OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18010892)
DONALD LIST	) Date Issued: July 16, 2019)))

OPINION

Representing the Parties:

For Appellant:	Donald List Robert B. Rosenstein, Rosenstein & Associates
For Respondent:	Bradley W. Kragel, Tax Counsel IV Louis Ambrose, Tax Counsel IV
For Office of Tax Appeals:	Mai Tran, Tax Counsel IV

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Donald List (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing $444,025 of additional tax, plus applicable interest, for the 2009 taxable year.

Office of Tax Appeals (OTA) Administrative Law Judges Daniel Cho, Kenneth Gast, and Linda C. Cheng held an oral hearing for this matter in Los Angeles, California, on April 23, 2019. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether appellant has established that he is entitled to additional cost basis on the sale of certain stock in the 2009 taxable year.

FACTUAL FINDINGS

1. Appellant and Donna List (Donna) were married in 1984.

2. In 1988, appellant loaned $1 million to 3-V Fasteners Company, Inc. (3V), which was owned by Denny Ver Doorn (Denny)[1] and Daryl Ver Doorn (Daryl). Appellant's loan was later converted into a capital contribution in 3V. As a result, appellant acquired an ownership interest in 3V. This ownership interest was community property.

3. In 1994, appellant and Daryl purchased Denny's interest in 3V which resulted in appellant and Daryl each holding a 50 percent interest in 3V.[2]

4. Prior to his marriage to Donna, appellant owned stock in Alatec Products, Inc. (Alatec) as his separate property. Appellant and his parents collectively owned 100 percent of the shares in Alatec. In July 1997, Alatec purchased appellant's parents' shares for $2.69 million. Appellant provided a personal guarantee for the payments. In December of 1997, appellant and Alatec entered into an agreement with Pentacon, Inc. (Pentacon) whereby Pentacon agreed to purchase appellant's shares in Alatec for $12,665,581 in cash and 2,893,245 shares of Pentacon common stock.

5. On September 29, 1999, appellant and Donna executed the "Donald and Donna List Family Living Trust" (List Family Trust). According to the Trust Agreement, they transferred to themselves, as co-trustees, all property listed on Schedules A and B of the Trust Agreement. The Trust Agreement provided that the assets listed in Schedule A were the couple's community property and the assets listed on Schedule B were appellant's sole and separate property. Schedule B listed the Pentacon stock and certain partnership interests as appellant's separate property. Schedule A listed, in part, that stock other than Pentacon stock was community property. Schedule A also listed that all other assets not listed on Schedule B was the couple's community property. The Trust Agreement further stated appellant and Donna did not intend to change the status of these assets in creating the trust.

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[1] The parties refer to this individual as "Denny" or "Dennis." For ease of reference, we use the name "Denny."

[2] At the hearing, appellant testified that he did not remember when he acquired Denny's interest; however, according to appellant's exhibit 21, appellant agreed that he purchased Denny's interest in 1994, which was while he was still married to Donna. We believe appellant's prior written response to be more accurate than appellant's testimony at the hearing. In addition, there is some inconsistency as to how much appellant paid for the interest. At audit, appellant stated that he paid $500,000 for one-half of the buyout of Denny's interest. At protest, appellant stated that he paid $333,000 for that interest. However, based on the representation in the Separation Agreement, FTB allowed $500,000 for the buyout. On appeal, FTB contends that the allowed cost basis is overstated. However, as the statute of limitations expired pursuant to R&TC section 19057, FTB cannot issue an additional proposed assessment.

6. On or about December 21, 2004, appellant and Donna filed a Co-Petition for Dissolution of Marriage (Co-Petition) in the District Court for Boulder County, Colorado. In the Co-Petition, the couple indicated that they separated as of November 10, 2003.

7. On or about May 17, 2005,[3] the couple entered into a Separation Agreement, which stated in part, "[t]he parties have agreed on equitable division of their property and allocation of their debts." The parties also agreed that the "Separation Agreement, if approved and accepted by the Court, shall be incorporated by reference into any decree of dissolution of marriage entered herein, and made a part of said decree, or any order of the Court concerning property settlement . . . entered subsequent to the entry of said decree."

8. Section 7 titled "Property Division" of the Separation Agreement states that Donna received various financial accounts with Oppenheimer & Company totaling $5,898,324.20 as her sole property.[4] The Separation Agreement stated that these accounts, along with several other accounts, were held by the List Family Trust and that the couple would cooperate and take any action necessary to liquidate the trust to effect the division of property as agreed to in the Separation Agreement. The Separation Agreement further provided that appellant retained the interests in both 3V and Adept Fasteners, as his sole property free of any claims by Donna. The value of the couple's interest in 3V was listed as $1,500,000. The value of the couple's interest in Adept Fasteners was listed as zero.

9. Section 10 titled "Taxes" of the Separation Agreement states that the couple agreed to the following:

> [I]t is their intention that all transfers of property by and between the parties as set forth herein, regardless of title to said property, are transfers of marital property and not separate property, and are in exchange for marital rights and considerations, and therefore, the transfers are not a taxable event and no capital gains have been declared or need to be declared.

[3] The copy of the Separation Agreement in the appeal record is signed by appellant on May 17, 2005. However, Donna's signature is missing.

[4] Due to rounding, the parties agree that the amount claimed as additional cost basis is $5,898,322. This does not materially affect the outcome of this appeal.

10. On June 17, 2005, the Boulder County District Court granted the Decree for Dissolution and ordered the marriage dissolved. The court further ordered the couple to perform the provisions of the Separation Agreement as it applied to each of them.[5]
11. On January 13, 2009, appellant and Daryl sold their shares in 3V to a third party for $36.2 million. Appellant's share of the proceeds was $18.1 million.
12. Appellant filed a 2009 California tax return on October 10, 2010. Appellant reported federal adjusted gross income of $12,139,277. Appellant's 2009 federal tax return included Form 4797, Sales of Business Property, reporting gross proceeds from the 3V stock sale of $18,100,000, gain of $12,391,234, and a cost basis of $5,708,766.
13. FTB conducted an audit of appellant's 2009 tax return. On August 7, 2012, FTB requested appellant to provide supporting documentation for the items included in the cost basis of the sale of appellant's interest in 3V. Appellant stated that he became an investor in 3V when his $1 million loan was converted into a capital contribution. Appellant also stated that he and Daryl bought out an earlier owner, which increased appellant's basis by an additional $500,000.
14. Appellant submitted a declaration from Donna dated May 15, 2013, in which she stated that she sold her interest in 3V to appellant for approximately $5,898,322. Donna further stated that appellant purchased her interest with separate property he obtained from Alatec and Pentacon.
15. On June 5, 2013, appellant's representative informed FTB that appellant and Donna originally held a joint interest in 3V with a combined basis of $1 million. Appellant further stated that he purchased Donna's interest for $5,898,322, which increased his basis in the stock to $6,398,322 (i.e., $500,000 (appellant's share of the original basis) + $5,898,322 (the purchase price of Donna's interest)).
16. Appellant also submitted a declaration dated November 14, 2013, in which he stated that he purchased Donna's interest in 3V using his separate property on May 17, 2005 (i.e., the date of the Separation Agreement).
17. On January 28, 2014, FTB issued an AIPS, determining that appellant's cost basis in the 3V stock was $1,500,000 based on the value stated in the Separation Agreement. FTB

[5] The Decree for Dissolution references a Separation Agreement as Exhibit A. That exhibit is not part of the appeal record.

concluded that the amounts transferred to Donna under the Separation Agreement did not reflect a sale of stock but rather a division of marital property. FTB adjusted appellant's cost basis in 3V from $5,708,766 to $1,500,000. FTB issued a Notice of Proposed Assessment (NPA) dated May 6, 2014, in accordance with its determination in the AIPS.

18. Appellant timely protested the NPA, maintaining that the cost basis should include the $5,898,322 paid to Donna. After review, FTB issued a Notice of Action dated September 15, 2015, affirming the NPA.

19. Appellant then filed this timely appeal.

DISCUSSION

Generally, the gain from the sale of property is determined by subtracting the adjusted basis from the amount realized. (IRC, §§ 1001, 1011 & 1012.)[6] The question of a taxpayer's cost basis is an issue of fact. (*Appeal of Giesea* (86-SBE-016) 1986 WL 22687.) FTB's determination is prima facie correct, and the taxpayer bears the burden of establishing a different cost basis. (*Moore v. Commissioner* (9th Cir. 1970) 425 F.2d 713; *Appeal of Lewis* (84-SBE-132) 1984 WL 16214.) Unsupported assertions are insufficient to satisfy the taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) Courts are not bound to accept a taxpayer's self-serving and unverified testimony. (*Korhauser v. Commissioner*, T.C. Memo. 2013-230.)

On appeal, appellant contends that FTB's calculation of his cost basis in the 3V shares incorrectly excludes the amount paid to Donna. Appellant contends that the correct cost basis is $6,731,322 (i.e., $500,000 (appellant's share of the original basis) + $333,000 (buyout of Denny's interest) + $5,898,322 (purchase of Donna's interest)).

In contrast, FTB contends that appellant's basis is limited to $1,500,000 because the transfer of Donna's interest pursuant to the Separation Agreement was a nontaxable event pursuant to Internal Revenue Code (IRC) section 1041. We agree with FTB.

IRC section 1041(a) provides that no gain or loss shall be recognized on a transfer of property from an individual to (1) a spouse; or (2) a former spouse, if the transfer is incident to divorce.[7] Such a transfer is treated as acquired by the transferee by gift and the basis of the

[6] California conforms to Internal Revenue Code (IRC) sections 1001 and 1011 through 1016 pursuant to R&TC section 18031.

[7] California conforms to IRC section 1041 pursuant to R&TC section 18031.

transferee in the property shall be the adjusted basis of the transferor. (IRC, § 1041(b)(1) & (2).) A transfer is "incident to the divorce" in either of the following two circumstances: (1) the transfer occurs within one year after the date on which the marriage ceases; or (2) the transfer is related to the cessation of marriage. (IRC, § 1041(c)(1) & (2); Temp. Treas. Reg. § 1.1041-1T(b), Q&A-6.)

IRC section 1041 does not define "cessation of marriage." However, Temporary Treasury Regulation section 1.1041-1T(b) provides a rebuttable presumption that a transfer of property is related to the "cessation of the marriage" if (1) the transfer is pursuant to a divorce or separation instrument as defined in IRC section 71(a)(2), and (2) the transfer occurs not more than six years after the date on which the marriage ceases. (Temp. Treas. Reg. § 1.1041-1T(b), Q&A-7.)[8] As relevant to this appeal, IRC section 71(b)(2) provides that the term "divorce or separation instrument" is either (a) a decree of divorce or separate maintenance or a written instrument incident to such a decree or (b) a written separation agreement.

If IRC section 1041 applies, then the transferor of property under IRC section 1041 recognizes no gain or loss on the transfer even if the transfer was in exchange for the release of marital rights or other consideration. (Temp. Treas. Reg. § 1.1041-1T(d), Q&A-10.) This rule applies regardless of whether the transfer is of property separately owned by the transferor or is a division (equal or unequal) of community property. (*Ibid*.) The transferee of the property recognizes no gain or loss upon receipt of the transferred property. (Temp. Treas. Reg. §1.1041-1T(d), Q&A-11.) In all cases, the basis of the transferred property in the hands of the transferee is the adjusted basis of such property in the hands of the transferor immediately before the transfer. (*Ibid*.) Even if the transfer is a bona fide sale, the transferee does not acquire basis in the transferred property equal to the transferee's cost. (*Ibid*.)

Here, the Separation Agreement specifically addressed the transfer of the 3V stock interest, providing that appellant would retain the interest free of any claims by Donna and that Donna would receive various financial accounts totaling $5,898,322 as her sole property. The Separation Agreement provided that the couple agreed on an equitable division of their property and allocation of their debts. The Separation Agreement was incorporated into the couple's

[8] When applying the IRC for purposes of the Personal Income Tax Law (PITL), temporary Treasury Regulations are applicable as regulations under the PITL to the extent that they do not conflict with the PITL or with regulations issued by FTB. (R&TC, § 17024.5(d).)

Decree for Dissolution of Marriage dated June 17, 2005,[9] and the Colorado Boulder County District Court ordered "that the parties shall perform the respective provisions of the separation agreement . . . ." Based on the foregoing, we conclude that the marriage ceased on June 17, 2005, with the Decree for Dissolution of Marriage, and the transfer of stock occurred on or after June 17, 2005, in accordance with the court's order. Therefore, the transfer of Donna's interest in 3V is a nontaxable event pursuant to IRC section 1041(b), and appellant is not entitled to additional basis of $5,898,322 from the transfer of Donna's interest to appellant.

Appellant argues that the plain language of the Separation Agreement did not satisfy the requirements to be a "separation agreement" for purposes of IRC section 1041(c). Appellant contends that, for a sale to be related to the "cessation of marriage," a separation agreement must effectuate the stock sale (i.e., serve as the actual mechanism for the stock sale). Appellant argues that the Separation Agreement does not use the word "sale" or "sell." Appellant argues that the Separation Agreement merely acknowledges appellant's ownership interest resulting from a separate sale of the 3V stock. Appellant contends that the Separation Agreement is not a "buy-sell" agreement and did not effectuate the sale of the 3V stock.

As discussed above, the transfer of property is presumed to be related to the cessation of marriage if the transfer is pursuant to a divorce or separation agreement and the transfer is within six years after the date on which the marriage ceases. (Temp. Treas. Reg. § 1.1041-1T(b), Q&A-7.) The Separation Agreement specifies the transfer of Donna's interest in 3V to appellant and Donna's receipt of $5,898,322. Contrary to appellant's assertions, IRC section 1041 does not require that the Separation Agreement state that there is a "sale" between appellant and Donna. The Separation Agreement was a division of the couple's property. Thus, we find that appellant's contentions have no merit. Moreover, we note that IRC section 1041 is intended to treat spouses and former spouses as one economic unit, and to defer the recognition of any gain or loss on interspousal property transfers until the property is conveyed to a third party outside the economic unit.[10] (*Young v. Commissioner* (4th Cir. 2001) 240 F.3d 369, 375.)[11]

[9] We further note that the Decree for Dissolution incorporated the Separation Agreement. Therefore, the Separation Agreement also qualifies as a written instrument incident to a decree of divorce. (IRC, §71(b)(2).)

[10] See also *Balding v. Commissioner* (1992) 98 T.C. 368, for a detailed explanation of the rationale for the enactment of IRC section 1041.

[11] The *Young* court further reasoned that Congress weighed the equities and established a policy that no gain or loss will be recognized on a transfer between former spouses incident to their divorce. Therefore, anytime

Appellant also contends the sale of Donna's interest is not "incident to the divorce" because the marriage ceased on November 10, 2003, and the sale of Donna's interest occurred more than one year after the marriage ceased. (IRC, §1041(c)(1).) Appellant notes that he and Donna began living separately on or about November 10, 2003, and contends that Donna would have been eligible for head of household filing status for 2004 pursuant to IRC section 7703.[12] Although the couple may have begun to live separately on or about November 10, 2003, they continued to be married until the court issued the Decree for Dissolution of Marriage on June 17, 2005.[13] Under Colorado law, a decree of dissolution of marriage or of legal separation is final when entered, subject to the right of appeal. (Colo. Rev. Stat. Ann. § 14-10-120(1).) Therefore, appellant has not established that the marriage ceased on or about November 10, 2003.

Furthermore, while appellant places great emphasis on his and Donna's declarations to show that the sale of the 3V stock occurred in a separate transaction outside of the Separation Agreement, we find that the declarations are not supported by the documentary evidence. We are not required to accept unpersuasive or self-serving testimony of a taxpayer, an interested party or witness. (*Barr v. Commissioner*, T.C. Memo. 1992-552; *Kornhauser v. Commissioner*, T.C. Memo. 2013-230.) The declarations were prepared for audit and are dated in 2013, eight years after the purported separate sale occurred in 2005. Absent any corroborating evidence, we find that the declarations should be given less weight than the Settlement Agreement and Decree of Dissolution for Marriage.

However, even if appellant could demonstrate that a separate "sale" took place on May 17, 2005, as stated in their respective declarations, appellant and Donna remained spouses until June 17, 2005. (See Treas. Reg. § 301-7701-18(a).) As such, the alleged May 17, 2005 "sale" was between spouses and still subject to IRC section 1041(a)(1). IRC section 1041 applies to *any* transfer of property between spouses regardless of whether the transfer is a gift or is a sale between spouses acting at arm's length. (Temp. Treas. Reg. § 1.1041-1T(a), Q&A-2;

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former spouses transfer appreciated property incident to their divorce, the transferee spouse will bear the tax burden of the property's appreciated value after selling it and receiving the proceeds. Although this rule will undoubtedly create a hardship in some cases, the legislature has clearly set and codified this policy. (*Young v. Commissioner*, *supra*, 240 F.3d at 376.)

[12] IRC section 7703 provides the general rules of determining marital status for purposes of determining a taxpayer's filing status (i.e., married filing joint, married filing separate, or head of household).

[13] For federal tax purposes, the term spouse, husband, and wife mean an individual lawfully married to another individual. (Treas. Reg. § 301.7701-18(a).)

see also *Belot v. Commissioner*, T.C. Memo. 2016-113 [IRC section 1041 applies to divisions of marital property accomplished through sales as well as through settlement agreements].) Accordingly, this argument, even if true, does not warrant a finding that appellant is entitled to additional cost basis.

In summary, we find that IRC section 1041 applies to the transfer of Donna's interest in 3V to appellant. Thus, appellant's basis in Donna's 3V interest is limited to the adjusted basis of the interest held by Donna immediately before the transfer (i.e., one-half of $1,500,000). (IRC, §1041(b)(2).) Therefore, FTB properly disallowed $5,898,322 in cost basis related to the transfer of Donna's interest in 3V to appellant.

HOLDING

Appellant has not established that he is entitled to additional cost basis on the sale of 3V stock in the 2009 taxable year.

DISPOSITION

FTB's proposed assessment is sustained in full.

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Daniel K. Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

DocuSigned by:
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Linda C. Cheng
Administrative Law Judge