OTA. Where money is distributed  
19 by a partnership to a partner, no gain shall be recognized  
20 to the partner except to the extent that the amount of  
21 money distributed exceeds the adjusted basis, the  
22 partner's interest.

23           This rule is applicable to both current  
24 distributions, i.e. distributions other than in  
25 liquidation of an entire interest and to distributions in

1 liquidation of a partner's entire interest. So clearly  
2 when it comes to gain, neither the code or regs require  
3 liquidation for this basis offset to occur so long as  
4 Dr. Hunter was reporting a gain, which clearly, she was.

5 She was in gain territory, 5 million-plus. We're  
6 just simply not addressing liquidation. Or we should not  
7 address liquidation because we're not claiming a loss not  
8 as that term is applied in 731 and the Treasury Regulation  
9 under 731.

10 All right. As we discussed previously on the  
11 record, the original tax return claimed a 4.250 basis  
12 reduction to the long-term capital gain that was  
13 recognized in 2012 by Dr. Hunter. We need to spend --  
14 unfortunately, we need to spend a little bit of time  
15 focusing on the number, and what is the proper calculation  
16 of that basis number. There's no dispute that 4.250 was  
17 reported on the original return. There certainly is a  
18 dispute as to, obviously, whether or not it should have  
19 been reported. But that was the amount that was on the  
20 original return.

21 I want to now get a little bit of testimony from  
22 the Appellant's tax accountant, Mr. Cooper, to provide a  
23 little bit of background. First of all, how he came up  
24 with the 4.250 -- the 4.25 million, excuse me, 4,250,000  
25 number. And then prior to filing his request for appeal

1 hearing before -- here on June 8th, 2018, he calculated a  
2 higher basis number that the Appellant is asking the Court  
3 to consider applying here, further reducing her long-term  
4 capital gain on her 2012 return.

5 Just for the mechanics, Judge Lambert, perhaps I  
6 can bring up Mr. Cooper to exchange places for a moment --

7 JUDGE LAMBERT: Yeah. Sure.

8 MR. TARTER: Thank you -- with the Appellant.

9 JUDGE LAMBERT: And Mr. Cooper, if you could  
10 stand and raise your right hand.

11

12 BRENT COOPER,

13 produced as a witness, and having been first duly sworn by  
14 the Administrative Law Judge, was examined and testified  
15 as follows:

16

17 JUDGE LAMBERT: Thank you.

18

19 DIRECT EXAMINATION\*\*\*

20 BY MR. TARTER:

21 Q So Mr. Cooper thank you for coming to the  
22 hearing. I know it's always clear in hindsight when  
23 you're looking at tax returns and what not, but we'll get  
24 through it. I think everybody understands that. So I'm  
25 going to walk you through a few exhibits that have been



1 stipulated into this record for today's hearing?

2 A Okay.

3 Q First of all, let's start with the original  
4 return, which reported \$4,250,000 basis in Ms. -- in the  
5 Appellant's 2012 basis of the Bay Shores account  
6 partnership matter. I want you to look at what's been  
7 marked as Exhibit G. So just flip through all four pages  
8 of Exhibit G. Try not to mix them up with the other  
9 exhibits if you can.

10 Does this appear to be the calculation you used  
11 to calculate the \$4,250,000 number on the original return?

12 A Yes, it is.

13 Q Okay. So there's four pages of Exhibit G. The  
14 first three and part of the fourth has a lot of typed  
15 information. Did you prepare that?

16 A No, I did not.

17 Q Who did? Do you know?

18 A I was given this by Dr. Hunter. She received it  
19 from a meeting she had with the group, the Bay Shores  
20 group, prior to sale. And they were all discussing the  
21 basis calculation. And this one in particular was just  
22 hers, personally. I guess each individual partner  
23 received a similar breakdown. And the breakdown listed  
24 their calculation of the basis through the end of  
25 December 31st, 2011.

1                   And what happened was that's where it ended. The  
2 transaction happened during 2012. So we had -- I was  
3 trying to get from their calculation at the end of 12 --  
4 December 31st, 2011, to the end of the transaction when  
5 the transaction happened. And the numbers were moving  
6 around. We were trying to get as best of numbers as we  
7 can, and the tax deadlines were coming up. And we came up  
8 with the best estimate as we could come up with at that  
9 time.

10                   We knew we were close. We knew we weren't going  
11 to be exact, but we were close enough to get it done and  
12 move it forward. And that's where we came up with the  
13 calculated number with the -- which is \$3,446,942. We  
14 made an adjustment for the month during the -- from  
15 December 31st, 2011, through, I guess, it was May of 2012  
16 when the sale transaction happened.

17                   So our best guesstimate at that time with the  
18 data that was provided to us at the time, we came up with  
19 the \$4,250,000.

20                   Q    So question. What is the basis on page 4 of  
21 Exhibit G? There's a handwritten note that says plus  
22 850,000 -- or 850k.

23                   A    Right.

24                   Q    Okay. Did you mean by that 850,000?

25                   A    That's correct.

1 Q Okay. Is that in your handwriting?

2 A Yes, it is.

3 Q Okay. So you made a best guess. You modified  
4 what was handed to you from the partnership then?

5 A Yes.

6 Q Okay. Okay. After you did the calculation  
7 that's reflected on Exhibit G, did you have an opportunity  
8 to revisit and revise that calculation?

9 A Yes. After the fact -- actually, several years  
10 after the fact when all the data was provided to me,  
11 meaning all the years in questions of K-1s, I had a chance  
12 to go back to revise my initial estimate. And after going  
13 through all the figures --

14 Q Okay. I'm going to interrupt you.

15 A Okay.

16 Q I appreciate your narrative, but I want to try to  
17 ask questions.

18 A Okay.

19 Q Okay. And do my job.

20 A Okay.

21 Q Thank you.

22 A It's all right.

23 Q Take a look at Exhibit 12.

24 A Okay.

25 Q All right. Describe Exhibit 12. First of all,

1 did you create Exhibit 12? It's a 2-page document.

2 A Yes, I did create this Exhibit 12.

3 Q Okay. And in the protest that was filed with the  
4 OTA on June 8th, 2018, you make a statement in the  
5 computation on page 4 of that document. This document is  
6 not part of the exhibits, but it should be in the OTA's  
7 record. You say that the taxpayers over-reported their  
8 taxable gain from the 2012 distribution from Bay Shores by  
9 \$554,000. Your subtraction is \$4,804,429 minus the  
10 \$4,250,000.

11 So how did you determine that was the actual  
12 basis in 2012 -- the Appellant's basis in 2012 at the time  
13 of the transaction was \$4,804,429? Can you walk us  
14 through that on Exhibit 12?

15 A What -- how I created that and how I came up with  
16 that number was solely based on documents provided on the  
17 K-1s. So I took all the data on the K-1s and marked it  
18 down all the pluses and minuses and all the transactions  
19 that happened and tracked the basis on the K-1s, and  
20 summarized it here.

21 Q Okay. Next question. I'm looking at Exhibit 12  
22 that you created, page 1, and you've done a comparison,  
23 which is pretty handy, between the FTB calculation at the  
24 time -- that's since revised slightly. But at the time  
25 the FTB had a calculation as part of its audit record of

1       \$3,446,000.

2               Then you have a revised calculation column. As I  
3 read down through that, there's very little differences  
4 except for the last four items that's not on the FTB  
5 calculation, a \$10,457,251 number, a negative \$9,623,000  
6 and a positive \$876,000, and a negative \$48,338.

7               Did you obtain those numbers from Exhibit 4,  
8 which is the 2012 K-1 that you eventually received?

9               A    Yes, I did.

10              Q    Okay. What page are you looking at on Exhibit 4?  
11 Where did you get those numbers?

12              A    Exhibit 4, page 3 of 3.

13              Q    Okay. So at the bottom of Exhibit 4, page 3 of  
14 3, there's a -- there's what they call a column C,  
15 reconciliation; correct?

16              A    That's correct.

17              Q    And the column of numbers adds up to \$11,972,743;  
18 correct?

19              A    That's correct.

20              Q    And that \$11,972,000 number, isn't that the same  
21 number that's on Exhibit 4, page 1 of 3, at line -- it  
22 doesn't say line. It looks like -- it's about the middle  
23 of the page. It says "Member Share of Form 568  
24 Schedule M-2. That's the same number; right?

25              A    That's correct.

1           Q    Okay.  And did you have all this detailed  
2 information when you were calculating the \$7,250,000  
3 number on the original return?

4           A    \$4,250,000.  Yes.

5           Q    The \$4,250,000.  Did you have Exhibit 4, that  
6 detail?

7           A    No, I did not.

8           Q    Okay.  If you would have had that detail, what  
9 basis adjustment would you have put on the State's  
10 Schedule D when you prepared it?  What would have been  
11 your basis adjustment?

12          A    My adjustment would have been the \$4,804,429.

13          Q    Okay.  That's all I have for this witness.

14                JUDGE LAMBERT:  Okay.  Thank you.

15                MR. TARTER:  Thank you.

16                THE WITNESS:  Thank you.

17                MR. TARTER:  All right.  The final point I want  
18 to cover with the panel this afternoon is with respect to  
19 this idea that you can't deduct the Appellant's basis  
20 until there's been some sort of a liquidation.  So this is  
21 an alternative argument, and this is where the State  
22 spends most of its time.

23                   And in the interest of fairness, I had a  
24 conversation with lead counsel for the FTB, I think about  
25 last week, and I mentioned that I was going to cover this

1 argument. So I'm sure he's prepared. I thought a little  
2 bit about it. I refined it a little bit, but I didn't,  
3 you know, just in an effort of fair play, I had no desire  
4 to ambush the Franchise Tax Board with this alternative  
5 argument.

6 The alternative argument is, I believe that  
7 there's a good argument to be made, that by the end of  
8 2012 the Appellant's interest was deemed liquidated. I'll  
9 repeat that. At the end -- by the end of 2012, the  
10 Appellant's interest in Bay Shores was deemed liquidated.  
11 Now, by deemed liquidated, I mean applying the tax code as  
12 it was intended. I realize that under State law an entity  
13 does not formally dissolve until it, you know, files  
14 articles of dissolution (sic) or whatever, or checks a  
15 little box final and dissolved, et cetera.

16 I'm talking about a deemed liquidation, and I  
17 believe there's clear support for that in the code and  
18 regulations. As Dr. Hunter previously testified, by the  
19 end of 2012 Bay Shores was gone. No activity. And you  
20 don't have to take her word for it. I want to take the  
21 panel quickly through the exhibits, Exhibit 5, which is  
22 the 2013 K-1 of Bay Shores. If you look at line 1 -- it's  
23 always line 1, "Ordinary Business Income," zero.

24 Exhibit 6, now there's -- you actually have to go  
25 to Exhibit 5, page 8 of 8, so there was a slight mix up.

1 If you go to Exhibit 5, page 8 of 8, that is the first  
2 page of 2014 K-1. Line 1, "Ordinary Income," zero.  
3 Exhibit 7, 2015 K-1, "Ordinary Business Income or Loss,"  
4 zero. 8 -- Exhibit 8 -- you can look at all the years,  
5 including 2018 when the little final K-1 box is checked at  
6 the top of K-1, "Ordinary Income Business Loss," zero.

7 Treasury Reg Section 1.708-1. I'll repeat that.  
8 Treasure Reg 1.708-1(b), like boy, talks termination  
9 general rule. A partnership shall terminate when the  
10 options -- operations of the partnership are discontinued  
11 and no part of any business, financial operation, or  
12 venture of the partnership continues to be carried on by  
13 any of its partners in a partnership. This is what  
14 happened here. And I have an alternative argument to that  
15 argument.

16 If we just go down the regulation a little bit  
17 further, I'm at 1.708-1(b)(2). A partnership shall  
18 terminate when 50 percent or more, the total interest in  
19 partnership capital and profits, are sold or exchanged.  
20 That's what happened in 2012. I want to show an exhibit  
21 to the panel so they can do their own math if they want.  
22 Exhibit 14. Go to Exhibit 14, stipulated in the record.

23 This is a proceeds summary to Appellant,  
24 Dr. Hunter, her gross proceeds from the DaVita acquisition  
25 of HealthCare Partners. Her gross proceeds -- so it's the



1 left-hand column -- \$ 10,676,872. But she didn't get all  
2 of it. The final proceeds that closed was \$9,393,308.  
3 Why didn't she get the gross proceeds? Because as you go  
4 down the schedule -- and I think the State discusses this  
5 in one of its papers. Money was held back. It was  
6 litigation.

7 But if you divide the \$9,393,308 by the  
8 \$10,676,872, so the total of the first and the second  
9 column on Exhibit 14, page 1 of 1, roughly 88 percent.  
10 88 percent of the acquisition cost of the acquisition --  
11 excuse me -- proceeds were distributed. And Dr. Hunter  
12 wasn't special. I mean, all the partners received a  
13 similar statement based upon their percentage of  
14 ownership. So the point is that, clearly, well over  
15 50 percent of the partnership's capital was distributed  
16 before the end of 2012.

17 That also is a deemed termination under the  
18 Treasury Regulations. So whether or not you treat this as  
19 a current distribution, which 731(a)(1) says gain is  
20 limited by the basis, or you consider this to be a  
21 liquidation, you need to recognize by the end of 2012 the  
22 Appellant's basis can be used to offset these proceeds.  
23 If you ignore these provisions, panel, you get an absurd  
24 result. Think about it.

25 But the State is arguing is that -- I mean, the

1 State calculates her basis on its exhibit as about  
2 3.1 million. The State doesn't want petition -- excuse  
3 me -- Appellant to recognize any of that loss until 2018.  
4 The problem with that is it's a long-term capital loss.  
5 In 2018, if that is the year. She can begin reducing her  
6 income, she can reduce it -- limit it by \$3,000 a year.  
7 That's the gross long-term capital gain that you can  
8 deduct if you don't -- excuse me -- capital loss. That's  
9 the total long-term capital loss you can deduct with the  
10 State or the Feds, \$3,000, unless you have long-term  
11 capital gain.

12 \$3 million, if we take the State's number,  
13 conservative number, divide by 3,000 -- I calculated it  
14 last night. I confess. I used my calculator. I should  
15 have done it in my head. It's a thousand years. Unless  
16 she has capital gains, then she would have to report a  
17 \$3,000 deduction starting the '18 for the next thousand  
18 years to recover her partnership basis; a basis that was  
19 hard earned.

20 Partnership basis, if you look at the calculation  
21 by the State at '13, the reason her basis is so high is  
22 because she reported large amounts of partnership income  
23 with very little distribution. So her basis went up.  
24 Those were tough years. I'm just looking at Exhibit 13,  
25 column 2008. The partnership tagged her with \$691,893 of

1 taxable ordinary income, but the partnership only  
2 distributed to her about \$375,509. Probably enough to pay  
3 the taxes on the 691.

4           It would be nice if we had case law on every  
5 point made and examples, but the regulations are pretty  
6 clear. They provide examples with respect to gain  
7 transactions, and they provide examples with respect to  
8 liquidation transactions. But the bottom line is we  
9 should be using some common sense here. You can't  
10 construe these code sections and regulation sections too.  
11 Clearly that was not the intent to deny a taxpayer a basis  
12 reduction when the only chance she has to use it in full  
13 is in 2012.

14           That's the end of my opening statement.

15           JUDGE LAMBERT: Thank you.

16           FTB, you can take this opportunity to ask  
17 questions of the witnesses.

18           MR. HALL: We have no cross-examination.

19           JUDGE LAMBERT: Okay. We can now ask questions.  
20 I know I have a couple of questions, and maybe the panel  
21 has them as well. I just wanted to ask to clarify some of  
22 the arguments, Mr. Tarter. I think -- were you trying --  
23 were you stating that the distributive share and the  
24 distribution are the same amount -- they come from the  
25 same amount? Because I believe -- I mean, FTB can -- will

1 discuss later, but I believe FTB was arguing that there  
2 are different amounts. There's a distribution, and  
3 there's also a distributive share.

4 But you're saying that the amounts reported on  
5 the K-1 in different places are actually related to the  
6 same distribution?

7 MR. TARTER: Correct.

8 JUDGE LAMBERT: Okay. And we have the K-1, but  
9 if there's any other evidence to show that those are the  
10 same amounts, do you have -- what do you have to present  
11 to show that those aren't related to a single  
12 distribution? Do you have any evidence or documentation  
13 that we can look through?

14 MR. TARTER: Exhibit 14, which it was the  
15 partnerships, as I have understood it to be kind of their  
16 best guess of the result. They call it a proceeds  
17 summary. I mean, if you look at Exhibit 14, gross  
18 proceeds and final proceeds, those track pretty closely to  
19 the amounts in the K-1. So this document is titled DaVita  
20 Transaction Proceeds Schedule.

21 You compare the cash and value of DaVita shares  
22 distributed, and you get very close to the amounts  
23 reported on the K-1 as long-term capital gain as -- and on  
24 the distribution of money. So I understand the question  
25 is there proof about what's on the K-1 as it related to

1 the distribution, the exchange, the partnership interest  
2 in the DaVita HealthCare transaction. I think Exhibit 14  
3 does that pretty well.

4 JUDGE LAMBERT: Okay. Because the K-1 amounts,  
5 as listed as the distributive share and the distribution  
6 aren't -- they are different amounts on the K-1. Do you  
7 have an explanation as to why the amount listed as  
8 distributive share is different on the K-1 from the  
9 distribution amount if they're related to the same  
10 distribution?

11 MR. TARTER: So you're -- you're comparing -- I  
12 just want to make sure I'm clear on the question. So I'm  
13 looking at Exhibit 4, the 2012 K-1, and you're comparing  
14 the \$9,460,000, which is the net long-term capital gain,  
15 to the second page of the K-1 is \$9,000,202?

16 JUDGE LAMBERT: Correct.

17 MR. TARTER: Yeah. The difference is about  
18 \$200,000. I don't know what that percentage difference  
19 is. I can't actually calculate the difference just  
20 because the partnership return would have to be provided  
21 in detail for me to actually calculate both of those  
22 numbers. But based upon Exhibit 14, and based upon the  
23 other numbers on the K-1, which are insignificant, I think  
24 there's no reasonable dispute.

25 With all due respect, I don't think there's any

1 reasonable dispute, but the long-term capital gain  
2 resulting from the proceeds from the exchange that are  
3 reported on Exhibit 14, I don't think there's any -- any  
4 dispute that the long-term capital gain, 9.4, is coming  
5 primarily from the DaVita transaction.

6 JUDGE LAMBERT: Okay. On a related question, the  
7 basis calculation done by Mr. Cooper -- I think it was  
8 Exhibit 12. In the basis calculation on Exhibit 12, it  
9 shows that there's an addition for the amounts that appear  
10 to be the distributive share amounts, which includes  
11 ordinary income of \$836,904 and \$9,460,005 for long-term  
12 capital gain. And later on, there's a subtraction for  
13 distributions.

14 And I believe -- I mean, FTB can clarify, but I  
15 was -- I thought that what the FTB was stating is that a  
16 distributive share is added to the basis, and then the  
17 distribution is off. You only take a gain to the extent  
18 it surpasses your basis for the distribution.

19 So I guess my question is, if it's not -- if  
20 there was no distributive share, it appears that there's  
21 an addition to this basis calculation, which would be done  
22 if there's a distributive share. Because a distributive  
23 share, I was under the impression increases basis.

24 And here it looks the distributive share was  
25 increasing the basis.

1 MR. TARTER: That's correct.

2 JUDGE LAMBERT: I believe you were -- I thought  
3 we were arguing -- you were arguing there's no  
4 distributive share?

5 MR. TARTER: No.

6 JUDGE LAMBERT: You said -- I thought that you  
7 were saying it was only a distribution?

8 MR. TARTER: Yeah. It gets a little confusing.  
9 702 -- and, again, the State will clarify this. But I  
10 believe Code Section 702 talks about a partnership is  
11 required to take into income all -- its distributive share  
12 of income and loss and credits. That's 702.

13 And that -- and you can see that reflected in the  
14 State's calculation of basis on Exhibit 13. If the  
15 partnership -- if the Appellant's allocatable share of  
16 partnership income is reported, that increases basis, and  
17 then a distribution now decreases basis. That is not in  
18 dispute. I think that's one of the issues that's a little  
19 confusing.

20 Whether or not basis is going up or down, it  
21 still doesn't answer the questions about the \$9.4 million,  
22 long-term capital gain that was -- that the State wants  
23 reported in full. 731 is a separate code section. 702  
24 talks about distributive share. I hope I'm stating that  
25 right, 702 or 703. But 731 talks about the extent of

1 recognition of gain or loss on a distribution.

2 JUDGE LAMBERT: Okay. Yeah. I guess my question  
3 was -- before you said it was related to one distribution,  
4 and there was no distributive share. Whereas here it  
5 looks like it's being treated as two separate amounts, as  
6 a distributive share and a distribution. But I thought  
7 your argument was that there was only one distribution,  
8 and it was just reported by accident on the K-1 in two  
9 places.

10 MR. TARTER: No, I don't -- I don't think I used  
11 any of those terms, an accident or anything.

12 JUDGE LAMBERT: You said the distribution --  
13 there's one distribution, and it was reported in two  
14 places on the K-1. One place was distributive share and  
15 one place distribution, but it's related to one  
16 distribution is what you're saying.

17 MR. TARTER: No. I don't -- I don't think I used  
18 any of those terms, an accident or anything like that.

19 JUDGE LAMBERT: Okay. But you said that the  
20 distribution -- there's one distribution, and it was  
21 reported in two places on the K-1. One place was a  
22 distributive share, and one place was a distribution, but  
23 it's related to one distribution is what you're saying.  
24 I'm just trying to clarify.

25 MR. TARTER: Sure. On the K-1 there was one cash



1 distribution. No doubt about it. That's on line 19 of  
2 the K-1, Exhibit 4. There was one distribution out. And  
3 the question is, based upon that distribution out, did  
4 that trigger a basis reduction? And that's what 731 says.  
5 When there's a distribution of cash, then a taxpayer can  
6 reduce its long-term -- in this case long-term capital  
7 gain by the amount of that -- of her basis at the time of  
8 the distribution.

9 But that's why I spent some time on the  
10 alternative arguments, which is that primary argument  
11 relates to current distributions. I think there's also an  
12 equally valid argument that in effect this was a deemed  
13 liquidation or termination of the partnership interest at  
14 the end of 2012, which is why I brought it up because I  
15 think -- I think that path is clearer.

16 Based upon the code and the regs that I talked  
17 about previously, there was a deemed liquidation of the  
18 partnership interest at the end of the '12. Operation  
19 stopped when one -- or these are alternative arguments --  
20 or over 50 percent of the partnership's capital was  
21 distributed.

22 So if the panel has a concern about my primary  
23 argument, I would ask them to consider the deemed  
24 liquidation that occurred in to 2012, because I think it's  
25 maybe more valid argument. No -- no business continued

1 after 2012. Was there money in the bank account? Yes.  
2 But that does not change the status of the deemed  
3 liquidation in 2012.

4 But if I may, there is authority for that, but I  
5 may have exceeded my time. I don't want any --

6 JUDGE LAMBERT: No. That's fine.

7 MR. TARTER: I can do that on rebuttal if you  
8 want?

9 JUDGE LAMBERT: Well, just one more question on  
10 that --

11 MR. TARTER: Sure.

12 JUDGE LAMBERT: -- in terms of the authority. I  
13 believe from the FTB's argument that it appeared that they  
14 were stating that if it was a liquid -- liquidating  
15 distribution, that law applies to it when there's a loss.  
16 And in here it doesn't look like there was a loss but a  
17 gain.

18 MR. TARTER: The State would differ with that.  
19 The State is arguing that you can't deduct the basis as a  
20 loss until a liquidation has been consummated. And I'm  
21 okay with that. As a general rule, the State would argue  
22 that the liquidation isn't consummated -- isn't completed  
23 until 2018.

24 JUDGE LAMBERT: Okay. Well, I guess I was  
25 asking -- I believe -- I thought this distribution was not

1 a loss. It was not a loss.

2 MR. TARTER: That's my primary argument.  
3 Absolutely.

4 JUDGE LAMBERT: Okay.

5 MR. TARTER: Yeah. Absolutely. 731(a)(1) talks  
6 about a gain. And as we mentioned, the capital gain  
7 reported by the Appellant was \$5 million. That's a gain,  
8 not a loss.

9 JUDGE LAMBERT: So that gain qualifies -- that  
10 code section you're stating qualifies them when there's a  
11 deemed liquidation. You're saying it's related to when  
12 there's a deemed liquidation? That's relevance?

13 MR. TARTER: It could be either. 731(a)(1) talks  
14 about current distributions not in liquidation. And  
15 731(b) talks about losses recognized when there is a  
16 liquidation. I'm arguing both -- both could apply here.

17 JUDGE LAMBERT: Okay.

18 MR. TARTER: If it's not a current distribution,  
19 which the State argues this is not a current distribution,  
20 and, therefore, you can't deduct the gain. Then the state  
21 uses, you know, applies the standard of we're not  
22 liquidated. The interest is not liquidated until 2018.  
23 And I'm okay going down that path that no loss, i.e. the  
24 basis -- because there's no argument. You can ask the  
25 State when they -- when they present.

1           But there's no argument that beginning in 2018,  
2 she can write-off her basis as a long-term capital loss.  
3 There's no debate about that from the State's standpoint.  
4 I'm arguing that's an absurd result. This liquidation  
5 effectively took place in 2012. Operation stopped. Why  
6 should Appellant wait seven years to claim a basis loss  
7 seven years after all the gain from the exchange of her  
8 shares was completed?

9           The result is absurd. She has this huge  
10 long-term capital loss that she effectively cannot use  
11 because you were waiting until some arbitrary point in  
12 time when the final box is checked on the K-1. The code  
13 and the regs, obviously, apply a little bit of common  
14 sense.

15           If operations have ceased, or more than  
16 50 percent of capital has been distributed out of the  
17 partnership, we're done. We can then take the deduction  
18 of the basis against whatever income we're reporting on  
19 that 2012 return. I hope that's clear.

20           JUDGE LAMBERT: Yeah. I understand what you're  
21 saying.

22           MR. TARTER: I'm -- I'm just -- there's a couple  
23 of ways to argue the facts here, and I'm just arguing them  
24 both ways.

25           JUDGE LAMBERT: Okay. Thank you.

1 Judge Johnson, do you have any questions?

2 JUDGE JOHNSON: No questions for the witnesses.

3 I might have a couple of little questions, but I want to  
4 see if FTB can address them first, if I can hold off until  
5 after their time.

6 JUDGE LAMBERT: Judge Cho, do you have any  
7 questions?

8 JUDGE CHO: I have no questions at this time.

9 JUDGE LAMBERT: Okay. FTB you have 30 minutes.

10 MR. HALL: Okay.

11

12 OPENING STATEMENT\*\*\*

13 MR. HALL: Good afternoon, panel.

14 Nathan Hall appearing on behalf of the Franchise  
15 Tax Board. This case involves the improper reduction and  
16 capital gain claimed by Appellants in 2012 based on  
17 Dr. Hunter's reported interest in Bay Shores.

18 In reaching the correct result for this case,  
19 it's important to remember that partnerships are  
20 pass-through entities. On the most basic level, this  
21 means that partnerships themselves do not pay tax, rather  
22 the individual partners pay tax based on their respective  
23 partnership interests.

24 Generally speaking, that means if a partnership  
25 earned, for example, \$100 during the tax year, a partner

1 holding a 50 percent interest in the partnership would be  
2 required to report and pay tax on \$50 of the partnership's  
3 income. The rule providing operation for this concept is  
4 found in Internal Revenue Code Section 702.

5 To apply this rule to the case at hand, I would  
6 direct you to Appellant's 2012 California tax return  
7 marked as Respondent's Exhibit A, on page 6 line 2. This  
8 is page 104 of the PDF of the exhibits. Here, the  
9 Appellant's properly reported Dr. Hunter's distributive  
10 share or partnership capital gains in 2012, in the amount  
11 of roughly\$9.4 million. To be sure, this is the sum of  
12 capital gains reported on her scheduled K-1 from the  
13 partnership in 2012. This is shown in Respondent's  
14 Exhibit C on page 1 lines 8 and 9, which is page 126 of  
15 the PDF.

16 After the partners report the partnership income,  
17 what the partnership does with that income is an entirely  
18 separate matter. The partnership may retain some income  
19 and reinvest it or hold some back for litigation that's  
20 pending, or may distribute that income to the partners.

21 Internal Revenue Code Section 731 tells us  
22 whether there are any tax consequences upon a distribution  
23 to a partner. Determining whether there's a recognizable  
24 gain or loss upon a distribution depends on the partner's  
25 basis in the partnership. Gain upon a distribution is not

1 recognized except to the extent that the gain exceeds the  
2 partner's basis in the partnership immediately before the  
3 distribution.

4           Losses, if any, are not recognized except on a  
5 distribution and liquidation of the partner's entire  
6 interest in the partnership. To apply that concept here,  
7 we can see that the partnership reported a cash  
8 distribution to Dr. Hunter in 2012 of roughly  
9 \$9.2 million. This is shown in Respondent's Exhibit C on  
10 page 2, line 19(a). This is page 127 of the PDF.

11           As stated a moment ago, whether there is a gain  
12 or a loss based on a distribution depends on the partner's  
13 basis in the partnership. Respondent has provided the  
14 panel with its own calculation of Dr. Hunter's basis in  
15 the partnership, which is shown in the Respondent's  
16 Exhibit K.

17           While the parties appear to disagree on exactly  
18 what Dr. Hunter's basis in the partnership was, both  
19 parties estimated at roughly \$3.4 million at the beginning  
20 of 2012. Internal relevant code Section 705 provides the  
21 operating rules for determining a partner's basis in a  
22 partnership. Under that section, a partner's basis in a  
23 partnership is generally increased by her distributive  
24 share of partnership income and generally decreased by the  
25 amount of distributions to the partner.

1           As mentioned earlier, Dr. Hunter's distributive  
2 share of partnership income in 2012 was reported as  
3 roughly \$9.4 million. Applying Section 705 here, we would  
4 take the beginning basis of \$3.4 million and add  
5 Dr. Hunter's distributive share of income in the amount of  
6 \$9.4 million, resulting in a partnership basis of  
7 approximately \$12.8 million immediately prior to the  
8 distribution in 2012.

9           I'd like to take a minute to remind the panel  
10 that these numbers are only rough estimates to illustrate  
11 application of the rules. The numbers reflecting  
12 Respondent's position are stated in Respondent's briefs  
13 and accompanying exhibits. Turning back to Section 731,  
14 gain is not recognized to a partner upon a distribution  
15 except to the extent that any money distributed exceeds  
16 the basis of the partner's interest immediately before the  
17 distribution.

18           As we said, we have a basis immediately before  
19 the distribution of roughly \$12.8 million and a  
20 distribution of roughly \$9.4 million. Applying the  
21 distribution against Dr. Hunter's basis results in  
22 remaining basis of roughly \$3.4 million. Appellant's have  
23 argued on brief that Dr. Hunter was taxed on the  
24 distribution. However, as shown here that statement is  
25 incorrect. The distribution, as reported on the Schedule



1 K-1, reduced Dr. Hunter's partnership basis but did not  
2 result in a taxable event.

3 Now, the question of whether Appellants are  
4 entitled to claim a loss or offset to recover,  
5 Dr. Hunter's remaining basis in 2012 is governed under  
6 Section 731, which provides that a loss shall not be  
7 recognized except upon a distribution and liquidation of a  
8 partner's interest in the partnership. This begs the  
9 question of the meaning of the phrase, "liquidation of a  
10 partner's interest."

11 The Internal Revenue Code and regulations provide  
12 clarification on this point. The Internal Revenue Code  
13 states, quote, "The term liquidation of a partner's  
14 interest means the termination of a partner's entire  
15 interest in a partnership by means of a distribution or  
16 series of distributions. Furthermore, when there are a  
17 series of liquidating distributions, a partner's interest  
18 in the partnership is not deemed terminated until the  
19 final distribution has been made."

20 Under the plain language of the statute,  
21 Dr. Hunter's partnership interest was not terminated in  
22 2012. The scheduled K-1s show that Dr. Hunter continued  
23 to receive distributions based on her partnership's  
24 interest beyond 2012. For example, Dr. Hunter's Schedule  
25 K-1 for the 2013 taxable year shows that she received a

1 distribution from the partnership of roughly \$460,000 that  
2 year. This is reflected in Appellant's Exhibit 5 on  
3 page 1, box 19. This is page 19 of the PDF.

4 In 2018 Dr. Hunter received a distribution with  
5 respect to here partnership interest. Again, this is  
6 reflected in her Schedule K-1 for 2018 marked as  
7 Respondent's Exhibit O on page 3, line 19(a), which is  
8 page 236 of the PDF. Dr. Hunter's Schedule K-1s provide  
9 additional evidence that the 2012 distribution was not a  
10 liquidating distribution. If I could direct your  
11 attention back to Schedule K-1 for 2012, marked as  
12 Respondent's Exhibit C on page 126 -- excuse me --  
13 page 126 of the PDF.

14 Two things are apparent when you look at the  
15 Schedule K-1. First, it does not indicate that it is the  
16 final Schedule K-1 as discussed earlier. Second, a review  
17 of the partner's pending capital account in box E in the  
18 middle of page 1 of the exhibit shows that Dr. Hunter's  
19 ending capital account is approximately \$3.4 million.  
20 Generally, if the taxpayer's interest in the partnership  
21 is liquidated, the ending capital account will show zero.

22 Now, let's contrast that with the Schedule K-1  
23 issued to Dr. Hunter in 2018. This is marked as  
24 Respondent's Exhibit O on page 234 of the PDF. On page 1  
25 of the exhibit, line G, the box indicating that the K-1 is

1 the final K-1 is checked. Further, on the top of page 2  
2 of the exhibit, you can see that Dr. Hunter's ending  
3 capital account is zero. These are indicators that the  
4 partner's interest in the partnership has been liquidated  
5 or terminated during the taxable year. Based on this, it  
6 appears that 2018 would be the correct year to claim the  
7 loss.

8           Additionally, Dr. Hunter's subsequent tax returns  
9 are not consistent with Appellant's theory that they're  
10 allowed to claim a loss to recover the partnership basis  
11 in to 2012. Assuming that Dr. Hunter recovered her basis  
12 in 2012, at the beginning of 2013 her basis in the  
13 partnership should be zero. Remember with respect to  
14 distribution, gained is not recognized except to the  
15 extent that it exceeds the partner's basis in the  
16 partnership.

17           If Dr. Hunter had received a distribution in 2013  
18 with a partnership basis of zero, that distribution would  
19 exceed her basis and be considered taxable. As pointed  
20 out, the partnership did in fact report a distribution to  
21 Dr. Hunter in 2013 of roughly \$460,000. However, that  
22 distribution was not reported on her 2013 tax return.  
23 This is shown in Respondent's Exhibit N, page 6, line 13.

24           Now, Appellants have pointed to IRC, Internal  
25 Revenue Code Section 708, arguing there was termination of

1 the partnership in 2012. First of all, Section 708 and  
2 the accompanying regulations deal with partnership level  
3 determinations that and are not directly applicable to  
4 Section 731.

5 Second, the Treasury Regulations, if you --  
6 quoting Treasury Regulation 1.708-1(b), which is the  
7 regulation that Appellants read from earlier. That  
8 regulation provides that the partnership is not considered  
9 terminated until the winding up period is concluded and  
10 all remaining assets, including cash, are distributed to  
11 its partners.

12 So even if the partnership ceases doing business,  
13 the partnership is considered continuing during the  
14 winding-up period. Now, the code does not define the term  
15 "winding-up period", but it is Respondent's position that  
16 winding up is generally understood to include the process  
17 in which the partnership pays and settles any remaining  
18 debts or liabilities.

19 In this case, determining the partnership's  
20 liability as a result of a lawsuit and subsequent  
21 settlement would be considered a winding-up event for  
22 purpose of IRC Section 708. This did not conclude -- the  
23 litigation did not conclude until 2018, the same year in  
24 which the partnership distributed its remaining cash to  
25 the partners.

1 Appellants have failed to provide any authority  
2 to support the interpretation of -- their interpretation  
3 of Section 708 that the partnership can terminate while  
4 Dr. Hunter continues to receive distribution based on her  
5 partner's interest. Appellant's have also suggested --  
6 excuse me.

7 And to address Treasury Regulation 708-1(b)(2)  
8 regarding a termination based on the exchange of  
9 50 percent or more of the total interest in a partnership,  
10 Appellants have contradicted themselves here. Earlier  
11 Appellants stated that Ms. Davis's interest in Bay Shores  
12 was not sold or exchanged. That is true. Appellants  
13 supported this argument by citing to Exhibit A, page 6,  
14 which is 1 of 4 -- page 1 of 4 of the PDF.

15 Reviewing that exhibit, we can see that under  
16 Sales Price column B, there was no sale or exchange of  
17 Dr. Hunter's interest in the partnership in 2012. It's  
18 important to remember that the merger that occurred was  
19 between HealthCare Partners and DaVita, not Bay Shores.

20 Finally, Appellants have suggested that the  
21 result is unfair to Dr. Hunter. While Respondent  
22 understands where Appellants are coming from, the fact  
23 that the correct legal application would be more -- excuse  
24 me. The fact that it may be more financially advantageous  
25 for Dr. Hunter is not a reason to make an exception to

1 this rule.

2 If we're talking about matter of fairness, it  
3 would be incorrect to allow an exception to this rule  
4 simply because it results in a greater tax advantage for  
5 Ms. Davis. There could be other taxpayers, for example,  
6 who stand to benefit by recovering his or her basis in  
7 2018. Would we apply the rule differently for those  
8 taxpayers? Short of allowing the taxpayers to freely  
9 choose which year to recover their basis, it is most fair  
10 to apply the rules as written uniformly.

11 The facts show that Appellants incorrectly  
12 applied the partnership rules by reporting a loss and  
13 offsetting Dr. Hunter's basis in Bay Shores in 2012.  
14 Respondent's determination should be sustained.

15 Thank you.

16 JUDGE LAMBERT: Thank you. I just have a couple  
17 of questions. The Appellants were arguing that -- one of  
18 their arguments was that the amount was not a loss, even  
19 though it was reported that way. And your presentation  
20 focused on the fact -- on the argument that it was a loss.  
21 Can you trust their other argument that it was not a loss  
22 but a distribution that is a gain?

23 MR. HALL: Yeah. So with respect to recovering a  
24 partner's basis under section, that would be -- let me  
25 clarify here. Section 731, gain or loss, it's important

1 to understand or recognize that the gain or loss under  
2 Section 731 is with reference to the partner's basis in  
3 the partnership. That's how a 731 gain or loss is  
4 determined.

5 And so when we're talking about how the  
6 distribution effects basis and whether basis -- there's a  
7 basis recovery, a.k.a. a loss during that tax year, we  
8 have to compute the taxpayer's basis to determine whether  
9 there should be a loss. And with respect to claiming a  
10 loss or reducing or offsetting a distributive share of  
11 gain, in that case we're looking at Section 738 --  
12 731(a)(2).

13 JUDGE LAMBERT: Okay.

14 MR. HALL: I hope that answers your question or  
15 at least --

16 JUDGE LAMBERT: Okay. Also, one question in  
17 terms of Appellant's basis calculation that includes those  
18 amounts that they say tied to their K-1, do you have  
19 any -- what do you -- do you agree or disagree with those  
20 extra numbers added to their basis calculation?

21 MR. HALL: To the extent that they differ with  
22 Respondent's basis calculation which is in Exhibit K,  
23 Respondent disagrees. And I think our basis calculation  
24 is set forth in that exhibit. And that is our position.  
25 But I will reiterate that it is Respondent's position that

1 for the 2012 taxable year, basis determining --  
2 Dr. Hunter's basis in the partnership is of no relevance  
3 because she's not recovering her basis in that year,  
4 according to our position.

5 MR. KWOK: Judge Lambert, if I may jump in. We  
6 believe the Appellant is mixing up the requirements of 702  
7 and 731. According to 702, they have to recognize any  
8 income, any distributive share income. And that from  
9 page 1 of their 2012 K-1, that encompasses lines 1 through  
10 11, which encompasses also the net capital gains that  
11 Dr. Hunter was entitled to from the sale of HealthCare by  
12 Bay Shores.

13 731 is merely a computation of whether there's a  
14 gain or loss on the Appellant's own interest in the  
15 partnership itself in the interest -- in this case, the  
16 interest of Bay Shores. This has nothing to do with the  
17 sale to DaVita. The sale to DaVita was accounted for --  
18 should be accounted for under 702.

19 So we believe because there's a mix up -- because  
20 the Appellants are mixing these two things up, the only  
21 way that they can apply or offset their basis of \$4.2  
22 million is to do that under 731 as a loss. Because any  
23 gain is recognized under 702, and that's why we were  
24 addressing the loss portion of that 731(b).

25 JUDGE LAMBERT: Okay. Judge Johnson, do you have



1 any questions?

2 JUDGE JOHNSON: Thank you. One question for the  
3 Franchise Tax Board. To the extent that Appellant is  
4 raising the argument that -- excuse me -- that the  
5 \$4.2 million basis should have been around 4.8 instead, a  
6 difference of about \$550,000. What we're talking about  
7 today is a Notice of Action on a Notice of Proposed  
8 Assessment; is that correct? Seeking additional tax from  
9 the taxpayer?

10 MR. HALL: That's correct.

11 JUDGE JOHNSON: Okay. We're not talking about a  
12 claim for refund today?

13 MR. HALL: That's correct.

14 JUDGE JOHNSON: So to the extent that Appellants  
15 believe they overpaid, that would be a refund claim  
16 action; would it not?

17 MR. HALL: Correct.

18 JUDGE JOHNSON: Okay. And that's not before us  
19 today?

20 MR. HALL: Correct.

21 JUDGE JOHNSON: Okay. Thank you.

22 JUDGE LAMBERT: Judge Cho, do you have any  
23 questions?

24 JUDGE CHO: No. I don't have any questions.  
25 Thank you.

1 JUDGE LAMBERT: Appellants you have 15 minutes to  
2 make a rebuttal.

3 MR. TARTER: Hopefully, I won't need all that.  
4 Although I have been trying to speak slowly for the court  
5 reporter.

6

7 REBUTTAL STATEMENT\*\*\*

8 MR. TARTER: Primary position, I don't think I  
9 need to repeat. I think it's clear in the pleadings and  
10 whatnot with respect to the effect of 731 allowing an  
11 offset basis against a long-term capital gain when cash is  
12 distributed.

13 What I want to focus on is maybe coming a lot  
14 closer, factually and legally, to what the State is  
15 arguing in its papers and today, which -- with respect to  
16 termination. There was a definition provided earlier that  
17 liquidation of a partnership equals termination. I don't  
18 think there's any dispute between the parties that when  
19 a -- somebody's partnership interest is terminated, that  
20 the full basis can be allowed.

21 The Appellant's alternative position is that it  
22 occurred in 2012. And I don't think the State -- although  
23 I provide the State with the heads up that I was going to  
24 make that argument today. I don't think the State really  
25 is -- really completed that their defense of that

1 alternative argument.

2           Again, I want to be clear. 708, this is Treasury  
3 Regulation 1.708-1, talks about termination. A  
4 partnership shall terminate when the operations of the  
5 partnership are discontinued. The operations of the  
6 partnership are discontinued. This partnership was in the  
7 health care business. It was not in the litigation  
8 business. It was not a debt collector.

9           Were there two distributions, one in '13 and on  
10 in '18 to partners, including the Appellant? Yes. But  
11 that does not change the fact that in 2012 Bay Shores is  
12 gone, effectively, as an operation. Now, with respect to  
13 the -- a couple of lingering payments, I would ask the  
14 Court to consider a couple authorities. Because as you  
15 can imagine, this is not the first panel that has had to  
16 decide whether or not a strict reading of the code and  
17 regulations is required because of an absurd result will  
18 precipitate.

19           The case of Golder, G-o-l-d-e-r, versus United  
20 States, this is 64 F3d 663. This is a 1995 opinion by --  
21 out of the Northern District of Ohio. And it states the  
22 filings. There's no per se rule that the mere retention  
23 of certain assets or management of particular activities  
24 in anticipation of liabilities amounts to a continuation  
25 of a partnership.

1           That's what's going on here at Exhibit 15.  
2           There's a memorandum to the partners involved that  
3           discusses the litigation. And that finally, at the end of  
4           litigation a distribution can occur. Exhibit 14 shows  
5           roughly the schedule of the amounts that were held in  
6           escrow pending the results of litigation.

7           The Golder case -- I'm trying to get a page cite  
8           for you. Let me find one -- also references a number of  
9           cases, including LaRue v. Commissioner, out of the tax  
10          court, 90 TC 465. Only activity of the partnership was  
11          defense of the NY -- of the New York State lawsuit.  
12          However, that does not change the fact that the  
13          partnership no longer had any business or assets. And  
14          other cases are cited.

15          The State admits that wrapping up is not  
16          defined -- or winding up, excuse me. Winding up is not  
17          defined in the code of regs. But I propose to the panel  
18          that effective January 1st, '13, as the Appellant  
19          testified and as the facts show, no activity was taking  
20          place other than the fact that there was some litigation  
21          that held up a few of the payments. Cases like Golder and  
22          whatnot, do not extend that period of time to determine  
23          that the partnership is terminated.

24          The partnership was terminated in 2012 when it  
25          ceased operations. And also, alternatively, I don't

1 believe the State fully answered the regulation of  
2 1.708-1(b)(2). A partnership shall terminate when  
3 50 percent or more of the total interest of the  
4 partnership, capital and profit, is sold or exchanged.

5 Now, they talk about the Schedule D, which we've  
6 already talked about, is somewhat defective in this  
7 purpose. And saying well, we didn't put the number in  
8 Schedule D, so therefore there wasn't a seller exchange.  
9 The taxpayer shouldn't be completely bound by the position  
10 they took on the return. That's why we're here. We're  
11 trying to apply proper law to the facts. And the facts  
12 are that the Appellant's interest was exchanged for some  
13 cash and some shares in DaVita. And that transaction was  
14 completed substantively in 2012 except for some lingering  
15 payouts that resulted at the end of the lawsuit.

16 We shouldn't have to wait seven years. It  
17 creates an absurd result. And no court that I'm aware of  
18 has followed a strict interpretation that some  
19 nonoperational-type activity should control whether or not  
20 the partnership interest is deemed terminated.

21 That concludes my rebuttal.

22 JUDGE LAMBERT: I just have one question.

23 MR. TARTER: Go ahead.

24 JUDGE LAMBERT: FTB was stating that the merger  
25 agreement and the termination was between DaVita and HCP

1 and not related to Bay Shores. And they are stating that  
2 Bay Shores was not terminated. But maybe you could  
3 clarify, you know, if we're looking at liquidating  
4 distribution from Bay Shores and DaVita is the one that's  
5 terminating, how can we connect the dots to Bay Shores?  
6 So, yeah. I mean, so could you address that to these  
7 arguments?

8 MR. TARTER: Sure. HCP was owned by several  
9 practice groups. We know the percentage. It's been  
10 stipulated that Bay Shores owned about 20 percent. I  
11 think that's Exhibit 1. Let me see. Yeah, Exhibit 1,  
12 page 1, I believe -- no. I apologize. Exhibit 2, page 1.  
13 Bay Shores, Ms. Hunter's partnership owned about  
14 20 percent of HCP. Obviously, HCP was owned 80 percent by  
15 other practice groups. We could ask her to testify on  
16 that, but that would her testimony, is that HCP was owned  
17 by several practice groups.

18 Her practice group owned, according to the State,  
19 19.63 percent. Okay. So HCP is owned by a group of  
20 practitioners, Bay Shores and let's say four other  
21 practice groups, so 20 percent each. You want to buy HCP.  
22 How do you do it? You have to acquire HCP, you know. Who  
23 are the owners of HCP? Bay Shores is one of the owners.  
24 And in my example, four other 20 percent owners or  
25 partnerships are owned by HCP.

1           So DaVita comes in. They want to acquire HCP.  
2           How do they do that? They have to acquire HCP's owner's  
3           interest, which includes Bay Shores. Bay Shores is one of  
4           the owners of HCP. So DaVita effectively, in order to  
5           acquire HCP, has to acquire the partnership's interest  
6           that own HCP. And, of course, that filters down to the  
7           individual partners.

8           So the DaVita HealthCare transaction, obviously,  
9           required the approval of all the partners -- all the  
10          partnerships, which acquired the approvals of all of  
11          partners in order to complete the transaction. And  
12          because I mentioned at the start of my opening Exhibit 2,  
13          page 1 of 5, the State is very clear. On May 20th, 2012,  
14          DaVita HealthCare Partners acquired HealthCare. Period.  
15          That's what happened.

16                 JUDGE LAMBERT: Okay. Thank you.

17                 Judge Cho, do you have any questions?

18                 JUDGE CHO: No questions. Thank you.

19                 JUDGE LAMBERT: Judge Johnson?

20                 JUDGE JOHNSON: Yes. Thank you. Going back to  
21          the alternative argument, the deemed liquidation, the  
22          Franchise Tax Board kind of walked through the years that  
23          followed 2012.

24                 MR. HALL: Sure.

25                 JUDGE JOHNSON: They noted that there were some

1 distributions, and apparently, they were reported as no  
2 net gain due to remaining balance in her account. Does  
3 that sound accurate to you?

4 MR. TARTER: Let me look at 2013 K-1 just so I  
5 can keep up with you.

6 JUDGE JOHNSON: Sure. I believe it's Exhibit N.

7 MR. TARTER: Exhibit what?

8 JUDGE JOHNSON: I'm sorry. Exhibit N was the tax  
9 return.

10 MR. HALL: Yeah.

11 MR. TARTER: I'm looking at Exhibits 5, which is  
12 the 2013 K-1. It shows a distribution of \$459,000 but no  
13 taxable income. I think the State's argument was, you  
14 know, the basis would have been drawn down to zero. So,  
15 therefore, 2013's distribution should be taxable.

16 JUDGE JOHNSON: Under the deemed liquidation  
17 theory; right?

18 MR. TARTER: Under the deemed liquidation theory.  
19 And I'm not sure that's to be true. As the State pointed  
20 out in its papers, the Bay Shores did not elect  
21 installment method payment. In fact, at Exhibit 14 -- at  
22 Exhibit 14, there were gross proceeds. So in other words,  
23 Bay Shores reported all of its potential income in '14,  
24 including distributions that it anticipated to make.

25 In other words, it didn't -- it didn't elect the



1 installment method schedule. So my argument would be  
2 based upon the evidence in the case, that there was no  
3 additional income to report in '13, even though the  
4 distribution occurred. Because if you notice, final  
5 proceeds that closed -- I'm looking at Exhibit 14, page 1.  
6 Gross proceeds of about \$10.6 million versus final  
7 proceeds, \$9.3.

8 Bay Shores reported gross proceeds. In other  
9 words, all the partners reported anticipated gross  
10 proceeds from this transaction. There was no installment  
11 sell to -- to just give a percentage. 100 percent of the  
12 anticipated gross proceeds was reported in 2012. And the  
13 reason I know that there's a discrepancy is if you go to  
14 2018 K-1. This is Exhibit 10. So I'm looking at page 1  
15 of Exhibit 10, and it shows how the partnership was able  
16 to get the basis down to zero on its final K-1.

17 Now, keep in mind the partnership doesn't control  
18 the tax calculations at the partner level. But be that as  
19 it may, you'll see that the Bay Shores put a negative  
20 \$2,361,000 in order to zero out the basis or the capital  
21 account of the partnership. Most of that \$231 --  
22 \$2,361,000 is on page 2 of 10. Again, Exhibit 10, page 2  
23 of 10. You go down there toward the bottom. It shows  
24 transferred capital negative \$1,749,989. A negative.

25 The next page, page 3 of 10 of Exhibit 10 says

1 the transferred capital adjustment -- so this is the  
2 million-seven amount -- represents your book capital  
3 account balance before dissolution. Please consult your  
4 tax advisor. In other words, the partnership did not  
5 realize million-seven with respect to Appellant's  
6 2 percent interest. They basically wrote off a  
7 million-seven. And the reason they wrote off a  
8 million-seven is because they never received the gross  
9 proceeds, they anticipated in 2012, and that's explained  
10 in the memo, Exhibit 15.

11 The Department of Justice syphoned off a bunch of  
12 money, et cetera, through the litigation settlement. So  
13 we can speculate, I suppose, about whether or not the '13  
14 distribution or the '18 distribution -- those are the only  
15 two that occurred after '12, '13 and '18. We can  
16 speculate whether or not those were taxable.

17 But since Bay Shores never elected the  
18 installment method, all of the income was reported in  
19 2012. All of it. And in fact, to get the capital account  
20 right in 2018 when it closed its book, it had to write off  
21 a million-seven of income that was never distributed out  
22 to the petitioner.

23 So my argument would be is those distributions in  
24 '13 and in '18 were concluded in the taxable income that  
25 was deemed or, you know, the distribution, or that

1 allocation, the distribution allocation under 702 in 2012.  
2 I know that's a long answer to a short question, but I  
3 thought about it. And it's a good question, but that's my  
4 conclusion.

5 JUDGE JOHNSON: Okay. Thank you. I see that. I  
6 guess I don't see -- right now we'll go back and discuss  
7 this theory with the rest of the panel. Or those facts  
8 also don't allow that to be his theory as well as reported  
9 in all taxable in 2012 and the way it resulted.

10 I guess my question is there beyond speculation  
11 to suggest that partnership Bay Shores treated the 2012  
12 action as a deemed liquidation? Is there any evidence to  
13 suggest they did that? Or is this a theory that you've  
14 come up after the fact, and it doesn't actually reflect  
15 the actualities of what happened from 2013 to 2018?

16 MR. TARTER: Yeah. I -- I have no direct  
17 evidence of what the partnership would have thought of.  
18 These deemed terminations in 708 are -- I mean, are  
19 self-evident.

20 JUDGE JOHNSON: Clearly, we're concerned with the  
21 duty of consistency, if there were sort of any benefit of  
22 treating these actions in one way from 2013 on, some of  
23 those years, and not beyond the scope of -- of audit, and  
24 to now go back to 2012 to change how that transaction was  
25 treated.

1           MR. TARTER: Well, as far as duty of  
2 consistency -- and there's a statement and if --  
3 Mr. Cooper, we can talk approximate at that. But I helped  
4 him draft a statement with the 2018 return, which we  
5 followed the K-1 that was issued by the partnership. And  
6 we submitted a statement with the state return that  
7 stated, essentially -- depending on the panel's decision  
8 here -- we may need to amend '18.

9           We may need to bring that information -- that  
10 income in. The problem is the Appellant is a 2 percent  
11 owner of the partnership. It's been almost impossible  
12 with that limited partnership to get further information  
13 from the partnership as far as what other partners have  
14 been doing as far as consistency, that type of thing. So  
15 an impossible -- it's a difficult task. I know from a  
16 federal standpoint because I'm a federal guy, primarily,  
17 with all due respect to the State folks here.

18           Duty consistency really revolves around the  
19 partner himself or herself. Are they consistently doing  
20 things they should be doing? And with respect to '18.  
21 That can certainly be amended if -- if we determine, based  
22 upon the panel's decision, that amount should be required  
23 into income.

24           In other words, if the basis went down to zero in  
25 '18, then that amount should be reported as income. We

1 can report that as income. The Franchise Tax Board has  
2 two or three years to make sure that that's done  
3 correctly.

4 JUDGE JOHNSON: Okay. Thank you.

5 MR. TARTER: You're welcome. Good question.

6 JUDGE LAMBERT: Okay. I'm going to close the  
7 record.

8 MR. HALL: Excuse me.

9 JUDGE LAMBERT: Okay.

10 MR. HALL: I apologize. But would Respondent  
11 have an opportunity to briefly respond to the rebuttal?

12 JUDGE LAMBERT: Yes, just a very short time.

13 MR. HALL: Okay. We -- Respondent would just  
14 like to point out a couple of quick points. We haven't  
15 had a chance to look at the Golder Case. I don't imagine  
16 that case that was cited by Appellants discusses Section  
17 731 or 761. So we would like to remind the panel that,  
18 you know, this case really is governed under Section 731  
19 and 761, which defines the term "liquidation of a  
20 partner's interest."

21 And with respect to the 708(b)(1)(b)  
22 termination, you know, I pointed to the return merely to  
23 illustrate that Appellants had previously said  
24 Ms. Hunter's interest in Bay Shores was not sold or  
25 exchanged. That was their words. However, under this

1 technical termination under 708(b)(1)(b) requires a sale  
2 or exchange of 50 percent or more of the total interest in  
3 the partnership, which then they said had happened.

4 And so we'd like to just emphasize the fact that  
5 it was Bay Shores, the partnership, not DaVita -- excuse  
6 me. DaVita and HealthCare, not Bay Shores that exchanged  
7 interest. And finally, we do have -- believe there's a  
8 duty of consistency issue with respect to 2013.

9 Thank you.

10 JUDGE LAMBERT: Okay. So I'm going to close the  
11 record and conclude the hearing. Thank you to both  
12 parties for coming in today. We will issue a written  
13 opinion within 100 days. Thank you. This hearing is now  
14 closed.

15 (Proceedings adjourned at 1:43 p.m.)  
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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 13th day of January, 2020.

\_\_\_\_\_  
ERNALYN M. ALONZO  
HEARING REPORTER