

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18011311
)
MAHNAZ DANESH AND) Date Issued: April 2, 2019
)
IMAD MAZBOUDI)
)
_____)

OPINION

Representing the Parties:

For Appellants: Mahnaz Danesh, Taxpayer
Imad Mazboudi, Taxpayer

For Respondent: Ciro Immordino, Tax Counsel IV
Natasha Page, Tax Counsel IV

For the Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Mahnaz Danesh (appellant) and her spouse Imad Mazboudi (collectively, appellants) appeal an action by respondent Franchise Tax Board (FTB) denying their claim for refund in the amount of \$79,707 for the 2012 tax year.

OTA Administrative Law Judges Andrew Kwee, Kenneth Gast, and Amanda Vassigh heard this appeal on January 24, 2019, in Van Nuys, California. At the conclusion of the oral hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether appellants established a \$829,527 reduction in taxable income for the 2012 tax year because this amount of gain realized during 2012 qualifies for like-kind exchange treatment pursuant to Internal Revenue Code (IRC) section 1031.

FACTUAL FINDINGS

1. Mahnaz Danesh and her brother Shahraz Danesh (appellant’s brother) entered into a business arrangement, the specific terms of which were not memorialized in writing. The

nature of the arrangement included the acquisition, management, and/or operation of businesses on real property, including gas stations. During the course of the arrangement, seven different California corporations were formed (the corporations). The shares of stock for six of the corporations were owned one-third by appellant, and two-thirds by appellant's brother. Appellant's brother owned all the stock in the remaining corporation; however, appellant disputed her brother's right to sole ownership in that corporation. Appellant and her brother were unable to continue their business arrangement. As a result, during 2011, appellant filed an action or actions in Orange County Superior Court against her brother and the corporations alleging misappropriation, and petitioning for involuntary dissolution of some or all of the corporations.

2. On June 15, 2012, appellant, her brother, and the corporations entered into a Settlement and Release Agreement (settlement agreement). The settlement agreement was signed by appellant and her brother, individually, and in his respective capacity as president for each of the corporations. The terms of the settlement agreement included the following transactions:
 - a. First, appellant's brother sold all his shares of stock in Haster Plaza, Inc. (Corporation 1) to Corporation 1 for an unspecified redemption (selling) price to be paid by Corporation 1. In exchange, appellant relinquished her legal claim to ownership of stock in Calvada Retail Group, Inc. (Corporation 2), and all other claims alleged against her brother in her lawsuit. In other words, after the transaction appellant became the sole shareholder of Corporation 1, her brother became the sole shareholder of Corporation 2, and there were no remaining disputes as to proper legal ownership of these two corporations.
 - b. Second, appellant sold all her shares of stock in Calvada Development, Inc. (Corporation 3) to Corporation 3 for a stated redemption (selling) price of \$403,333.33.¹
 - c. Third, appellant sold all her shares in Aliso Viejo Petroleum, Inc., Calvada Management Group, Inc., San Clemente Petroleum, Inc., and Triple Net

¹ This amount represents one-third of Corporation 3's cash on hand at the time of the settlement agreement, to be distributed by Corporation 3. Additionally, appellant was entitled to receive one-third of the proceeds ultimately recovered, if any, by Corporation 3 pursuant to an unrelated litigation matter.

Management Group, Inc. (Corporations 4 - 7, respectively) to either her brother or the respective corporations (the settlement agreement specified either her brother or the respective corporations would acquire or redeem these shares), for a stated selling price of \$1,409,738.²

3. On June 29, 2012, appellant received a cashier's check in the amount of \$806,238 from her brother, representing the \$1,409,738 in sales proceeds from her sale of stock in Corporations 4 - 7, less \$600,000, which was paid into a trust account (see footnote 2), and less \$3,500 paid for her share of escrow fees.³
4. On October 19, 2012, the parties to the settlement agreement appeared before a judge in the Orange County Superior Court and stipulated on the record that the parties wanted the court to enter judgment pursuant to the terms of the settlement agreement and retain jurisdiction over the parties to enforce their settlement agreement, until full performance thereof, pursuant to Code of Civil Procedure section 664.6. Thereafter, the court entered judgment in the matter pursuant to the terms of the settlement agreement.
5. Appellants timely filed a joint 2012 California Resident Income Tax Return reporting \$829,527 in gain from the sale of stock in corporations 4 - 7, and total California tax for 2012 of \$79,707. Appellants also reported the same amount of gain in a similar manner on Schedule D, Capital Gains and Losses, of their 2012 federal return, where appellants reported a total sales price of \$1,006,405, cost basis of \$176,878, and net gain of \$829,527, on the sale of stock in Corporations 4 - 7.⁴
6. Appellants did not report any gain (or loss) from the sale of stock in Corporation 3 on their originally filed 2012 tax returns.
7. On or around January 6, 2014, appellants filed an amended 2012 California tax return claiming a refund of all taxes paid for 2012 (\$79,707). The return claimed a refund based

²The settlement agreement specified that \$600,000 of this amount would be paid into a trust account, to be used for specified purposes, including reducing debt owed by Corporation 1, with specified amounts of "savings" to be split 1/3 to appellant, and 2/3 to her brother. The settlement agreement also provided for reducing the total consideration of \$1,409,738, by cash distributed to appellant in exchange for her stock in Corporation 3.

³It is unclear what amount, if any, of this payment was in exchange for stock in Corporation 3, or what amount of cash, if any, was separately distributed by Corporation 3.

⁴Appellants reported \$829,527 in gain from the sale of stock in Corporations 4 – 7 on Form 8949 (Sales and Other Dispositions of Capital Assets), and individually identified those corporations by name on the form. This reported amount of gain from the sale of stock in Corporations 4 – 7 is the item at issue in this appeal.

on two separate issues, and FTB conceded one of the issues.⁵ The remaining issue was a reduction to taxable income of \$829,527, based on their contention that this gain qualified for deferred recognition under IRC section 1031. In support, appellants attached FTB Form 8824, Like-Kind Exchanges, reporting \$0 in cash received, like-kind property of \$2,100,00 received, an adjusted basis of \$593,471 in the like-kind property given up, and deferred gain of \$1,506,529 on the exchange. The real property appellants reported on the form as having been received in the exchange was owned by Corporation 1. Appellants reported giving up three items of like-kind property in the exchange. It is unclear which corporation or corporations owned which of these three properties. Appellants also attached a federal amended return explaining that their prior accountant did not consider all the facts involved and that the originally reported taxable capital gain income was eligible for IRC section 1031 treatment.

8. Appellant testified at the oral hearing that legal title to all of the real property for which appellants are claiming like-kind exchange treatment was owned in the name of one of the corporations at the time of the settlement agreement. Appellant further testified that while she and her brother had an oral business arrangement, all seven of the entities identified in the settlement agreement were corporations.
9. By Notice of Action (NOA) dated September 9, 2015, FTB denied appellants' claim for refund of \$79,707. Appellants timely appealed the NOA on December 8, 2015.

DISCUSSION

Gain realized from the disposition of property generally must be recognized unless the taxpayer establishes it is entitled to nonrecognition treatment. (See IRC, §§ 61(a)(3), 1001(c); *Insurance & Title Co. v. Commissioner* (2d Cir. 1929) 36 F.2d 842, 844.) California conforms to IRC section 1031, which provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. (R&TC, §§ 18031 [Personal Income Tax], 24941 [Corporation Tax Law]; IRC, § 1031(a)(1).)

In order to qualify for IRC section 1031 nonrecognition treatment as an “exchange of

⁵ FTB conceded a \$39,477 reduction to taxable income on July 3, 2018, in response to our request for additional briefing on evidence submitted by appellants.

property,” the transaction must be a transfer of property for property, rather than a transfer of property for money. (Treas. Reg. § 1.1031(k)-1(a).) Thus, if the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. (Treas. Reg. § 1.1031(k)-1(f)(1).)

In the instant appeal, the property that appellants legally held and legally gave up in the transaction was stock in four California corporations (Corporations 4 - 7). The law is clear that deferred recognition of gain under section 1031 is statutorily inapplicable “to any exchange of stocks, bonds, or notes.” (IRC, § 1031(a)(2)(A).) Although appellants contend that these corporations held real property, even if true, this is not legally relevant because appellants, and not the corporations, are claiming IRC section 1031 treatment. (See *Starker v. United States* (9th Cir. 1979) 602 F.2d 1341, 1350 [a taxpayer cannot be said to have “exchanged” property within the meaning of IRC section 1031 if the taxpayer did not hold legal title to that property, even if a corporation transfers such property at the direction of the taxpayer].) Therefore, IRC section 1031 treatment is inapplicable under the facts of this case because solely non-qualifying property was exchanged.

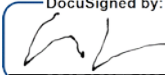
Furthermore, the settlement agreement was structured as a sale of stock instead of as an exchange of property, and the Superior Court entered judgment pursuant to the terms of the settlement agreement. (See *Robinson v. Commissioner* (5th Cir. 1995) 70 F.3d 34, 37 [tax authorities must give “proper regard” to allocations of an award entered by a court in a bona fide adversary proceeding].) FTB provided a copy of a cashier’s check and payment summary establishing that appellants received the entire sales proceeds of \$1,409,738 from the sale of stock in Corporations 4 - 7, in cash, as provided in the settlement agreement (i.e., \$806,238 in cash paid directly to appellant, \$3,500 paid for her escrow fees, and an additional \$600,000 paid into a trust). As indicated above, “a transfer of property for money” does not qualify for IRC section 1031 treatment, and here appellants transferred the stock in exchange for money instead of qualifying property of a like kind. (Treas. Reg. § 1.1031(k)-1(a).) Therefore, for either one of these reasons (exchange of non-qualifying property, or the transfer of property solely for money), appellants do not qualify for nonrecognition of gain under IRC section 1031.

HOLDING

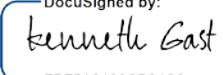
Appellants failed to establish entitlement to an \$829,527 reduction to taxable income based on qualifying for nonrecognition of gain under IRC section 1031.

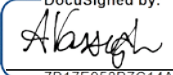
DISPOSITION

FTB’s action is sustained, subject to FTB’s concession that appellants’ 2012 taxable income be reduced by \$39,477.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Kenneth Gast
Administrative Law Judge

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Amanda Vassigh
Administrative Law Judge