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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
LIONEL F. CONACHER and) OTA NO. 18022358
JOAN T. DEA,)
)
APPELLANT.)
)
_____)

Transcript of Proceedings, taken at
12900 Park Plaza Dr., Suite 300, Cerritos,
California, 90703, commencing at 3:45 p.m.
and concluding at 5:15 p.m. on Thursday,
July 23, 2020, reported by Ernalyn M. Alonzo,
Hearing Reporter, in and for the State of
California.

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APPEARANCES:

Panel Lead: ALJ JEFFREY MARGOLIS

Panel Members: ALJ KENNY GAST
ALJ MIKE LE

For the Appellant: L. CONACHER
MARDIROS DAKESSIAN
STEVEN RAUSER

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD
By: KAMALPREET KHAIRA
LOU AMBROSE

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-14 were received at page 9.)

(Department's Exhibit A was received at page 9.)

P R E S E N T A T I O N

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By Ms. Khaira	26

1 Cerritos, California; Thursday, July 23, 2020

2 3:45 p.m.

3

4 THE COURT: We're now on the record.

5 Again, my name is Jeffrey Margolis, and I'm the
6 lead judge in the appeal of Lionel Conacher and Joan Dea,
7 OTA Case Number 18022358. The date is July 23rd, 2020,
8 and the time is approximately 3:45. I'm joined here with
9 my colleagues -- at least virtually -- Judges Kenny Gast
10 and Mike Le. Although, I am the lead ALJ for purposes of
11 conducting today's hearing, my fellow panelists will have
12 an equal say in our deliberations in deciding this appeal.

13 I ask that the parties now identify themselves
14 for the record, beginning with Appellant's counsel.

15 MR. DAKESSIAN: Good afternoon, Your Honor.
16 Mardi Dakessian on behalf of the taxpayers.

17 MR. ROUSER: Steve Rouser. I'm here on behalf of
18 the taxpayers as well.

19 JUDGE MARGOLIS: And for the FTB.

20 MS. KHAIRA: I'm Kamalpreet Khaira on behalf of
21 Respondent.

22 MR. AMBROSE: And Lou Ambrose on behalf of
23 Respondent.

24 JUDGE MARGOLIS: Okay. Thank you very much.

25 Let's make sure that we basically agree on the

1 basic issue to be decided today. It's my understanding
2 that the is what is the proper basis for U.S. tax purposes
3 of Mr. Conacher's stock. I believe it was TWP Acquisition
4 Corp., although some documents say it was just TWP. But
5 whatever. The stock that was sold in 2011 up -- there was
6 exchange for Stifel Financial shares, and those Stifel
7 Financial shares were sold in 2011.

8 So the question is, what is the basis of the
9 Stifel Financial shares that were sold in 2011? Is that
10 correct Mr. Dakessian?

11 MR. DAKESSIAN: Yes, Your Honor. That's correct.

12 JUDGE MARGOLIS: Is that correct, Ms. Khaira?

13 MS. KHAIRA: Yes, that is correct.

14 JUDGE MARGOLIS: Ms. Khaira?

15 MS. KHAIRA: Yes, that is correct.

16 JUDGE MARGOLIS: Okay. Thank you.

17 Mr. Rauser, I don't know if you're going to be
18 talking much, but we really can't see you very well with
19 all the back lighting. You might want to close your
20 shades.

21 And Ms. Khaira, I'm having a little trouble
22 hearing you. So you may want to get a little closer to
23 the microphone. Okay.

24 Thanks, Mr. Rauser. That's much better. When
25 you get back please mute your microphone, if you can.

1 Okay. At our prehearing conference several weeks
2 ago, both sides informed me that they would not be calling
3 any witnesses today.

4 Is that still correct, is it not, Mr. Dakessian?

5 MR. DAKESSIAN: Yes, Your Honor. That's correct.

6 JUDGE MARGOLIS: Ms. Khaira, correct?

7 MS. KHAIRA: That's correct.

8 JUDGE MARGOLIS: Okay. Let's go over the
9 exhibits. I asked you in our prehearing conference --
10 after our prehearing conference to try to agree amongst
11 yourselves which of the exhibits that were attached to the
12 pleadings might be admitted. I hope you've done so, so we
13 can go over this pretty quickly. I sent you a copy of the
14 exhibits in a PDF format. Have the parties agreed on the
15 exhibits that could be admitted today?

16 MR. DAKESSIAN: Your Honor, as a preliminary
17 matter I would note one exhibit seems to be included as
18 Appellant's exhibit, Your Honor. And that's Exhibit 11,
19 which is an excerpt from BNA Portfolio. That was actually
20 not our exhibit. That was --

21 JUDGE MARGOLIS: Oh, that's correct. I was made
22 aware of that mistake. It doesn't -- who we were going to
23 give attribute the exhibit to, we'll note that. Although,
24 I don't think it really matter whose exhibit it is. And,
25 obviously, the articles would not be admitted as evidence

1 of facts, simply, for the convenience of the Board in
2 deciding this matter.

3 Are there objections to what I've labeled as
4 Exhibits 1 through 14, Mr. Dakessian?

5 MR. DAKESSIAN: Your Honor, the only objection we
6 had in this address, which is the evidentiary value of the
7 BNA Portfolio. With that understanding, we have no
8 objections.

9 JUDGE MARGOLIS: Okay. And what about -- do you
10 have any objection to -- that's also your objection to
11 Respondent's Exhibit A, the article, as well?

12 MR. DAKESSIAN: That's correct, Your Honor.

13 JUDGE MARGOLIS: Okay. FTB do you have any
14 objections to the exhibits that were circulated in the
15 hearing summary?

16 MS. KHAIRA: Your Honor, we do not have any
17 objections.

18 JUDGE MARGOLIS: Ms. Khaira, I think I heard you
19 say you do not, but please get closer. It's very hard to
20 hear you.

21 MS. KHAIRA: We do not have any objections.

22 JUDGE MARGOLIS: Okay. The exhibits attached --

23 MS. KHAIRA: I can definitely call in from our
24 phone, if that will help.

25 JUDGE MARGOLIS: You're going to have to speak

1 louder.

2 MS. KHAIRA: If this audio persists, I can call
3 in from our phone if that will help.

4 JUDGE MARGOLIS: That's -- I hope that won't be
5 necessary, but maybe if you can just position your
6 microphone closer to your face somehow. Are there papers
7 in front of it? Speak now, Ms. Khaira, just for a second.

8 MS. KHAIRA: Can you hear me better? I'm
9 speaking through a laptop.

10 JUDGE MARGOLIS: Okay. I think that's -- unless
11 anyone is -- that's probably sufficient for now. If
12 anyone can't hear, please just let me know and we'll ask
13 her to call in.

14 Okay. Subject to Mr. Dakessian's qualifying of
15 certain exhibits, they will all be moved into evidence.

16 (Appellant's Exhibits 1-14 were received
17 in evidence by the administrative Law Judge.)

18 (Department's Exhibit A was received in
19 evidence by the Administrative Law Judge.)

20 At our prehearing conference both sides said that
21 they would take about 20 to 30 minutes to make their
22 presentations. I'm going to let Appellants go first and
23 give them up to 30 minutes, and then I will have
24 Respondent go and eventual allow Mr. Dakessian a
25 five-minute rebuttal period.

1 Canadian transaction. Before I begin, we're all getting
2 used to this format, so let me just back up a second.

3 Judge Margolis, Judge Gast, Judge Le, good to see
4 you today. Thanks for accommodating us via video
5 conference. I like this medium, and I'm hopeful that
6 we're able to convey our message to us today. Thank you
7 for giving us an audience. Let me just start there.

8 So Judge Margolis and Judge Gast who were both
9 present at the prehearing conference, there was some
10 discussion there as to whether the transaction question on
11 the front end, the sale of Westwind to TWP, whether that
12 was a taxable sale under U.S. law. And there was some
13 discussion as to whether that should be the subject of the
14 hearing today or one of the subjects here today.

15 And we feel very strongly that, Your Honors, that
16 the issue of whether this is a valid 351 or a disputed 351
17 has already been decided. That is already something that
18 has been admitted to by the FTB, conceded. It is an
19 undisputed fact, and I don't know if it makes any sense to
20 sort of go through what we believe the judicial admissions
21 were and what the legal effect of that is.

22 So I just wanted to just put that out there as a
23 preliminary matter, because we think that there is no
24 authority for the OTA to now go back and try -- if it's
25 the intention of the panel try and go back and open up the

1 discussions, whether this is valid, I just want to put it
2 out there and hear from the judges.

3 JUDGE MARGOLIS: Well, Mr. Dakessian, you've
4 already briefed the -- you already spent a lot of time in
5 your brief claiming that these are judicial admissions
6 that are binding on it. So if you don't have anything to
7 add to that, or if you're not going to respond
8 substantively, I guess there is no need to go over the
9 judicial admission argument, unless you wish to.

10 MR. DAKESSIAN: I do. I do wish to, Your Honor,
11 because I think it's critical. I think it's an important
12 issue. So with that let's go to the first slide.

13 JUDGE MARGOLIS: Mr. Dakessian?

14 MR. DAKESSIAN: Yes, sir.

15 JUDGE MARGOLIS: Our court reporter is having
16 trouble hearing you from what I understand. Can you try
17 to stand a little closer and speak a little louder.

18 MR. DAKESSIAN: Yes. Is this better?

19 JUDGE MARGOLIS: I'll let you know when I hear
20 from my court reporter. It's a little better for me, yes,
21 but you can continue.

22 MR. DAKESSIAN: So as I mentioned, Your Honor, we
23 respectfully denounce any authority that allows the FTB to
24 open up an issue that has already been agreed upon by the
25 parties and has been resolved now for three years, if you

1 go back to the date of the FTB determination letter of
2 July of 2017.

3 So in terms of presenting any additional
4 information on the 351, or whether it was a 351, we don't
5 believe that's the case. I don't think -- and I haven't
6 seen any authority that would allow this panel to
7 resuscitate an issue that's already been resolved. And if
8 there is any authority, I'd like to know about it so that
9 I could properly advise my clients.

10 So we're happy to go through the record and point
11 out the six different instances where the FTB has said
12 that this is a taxable -- this transaction would have been
13 taxable under U.S. law. And they did it five times in the
14 written record. And then, of course, when we had the
15 prehearing conference, they reaffirmed this was, in fact,
16 a taxable transaction.

17 In their opening brief, on page 1 of their
18 opening brief, they said it. And I can go through this
19 slowly, but it sounds like you're going to get the essence
20 of what I'm trying to say here. Page 6 of their opening
21 brief they say, "Respondent agrees that none of the
22 tax-free reorganization provisions of the IRC apply to
23 this transaction."

24 And they go on to say for the third time in the
25 opening brief on page 8, they discuss Biddle and they --

1 and they talk about the meaning of Biddle, even though
2 such a transaction would have been taxable under U.S. law.
3 And then on page 11 of the opening brief, again, they say,
4 "Respondent agrees that the sale of the Westwind stock did
5 not qualify as a tax-free transaction."

6 And this -- the first that is mentioned in the
7 record of this is back in 2017 when they say the
8 transaction between Westwind and TWPA is not a tax-free
9 exchange for IRC Section 351. And then, of course, based
10 on the prehearing conference, Your Honor wrote in the
11 minutes and order that, "Both sides have stated that the
12 sale of Westwind to TWPA would not have been a partially
13 tax-free or tax-deferred transaction."

14 Now, the importance of this, from a legal
15 perspective we have both in our briefs, but I wanted to
16 drive the point home because there is a very clear and
17 strong legal effect these multiple invasions of the
18 Westwind sale to TWPA is taxable. That is these are
19 judicial admissions.

20 There is a California case that we cited called
21 Valerio that discusses the impact of this. It's Valerio
22 versus Andrew Younquist Construction. And it says that in
23 the case of a judicial admission, facts alleged must be
24 assumed to exist. Any finding adverse to the admitted
25 facts drops from the record any legal conclusion which is

1 not upheld by the admitted facts are erroneous.

2 And it goes on to say when allegations in a
3 complaint are admitted, no evidence needs to be offered in
4 the support. Evidence is not admissible to prove their
5 untruth. No finding on their own is necessary, and a
6 finding contrary to its untruth is error. We wanted to
7 drive that point home.

8 In another case called Addy versus Bliss Glennon,
9 which we also cited, it says, "A judicial admission in a
10 pleading, or in this case in documents that the FTB filed
11 in anticipation of protest or anticipation of appeal, is
12 not merely evidence in the fact. It's a conclusive
13 concession of the truth of the matter fact, which has the
14 effect of removing it from the issues."

15 So, you know, whether you think of this as an
16 admission or a stipulation, I think the cases are very
17 clear. There's even a case called Title Insurance Company
18 versus State Board of Equalization, which says, "The
19 courts must respect stipulations." I realize this is not
20 a court, but the analogous rule should apply. And, in
21 fact, under the OTA's own rules, relevant evidence is
22 described as -- let's see here.

23 Relevant evidence under the OTA's rules is by
24 reference to disputed facts. So there's no evidence with
25 respect to whether this was a taxable sale that is

1 relevant to this proceeding. It has already conceded by
2 the FTB. And the reason for this is, I think evident, but
3 I'll say it again, which is that in order to have a
4 productive and orderly administrative process -- we've got
5 an audit; we've got a protest; and we've got an appeal.

6 And we can't have a situation where an
7 administrative appellate body is revisiting issues that
8 have already been resolved. I really don't think there's
9 an authority for that, respectfully, I might add. So we
10 feel very strongly about this, that the impact of the
11 FTB's concession is conclusive that the Westwind sale for
12 all purposes relating to the resolution of this appeal is
13 taxable. And any conclusion reached by the OTA that is
14 based on a contrary conclusion with respect to the
15 Westwind transaction would be, per se, legal error.

16 With that in mind, there is one issue in this
17 case as we correctly identified, it is the issue of basis.
18 This slide shows you the numerical difference in basis in
19 calculation as computed by the FTB protest unit versus our
20 position on the issue basis. I also wanted to discuss the
21 Notices of Action briefly just so we have it in the
22 record. We're not, you know, for purposes of this
23 hearing, we're not getting into computations or -- or
24 what-have-you. But these are the numbers that appear on
25 the Notices of Action -- the record.

1 So in terms of factual background, we think the
2 facts are undisputed, but I think it would be worth just a
3 quick recap for the judges, which is essentially just a
4 very brief timeline of what took place. Lionel Conacher
5 founded Westwind in 2002 in Canada. In 2008 after growing
6 the company for six years, TWPA acquired Westwind in a tax
7 transaction.

8 And in 2009 the Conachers came to the United
9 States. 2010 was when Stifel and TWPA merged. 2011 was
10 the tax year in question, the sale that took place. And
11 2013 is mentioned here only because there's an impact on
12 carry forward 2013 that is the subject of one of the three
13 Notices of Action here.

14 So back to the issue of basis. So there's a
15 specific statutory rule regarding basis. And that
16 specific statutory rule, the general rule which California
17 incorporates by reference, 1803 of the Revenue Tax Code.

18 Are you seeing everything clearly on your end?

19 JUDGE MARGOLIS: Yeah. I'm smiling at the
20 impressive pictures.

21 MR. DAKESSIAN: Well, I hope we're equally
22 impressive on substance. Thank you.

23 But there's a general rule that basis is cost
24 unless otherwise provided in the code. And it's a very
25 simple walk through. We'll do it here. Initially, the

1 1001 of the IRC, and it says that the computation of gain
2 or loss is determined using the adjusted basis provided in
3 Section 1001. Section 1011 in turn says that, "The
4 adjusted basis for determining the gain or loss shall be
5 the basis determined under Section 1012 or other
6 applicable sections." Section 1012 here it's undisputed.
7 This is an applicable section.

8 And then Section 1012 says, "The basis of the
9 property shall be the cost of such property, except as
10 otherwise provided -- except as otherwise provided where
11 in the subchapter, subchapter O and subchapter C, K, and
12 P." We will note that the referral based on Canadian
13 Section 85 is not one of the enumerated exceptions, but
14 that's one of the themes of our presentation today; which
15 is that FTB and their position is based on words that do
16 not exist for the statute.

17 The statute says, "Basis equal cost, unless
18 otherwise provided." No relevant exception exists. And
19 so what is the FTB's -- oh, before we get there, 358 is
20 the only relevant provision. Again, you can see the text
21 there. It specifically enumerates the instances in which
22 you're going to have a carryover basis, 351, 4, 5, 6, 361.

23 So we've already established through the
24 beginning portion of this presentation and through the
25 concession by FTB that this not included in the

1 transactions. So nothing else. No relevant exceptions
2 exist. So this would ordinarily end the discussion, but
3 the FTB argues that -- well, what is their position?
4 Their position is little bit, you know, difficult to
5 ascertain. They'll do a better job of presenting it than
6 I will.

7 But just based not the briefing, what we've been
8 able to see is that the core of their position is
9 irrespective of what the operative IRC statutes say, that
10 TWPA stock -- here's what it says, "Not entitled to a fair
11 market value basis as of the date of sale because the
12 transaction was not subject to tax under Canadian law."

13 So, you know, this whole issue revolves around,
14 as it always does, the text of the relevant statutes. And
15 there is sort of a corollary principle of that as a
16 general rule, you have tax principles apply. I know the
17 FTB disputes that. But as far as we're concerned, and as
18 far as a fair reading of the cases is concerned, the
19 default rule that's been established for decades by the
20 U.S. Supreme Court is that U.S. tax principles apply,
21 unless there is clear congressional intent to the
22 contrary.

23 And clear congressional intent, again, this is
24 just back to the basic rules of statutory interpretation.
25 Clear congressional intent as found, first, in the

1 statutory text, the statutory text is unclear and then you
2 can look to extrinsic aids. And here, as far as we're
3 concerned based on Biddle, which articulates its principle
4 based on Amoco, which was cited in our brief. Based on
5 Goodyear, this is the key principle. The default rule,
6 U.S. tax principles apply.

7 Now, FTB has never even contended in its briefing
8 that the text -- nor could it. How could it? -- that the
9 text of the operative Internal Revenue Code provisions,
10 specifically, Section 1012 and Section 358, they create no
11 exception for foreign transaction, much less Canadian
12 transaction based on a Section 85 election. So there's
13 nowhere to go, really, in the statute.

14 Incidentally, there's also the Revenue Ruling
15 84-139, which again, articulates this general principle.
16 And, you know, when you go back to the words of the
17 statute, which we do here, this is 358. Again, these are
18 the situations 351, 354, 355, 356, 361, these are the
19 exceptions to the general rule that could possibly apply.

20 The words that the FTB is looking for don't
21 exist. And for the FTB to prevail, it's our position that
22 these are the words that would need to be added to the
23 statute where the taxpayer makes an election under foreign
24 law. This sort of clear congressional intent is required.
25 There's nothing -- it's not that complicated. These words

1 don't exist in the statute. So that's the beginning and
2 the end of discussion.

3 And I would also add that the statute is quite
4 clear. It lists out these five exceptions to the general
5 rule. And there's a principle that we provided in terms
6 of statutory construction and maximum interpretation.
7 It's Latin, "expressio unius est exclusio alterius", which
8 is a fancy way of saying exceptions to the general rule
9 are specified in statute. Then one may not imply the
10 additional exceptions unless there is a clear legislative
11 intent to the contrary. Again, they backed the statutory
12 text and the expressed intent of Congress.

13 So U.S. principles apply, no relevant exceptions.
14 The statute controls. Words of the statute controls. So
15 when confronted with this reality, FTB pivots a little bit
16 in its briefing, and it argues that well, fundamentally
17 this is inequitable treatment. And we're not required to
18 uphold inequitable treatment, no matter what the words of
19 the statute says. Again, we don't need to rely on what
20 the FTB subjective notions of equity actually are because
21 we have a statute that directs and tells tax agencies and
22 taxpayers what the rules are.

23 And I would note that the OTA published an
24 opinion in 2018 called Estate of, Gillespie, which
25 involved what appears to be on its face a very different

1 issue; which was whether there was an equitable exception
2 to an untimely filing of a refund. This is a published
3 precedential OTA decision.

4 I think the reason it was precedential is because
5 you get these sad stories from taxpayers coming up and
6 saying, you know, I was a bit late. I filed a refund a
7 day late, but I'm really entitled to it, and I should get
8 it. You know, can't we invoke equitable estoppel? Can't
9 we invoke some equitable powers? Or isn't the OTA charged
10 with some equitable powers just to help us provide with
11 relief?

12 And the FTB argued there, and the OTA sustained
13 the evidence and said our hands are tied by the words of
14 the statute. If Congress wanted us to be able to have an
15 equitable exception to the clear statutory rules with
16 refunds, then it would have said so. And so now we have
17 the FTB, when the shoe is on the other foot, not liking
18 the language of the statute and arguing for equity. We
19 reject that out of hand.

20 We would also note, however, that the equities in
21 this concern, if there were any, favor the taxpayers.
22 It's a Canadian company founded in Canada. The group of
23 Canada was operated in Canada. It was sold in Canada in
24 2008. So in other words, it had absolutely nothing to do
25 with California. And so it makes no sense for the FTB to

1 argue that it would somehow be fair for California to
2 subject what is essentially a Canadian transaction to the
3 tax.

4 And I'm fairly certain that the FTB would not be
5 arguing to the converse. The FTB would not be arguing
6 that we're entitled to a refund if we paid more in
7 Canadian tax than what California would have allowed. Of
8 course not. They would never do that. The answer would
9 be, as it argued in Gillespie, that no matter how
10 inequitable circumstances -- and in Gillespie, by the way,
11 you have a disabled woman who was elderly and could not
12 file the returns on time.

13 And the FTB's position was, it's so sad, but we
14 can't do anything. And so now the shoe is on the other
15 foot, and we are now -- we are making this argument that
16 we've got to follow the text of the statute. And, you
17 know, whatever equitable concerns exist, including the
18 fact that Mr. Conacher lost money relative to where he was
19 at the time of the Westwind sale and where he ended up
20 with Stifel, the equities are on the taxpayer's side.

21 And the final point I'm going to make is a rule
22 that I believe in deeply, and I think is very, very
23 important part of California law, which is the taxing
24 statutes in case of any doubt must be construed in favor
25 of taxpayers so if there's any ambiguity or confusion or

1 doubt or -- or lack of clarity in the statute, that burden
2 is not borne by the taxpayers under California law. All
3 doubts must be resolved in favor of the taxpayers.

4 A case was cited called Edison Stores versus
5 McColgan that says exactly that. In case of doubt when
6 interpreting taxing statutes, statutes of funding taxes,
7 constructions to favor the government, the taxpayer rather
8 than the government.

9 And in a case called Whitmore versus Brown, it
10 says quite clearly a statute will not be held to impose a
11 tax unless it's clear and explicit. We think it's clear
12 and explicit for the extent the FTB basically conclude to
13 any ambiguities, those ambiguities must be resolved in our
14 favor.

15 The net result of all this based on the
16 stipulated facts, the relevant statutes, and cases all
17 leads to one conclusion. And that is that the taxpayer's
18 position on basis is correct.

19 JUDGE MARGOLIS: Mr. Dakessian, can you stop for
20 one second? Judge Gast just lost his connection. Stop
21 one second. Judge Gast lost connection.

22 JUDGE GAST: Judge Margolis, I am back. I'm
23 sorry.

24 MR. DAKESSIAN: Oh, I apologize. Judge Gast,
25 where did we leave off?

1 JUDGE GAST: Let me see here.

2 JUDGE MARGOLIS: Statutory construction.

3 JUDGE GAST: Yeah. I think you were talking
4 about the Edison case.

5 MR. DAKESSIAN: Yes, Your Honor.

6 JUDGE GAST: Sorry about that.

7 MR. DAKESSIAN: No worries at all, Your Honor.
8 Thanks for redirecting.

9 So the point I was making with the Edison case is
10 that if there's any ambiguity in the taxing statute, we
11 don't believe it exists. If there is any ambiguity,
12 California law for decades the jurisprudence is quite
13 consistent that those doubts ought to be resolved in favor
14 of the taxpayer.

15 And Judge Gast had made a similar point with
16 respect to Whitmore versus Brown case, which is also cited
17 in our briefing, that statute will not be held to the
18 imposed tax. We think it's clear what the result would
19 be, and we lost you right around there. I didn't see this
20 slide either, I should say.

21 So based on what we've presented, based on the
22 judicial admissions regarding the Section 351 issue based
23 on the undisputed evidence in the record, and based on the
24 relevant statutes and cases, we respectfully request that
25 the taxpayers' appeal be granted with the FTB's Notices of

1 Action.

2 Thank you.

3 JUDGE MARGOLIS: Thank you, Mr. Dakessian.

4 Ms. Khaira, are you ready to present the FTB's
5 position?

6 MS. KHAIRA: Your Honor, can you give me a
7 minute? I'm going to dial in. I will be on video, but my
8 audio --

9 JUDGE MARGOLIS: Okay. That will be fine.

10 (There is a pause in the proceedings.)

11

12

PRESENTATION

13 MS. KHAIRA: Okay. I'm going to begin.

14

15 So the issue before us today is whether
16 Appellants have established that Respondent erred in the
17 determination of the adjusted basis in Appellants' Thomas
18 Weisel Partners Acquisition company stock, which I will
19 refer to as TWPA, and capital gain resulting from the 2011
20 stock sale.

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Mr. Lionel Conacher was the CEO, president, and
shareholder of Westwind Capital, a Canadian corporation
when in 2008, Westwind was acquired by California-based
Thomas Weisel Partners Group, which I will refer to as
TWPG, via its wholly owned Canadian subsidiary TWPA.

Appellants were Canadian residents at the time of

1 this acquisition. As consideration for Appellants'
2 Westwind shares, Appellants received approximately
3 5.8 million in cash and in equivalent to 1,523,723 TWPA
4 shares. For Canadian purposes, Appellants elected to
5 defer tax on the capital gain on the stock portion of the
6 sale as allowed by Canadian law.

7 In 2009 Appellants immigrated and became
8 residents of the United States and California. Under
9 Canadian law upon immigration, Canadian residents are
10 considered to have sold certain types of property at their
11 fair market value and to have immediately reacquired them
12 for the same amount. This is called a deemed disposition,
13 and the immigrant may be required to report any capital
14 gain and pay a departure tax on that gain.

15 Appellants reported the deemed -- sorry.
16 Appellants reported the deemed disposition of the
17 remaining TWPA exchangeable shares and recognized a gain
18 of \$4,516,141 on their 2009 Canadian departure tax return.
19 In 2010 TWPG was acquired by Stifel Financial Corporation,
20 which I will refer to as SF Inc., in a U.S. acquisition.
21 Appellants were California residents on the effective date
22 of this acquisition.

23 SF Inc., acquired all outstanding shares of
24 TWPG's common stock in a stock to stock merger.
25 Appellants received SF Inc. shares for each TWPG share

1 that they owned. In 2011 Appellants sold 136,613 SF Inc.
2 Shares, reporting a basis of 4,152,00. The primary issue
3 at appeal concerns Appellants' basis in a TWPG
4 exchangeable shares received from the Westwind
5 acquisition.

6 The basis of the TWPA exchangeable stock,
7 otherwise TWPG stock carries over to Appellants' basis in
8 their S.F. Inc. shares. So Respondent's position is that
9 Appellants' basis in the TWPG shares should remain their
10 original basis in the Westwind shares, which were
11 exchanged in the 2008 acquisition because the shares were
12 acquired in a tax-free transaction.

13 Pursuant to Internal Revenue Code 1001, a
14 taxpayer is required to pay income tax on all amounts of
15 gain recognized on the sale of property including stock.
16 Under the Internal Revenue Code and Revenue and Taxation
17 Code, one who receives stock in exchange for stock
18 generally recognizes gain or loss on the transaction,
19 unless the exchange qualifies as a non-recognition event.
20 Thus, recognition is a key element of the U.S. income tax
21 system with respect to this transaction.

22 Respondent agrees that none of the Internal
23 Revenue Code tax-free reorganization provisions apply to
24 the Westwind acquisition. Therefore, if U.S. tax law
25 applied, Appellants were required to recognize the gain

1 from the sale of Westwind stock. And upon recognition of
2 that gain, Appellants would take a new basis in the TWPG
3 stock.

4 However, instead Appellants receive the stock in
5 a tax-free transaction and do not receive a new cost basis
6 in the TWPG stock. Appellants argue that case law
7 precedent establishes that United States tax law must be
8 applied to the 2008 stock sale transaction, such that
9 Appellants' deferral under the Canadian Income Tax Act is
10 disregarded. And, therefore, Appellants are treated as
11 recognizing gain and, thus, are allowed an increased basis
12 equal to approximately 13 million, which according to
13 Appellants is the fair market value at the time of the
14 transaction.

15 Appellants misstate the case law decision where
16 courts have decided the proper interpretation of foreign
17 tax law principles for purposes of applying U.S. tax law.
18 In none of those cases do the courts decide as Appellants
19 assert that is a fundamental principle that U.S. tax law
20 applies when characterizing a transaction for U.S. tax
21 purposes regardless of how it is treated under foreign
22 law.

23 Rather, those cases stand for the proposition
24 that a foreign tax item or taxable event may be
25 interpreted in terms of U.S. tax law principles when

1 necessary to determine the proper application of U.S. tax
2 law. In *Biddle v Commissioner*, the court held that for
3 purposes of determining the foreign tax credits, a U.S.
4 taxpayer is allowed to deduct tax amounts paid by the
5 taxpayer rather than tax amounts paid by the corporation.
6 Otherwise a shareholder in a U.K. corporation is receiving
7 a tax benefit in the form of a credit for a tax that he or
8 she did not -- has not paid, which is not available to a
9 shareholder in a U.S. corporation.

10 Therefore, *Biddle* actually supports Respondent's
11 position that Appellants are not entitled to a step-up in
12 basis in the TWPG stock because they elected to defer
13 rather than pay Canadian tax on the gain in the Westwind,
14 TWPG transaction.

15 If a U.S. taxpayer had deferred tax on sale of
16 stock, he or she would not be able to include the amount
17 of the tax in the basis of stock received in that
18 exchange. Here, Appellants engaged in a stock sale
19 transaction and made an election under Canadian law to
20 defer tax on the gain from that sale. For the purpose of
21 applying U.S. tax law to determine the U.S. tax
22 consequence of that deferral, this body must engage in a
23 factual use of Canadian tax law to determine how that
24 deferral election effects tax basis treatment under U.S.
25 law.

1 As a factual matter, under Canadian law
2 Appellants paid no tax at the time of the transaction and,
3 therefore, the stock would not have an increased basis
4 under U.S. tax law. Thus, the upholding in Biddle
5 supports Respondent's position that Appellants' basis in
6 the Westwind stock carryover to the TWPG stock in the
7 sales transaction, even though such a transaction would
8 have been taxable under U.S. tax law.

9 In United States versus Goodyear Tire and Rubber,
10 the court reviewed the relevant administrative and
11 regulatory authorities and legislative history to
12 determine whether it was appropriate to interpret the law
13 in accord with its intended purpose by incorporating
14 domestic tax law principle.

15 Here, Respondent had incorporated the domestic
16 tax principles whereby only a taxable sale of stock by a
17 taxpayer results in a basis of the fair market value of
18 that stock at the time of the sale and the property
19 received in the exchange. Under U.S. tax law principles,
20 the basis of a property is equal to its cost, only if the
21 transaction in which the property was acquired was a
22 taxable exchange.

23 When this U.S. tax law principle is applied to
24 the non-taxable exchange of the Westwind stock by the TWPG
25 stock, the result is the Appellants who were Canadian

1 nationals and residents at the time of the transaction are
2 afforded the same tax treatment as all other taxpayers.

3 In *Williams v. Commissioner* cited by *Estate of*
4 *Donald v. Commissioner*, the U.S. tax court held that
5 property acquired in a taxable exchange takes on a basis
6 equal to its fair market value at the time of the
7 exchange. And in that event, the basis of the property
8 received will equal the adjusted basis of the property
9 given plus any gain recognized or should have been
10 recognized.

11 These authorities validate that under domestic
12 tax law principles, the TWPG stock would have taken a
13 basis equal to its fair market value only if the
14 transaction had been a taxable exchange. The basis for
15 the TWPG stock is determined by applying U.S. tax law
16 principles regardless of whether the sale took place in
17 California or Canada. Thus, there is equal tax treatment
18 for a Canadian citizen who is now a California resident
19 who engaged in a transaction in Canada and a U.S. citizen
20 who is now a California resident who have engaged in a
21 similar transaction in California.

22 Because Appellants paid no gain on the sale of
23 the Westwind stock, under U.S. tax law, Appellants were
24 not entitled to a step-up in basis in their TWPG stock.
25 The transaction cannot be treated as the Appellants' pay

1 tax on the capital gain. There's no authority for
2 Appellants' characterization of a non-taxable transaction
3 under foreign law as a taxable transaction under U.S. law.
4 Ultimately, taxpayers have not established that the
5 exchange of the TWPG stock for the Westwind stock should
6 be characterized as a taxable transaction under U.S. law.

7 And I am done.

8 JUDGE MARGOLIS: Okay. Thank you very much.

9 Let me ask my co-panelists first if they have any
10 questions. Judge Gast, why don't you start.

11 JUDGE GAST: Yeah, I have some questions. I
12 think I'll start with the FTB. I just want to be clear.
13 I think I'm clear from Appellants that U.S. tax law
14 applies, which to me means California law as it conforms
15 to U.S. tax law. But, Ms. Khaira, I'm hearing that you
16 agree with that, or do you think Canadian law applies?

17 MS. KHAIRA: Can you hear me?

18 JUDGE MARGOLIS: Not as well as when you were on
19 the phone.

20 MR. AMBROSE: Judge Gast, this is Lou Ambrose.
21 Her telephone connection or telephone audio is
22 disconnected.

23 JUDGE MARGOLIS: Why don't you speak extra loud
24 and close to the computer and see how we hear you,
25 Ms. Khaira?

1 MR. AMBROSE: Okay. She's calling back.
2 (There was a pause in the proceedings.)
3 MS. KHAIRA: Hello.
4 JUDGE MARGOLIS: We can hear you.
5 MS. KHAIRA: Okay.
6 JUDGE MARGOLIS: Do you recall Judge Gast's
7 question?
8 MS. KHAIRA: No. Can you please repeat the
9 question? Thank you.
10 JUDGE GAST: Yes. This is Judge Gast. Sorry
11 about that. I'm clear on Appellants' position that U.S.
12 tax law applies to this transaction that occurred, you
13 know, in 2008. What is your viewpoint of that? Did I --
14 I wasn't sure if you think U.S. tax law applies as well.
15 And when I say U.S. tax law, I mean California laws as it
16 conforms to U.S. tax law. Or do you think Canadian tax
17 law applies?
18 MS. KHAIRA: I think that under the Goodyear
19 case, the Supreme Court said that you should read tax
20 court provisions and to incorporate U.S. tax law absolute
21 clear congressional intent that foreign tax law controls.
22 So it is our position that as a factual matter we need to
23 look at how Canadian law was applied.
24 JUDGE GAST: Okay. All right. My next question
25 relates to -- it seems like there is a lot of authority --

1 judicial authority addressing a situation like this where
2 someone moves into a state such as California, and what do
3 you do about the basis computation. California does have
4 a statute, 17041(a)(1) that talks about, you know, if you
5 move into the state, you recompute, you know, carryover
6 items deferred income, suspended losses, suspended
7 deductions. There's a publication, 1100 that FTB has.
8 Why aren't those sufficiently analogous?

9 Because I'm thinking you start with the
10 Revenue & Taxation Code. And basically what 17041(a)(1)
11 says -- and maybe stock basis is not a carryover item, but
12 a resident does compute capital losses, partnership basis,
13 et cetera, as if they were a resident in non-residency
14 years. And it doesn't seem like it matters whether gain
15 or loss is recognized in the prior years. I just -- I
16 know it's kind of a long-winded question, but do you have
17 a response for that?

18 MR. AMBROSE: Yeah. Judge Gast, this is Lou
19 Ambrose. We haven't looked at that, but I guess I would
20 just note that if we're looking at this -- if we're
21 looking at the basis, if we're treating the basis of the
22 TWPG stock, you know, at the time they immigrated, I
23 don't -- I don't think they -- I don't think that under
24 Canadian law they had, you know, their basis was suggested
25 as a result of the tax-deferred transaction.

1 I don't think they got a step-up in basis as a
2 result, you know, under Canadian law. If they had stayed
3 in Canada, they wouldn't have had a step-up basis as a
4 result of the tax or exchange as far as I know. I don't
5 know. I don't think those facts are on the record.

6 JUDGE GAST: This is Judge Gast. Thank you. So,
7 you know, the hypotheticals too here is how to get to the
8 right answer. But if the taxpayer in this situation in
9 Canada, let's say in 2009, sold the stock for a loss and
10 they claimed a loss on the Canadian return. Would FTB
11 allow a similar loss on the California return if the facts
12 were reversed? If they sold it and they claimed a loss on
13 the Canadian return when they come to California, is
14 California going to allow a double deduction?

15 MR. AMBROSE: So they'd have a capital loss carry
16 forward? That's what you're saying? They'd have a
17 capital loss carry forward?

18 JUDGE GAST: Yes. Yeah.

19 MR. AMBROSE: I suppose. I don't know. We
20 haven't looked at that.

21 JUDGE GAST: Okay. I apologize. I know these
22 are hypothetical questions, but sometimes to get to the
23 heart of some of these issues we have to ask some of these
24 questions. Going back to one more -- a few more
25 hypotheticals here, and I'm going to focus on that instead

1 of the numbers. It seems like the parties don't dispute
2 the numbers.

3 What happens in a situation when, you know, here
4 where -- let's focus again on the departure tax. And,
5 yeah, the Appellants, let's say, you know, reported a
6 smaller portion of the gain because the value of the stock
7 went down from 2008 -- presumably put because of the Great
8 Depression. And then, you know, so they report a smaller
9 portion of it, but the rate is a lot higher in Canada. It
10 looked like there was a marginal rate of 30 percent.

11 And I didn't do any calculation, obviously, but
12 if they paid enough tax that would have equivalent to what
13 they would have paid in 2008, had this occurred in
14 California, would that be enough to get a full basis
15 step-up, if you're understanding my question?

16 MR. AMBROSE: Yeah. I think I understand your
17 question.

18 JUDGE GAST: In other words, there's deferring
19 rates. There's, you know, there's deduct -- you know, the
20 foreign law and California law is just not the same.

21 MR. AMBROSE: Yeah. Right.

22 JUDGE GAST: So what does it really mean to
23 report the income, you know, that's equivalent?

24 MR. AMBROSE: Well, okay. So you're asking
25 whether -- if the rate -- if the tax rates were different

1 between Canada and, you know, U.S. federal or California,
2 whether they would be given -- whether there -- we'd just
3 treat that as if it had been a taxable transaction. And
4 in the United States or in California and, you know, as a
5 result, adjust to the basis to reflect fair market value
6 at the time of the -- or cost at the time of the
7 transaction, right.

8 And the question -- I guess you raise the
9 question because Canadian tax rates could be a lot higher
10 or just the difference between the tax rate, right. I
11 think we would treat it as a taxable transaction. And I
12 guess I just would point out that, you know, tax rates
13 change in the United States, you know, quite often.

14 And somebody could have, you know, had, you know,
15 acquired stock back in or, you know, made this type of
16 transaction, you know, 10 years ago and, you know, the
17 rate was a lot higher and then a lot lower. And today
18 it's different than -- I don't think the tax rate itself
19 really matters as far as this analysis -- you know, in
20 terms of this analysis.

21 JUDGE GAST: Judge Gast. Okay. Thank you. Just
22 a few more questions here for FTB. Okay. So we talked
23 about -- the parties talked about the equities and whether
24 that favored the taxpayer or FTB in the situation. In a
25 situation -- you know, again another hypothetical

1 question, and I apologize. But in a situation where an
2 individual lives in Nevada and they -- Nevada doesn't have
3 an income tax -- personal income tax. They presumably, if
4 this transaction occurred in Nevada, it would have been
5 reported for federal purposes in 2008, and then the
6 individual moved to California in 2011 -- I'm sorry --
7 2009. They sold the stock in 2011. Is FTB's position
8 that individual would get a full step-up in basis? No
9 state level tax.

10 MR. AMBROSE: Well, yeah. They paid federal tax.
11 And, I mean, this isn't -- and, I mean, and just -- I
12 mean, those aren't the facts here though. I mean, this
13 is -- this is, you know, an international transaction.
14 And, you know, what we're relying on is, you know, our
15 reading of these cases that involve, you know, foreign law
16 or transactions that take place in other countries and,
17 you know, how we interpret foreign law for purposes of
18 U.S. tax purposes. So I think I don't know that -- I
19 guess in my view those aren't -- that's not comparable.

20 JUDGE GAST: Judge Gast. And let me turn it to
21 Mr. Dakessian. So going back to what happened in 2008,
22 your position is it doesn't matter what was actually
23 recognized in Canada, it's what would have been recognized
24 for California/U.S. tax purposes; is that correct?

25 MR. DAKESSIAN: That's correct, Your Honor.

1 JUDGE GAST: Okay. So aren't -- isn't that a
2 windfall for a Canadian resident when they move to
3 California, such in this situation where they never
4 recognized the income where interstate -- a California
5 resident would have recognized it and then, you know, they
6 would have received a step-up in basis?

7 MR. DAKESSIAN: I don't think we view it that
8 way. I'm going to let my colleague Steve Rauser address
9 this and talk about this situation. I don't think it
10 would result in a windfall. And it all depends on how we
11 view equal treatment under the law.

12 And Steve, if you could take this question.

13 MR. RAUSER: Sure. And, you know, let me expand
14 upon that a little bit. I mean, you know, as the FTB, you
15 know, is having this argument, it was making this equity
16 argument about how similarly situated taxpayers, you know,
17 are being treated, you know, the same necessarily. And I
18 think that the basis for that is using the results of the
19 Canadian tax law and applying that for, you know,
20 California purposes.

21 So such that because he had a non-recognition
22 transaction under Canadian law, and then you compare it to
23 a similar, quote, unquote, "Similar taxpayer that was in
24 another state that moves to California and then sells the
25 stock," the problem is that interpretation is kind of

1 apples to oranges, I think. And that's where the equity
2 problem comes in here.

3 If you really are taking it such that you're
4 putting everybody in the same situation like they did in
5 Goodyear -- and Goodyear, again, it was a lot of
6 discussion around this equity concept. But there, you
7 know, the only distinct factor was, you know, whether your
8 foreign entity was setup as a foreign branch or a, you
9 know, a foreign corporation subsidiary. And so, you know,
10 they had to equalize the treatment between those two.

11 What the FTB's position is, is this equity is,
12 you know, we treat it as a non-recognition transaction.
13 You know, the Appellants' first transaction is
14 non-recognition because it's classified such under
15 Canadian law and then come into California, they don't --
16 they, you know, if we allow Appellants' point of view,
17 they get this basis step-up and, you know, then they pay
18 tax later. So they've got this windfall.

19 And the comparison there is, you know, having
20 a -- at least I think this is what they're trying to
21 get -- a U.S. taxpayer that's the counterpart to that,
22 would have a non-recognition transaction under, you know,
23 California or federal law and then, you know, doesn't get
24 the basis step-up and, therefore, you know, recognizes
25 them, you know, the gain later on.

1 The problem is the FTB's characterization of how
2 to interpret, you know, the dependence on, you know,
3 foreign law. And, you know, they've reiterated a few
4 times about this factual usage. But I -- you know, if you
5 look at Biddle, they did that. They use it in a factual,
6 you know, circumstance. They -- the question in Biddle
7 was, who paid the tax? And that was necessary in order to
8 apply that, you know, determination to the, you know, the,
9 you know, the foreign tax credit that the individual is
10 claiming.

11 So what they did was they used foreign law to see
12 who actually paid the tax. What were the mechanics of the
13 transaction under U.K. law such that we can determine
14 whether or not the way it mechanically functioned is
15 substantially similar or equivalent to U.S. law? And what
16 the FTB has done is they've taken a more conclusory or
17 interpretive, you know, stand saying that, you know,
18 because it was classified as a non-recognition transaction
19 in Canadian, it's, therefore, has to be recognized as a
20 non-recognition transaction in U.S. and California down
21 the road.

22 The problem is there -- that's an improper
23 application of Biddle and Goodyear. Again, Biddle looked
24 at the foreign law to see how it functions so that it
25 could then see how it would apply factually to U.S. law.

1 And in that case, the corporation was the one that paid,
2 you know, the tax and, therefore, it wasn't the taxpayer.
3 So under U.S. law the taxpayer is the one required to pay
4 that dividend. They didn't under U.K. law. They applied
5 in that manner.

6 What the FTB is doing and, you know, and trying
7 to make this equitable argument, is saying, well, it's
8 classified as a non-recognition transaction in
9 California -- or I'm sorry -- in Canadian. And,
10 therefore, that classification -- that rule in Canada
11 should carry over and be applied, you know, for California
12 purposes. The problem is that's not what Biddle says.

13 And so if you're going to take this equity
14 standpoint, you really have to compare apples to apples.
15 And that would be a Canadian taxpayer that went through
16 the transaction that we have, that Conacher the Appellant,
17 went through, and you compare that to a transaction -- the
18 same transaction that a taxpayer in another state went
19 through. And if you do that, they're both going to be
20 for, you know, California purpose, taxable transactions.

21 The difference is, at the time that, you know,
22 Conacher had this initial transaction, he wasn't subject
23 to U.S. or California tax. He was a Canadian taxpayer.
24 But the issue, you know, the proper application is it's a
25 taxable transaction for a factual standpoint because the

1 mechanics of that transaction do not fit within a
2 non-recognition transaction for California and federal
3 purposes.

4 So if you want apples to apples on this equity
5 standpoint, then it has to be the same circumstantial
6 transactions both ways. And if you do that, I don't think
7 that they're getting a windfall.

8 JUDGE MARGOLIS: Let me interrupt briefly. I
9 guess the way I heard Judge Gast's question was, you know,
10 is there any policy other than the application of the
11 language of Goodyear? I mean, is there any policy in
12 favor of what appear -- might be viewed as a windfall?
13 Because in Goodyear the court was influenced in its
14 construction of the statute by looking at which
15 construction was more likely to generate double taxation
16 and which construction was most likely to allow the
17 taxpayer to escape taxation altogether.

18 So I mean, other than the statement in Biddle and
19 Goodyear that, generally, you look to U.S. law, unless
20 there's a clear congressional expression of intent
21 otherwise. What policy is there to allow the taxpayer to
22 claim a loss on a gain that's never been taken into
23 income.

24 MR. DAKESSIAN: Well, Judge Margolis, if I may
25 say -- you can hear me okay?

1 JUDGE MARGOLIS: Yes.

2 MR. DAKESSIAN: Yeah. So I think a key
3 distinction between Goodyear and what we have here, and
4 the reasons they got into those discussions of equity is
5 because the underlying term that they were trying to
6 interpret in the statute was ambiguous in term of
7 accumulated profits. And here there is no ambiguity of
8 the statute. Here we have a clear statutory track in
9 terms of how basis ought to be computed.

10 So the only reason you even get into those
11 extrinsic factors of equity, equity is in the eyes of the
12 beholder. But the only reason you even get there is
13 because there is ambiguity in the language of the statute.
14 Here, I think we have a very clear statutory path. And if
15 you note in FTB's presentation, they did not refer to the
16 words of the statute. They made an offhand remark with
17 respect to 1001 about this somehow, you know, that all
18 gain needs to be recognized.

19 And under U.S. law for U.S. purposes, gain would
20 have been recognized for U.S. purposes. So it's this sort
21 of circular argument. But no reference whatsoever to the
22 statute and that's a huge mistake. We have to focus on
23 what the words of the statute say. And I think all the
24 hypotheticals that Judge Gast was posing, I think
25 illustrate that to the extent that, you know, there are

1 these sorts of questions in terms of the Nevada
2 hypothetical and the hypothetical on capital loss, the
3 hypothetical on rate. If there's any ambiguity, that
4 ambiguity must be resolved in favor of the taxpayer.

5 That's what that highlights to me. Equity
6 policy, it's not Congress' intent as expressed in
7 subjective policy considerations if the words of the
8 statute are clear. So that would be my response to that.
9 I don't know if that is satisfactory.

10 JUDGE GAST: This is Judge Gast. I have probably
11 maybe one more question here. I'm going to go back to
12 FTB. And it seems like this issue is whether gain needs
13 to be recognized or not in a foreign jurisdiction. Can
14 you -- your position seems to be under IRC Section
15 1001(c). Recognize means reporting it on a return and
16 paying tax. My question, though, is how do you know
17 that's referring to a foreign tax return? Is there any
18 authority for that?

19 MR. AMBROSE: No. But, I mean, the notion is --
20 I mean, it is such a basic principle of U.S. tax law that,
21 you know, basis is only stepped up if you pay tax on the
22 gain. I mean, that's just so fundamental, you know. I
23 mean, if it wasn't, I mean, what would a 1031 -- I mean,
24 why would we need, you know, IRC Section 1031, you know.
25 When you don't pay tax on the gain, it's you carry over

1 the basis from the property that you disposed.

2 To me that's just so fundamental. And what those
3 cases stand for is that for purposes of U.S. tax law when
4 there's a foreign transaction, you apply the U.S. tax law
5 principle. So, I mean, I take your question. You know, I
6 take your point but I just -- there isn't anything in the
7 law that says that, you know. And of course, you know,
8 this -- this -- these judicial, you know, the just made
9 law, you know, the decisional law here is what's, you
10 know, sort of, you know, drive -- you know, I mean, that's
11 what our position is based on. So --

12 JUDGE GAST: Okay. Thank you. I'm sorry. Just
13 one more question for Mr. Ambrose. There is authority --
14 and I don't mean to -- you know, I don't know if you know
15 of this authority. It was a BOE decision. And I just
16 want to gage your thoughts on it where -- and I think
17 there's even tax court authority. But, you know, where a
18 taxpayer moves in from a foreign jurisdiction to
19 California, they have depreciable property that they been
20 depreciating as a non-resident. And California would
21 require them to step down that basis based on depreciation
22 they never claimed in California, which means when that
23 property is sold, I believe California would tax that.

24 That seems to be not in favor of a taxpayer who
25 moves in versus a California taxpayer who got the benefit

1 of the depreciation deductions. Do you have any thoughts
2 on that? And I know it's not on point. It's hard to find
3 thing on point for this, but does that have any analogy
4 here to you? And this is my last question.

5 MR. AMBROSE: Okay. So let me just make sure.
6 And, yeah, I am vaguely familiar with this case or this
7 appeal. So they had depreciable property in another state
8 but -- and they -- they did take the depreciation. They
9 did deduct depreciation on it your saying in the other
10 state or they didn't?

11 JUDGE GAST: Yeah, they did. So when they moved
12 to California the BOE said we don't care if you never
13 deducted the depreciation. You have to reduce your basis
14 by what you -- the depreciation that was allowable.

15 MR. AMBROSE: So even --

16 JUDGE GAST: I'm sorry. Go ahead.

17 MR. AMBROSE: No. You go ahead. I'm sorry.

18 JUDGE GAST: Yeah. I was just saying that by the
19 depreciation allowable, even though you never claimed it
20 in California, therefore, once you sell it you have to pay
21 gain on depreciation recapture and -- versus a California
22 resident wouldn't have to. It's still probably
23 depreciation recapture, but they would, you know, have the
24 benefit of that deprecation. It was just another
25 hypothetical I wanted to throw out there. You don't have

1 to if you don't know, if you don't want to respond but --

2 MR. AMBROSE: I guess I'd have to think about
3 that one.

4 JUDGE GAST: Okay. No problem.

5 Okay. Judge Margolis I don't have any more
6 question.

7 JUDGE MARGOLIS: Judge Le, do you have any
8 questions?

9 JUDGE LE: This is Judge Le. I have no questions
10 at this time.

11 JUDGE MARGOLIS: Okay. I have some questions.
12 First for the FTB, I mean, Mr. Dakessian, you know, he
13 makes a good point that, you know, how do we know that
14 you're going to treat people consistently. Like, for
15 example, when it's not to the FTB's benefit. You know,
16 you have an issue with any public ruling as how you're
17 going to deal with this transaction in the future. You
18 know, like I have trouble, you know, really believing
19 that.

20 Let's say a taxpayer comes in, and let's say they
21 claim a -- let's say they have a \$10 million asset in
22 Canada -- well, \$10 million basis in stock in Canada.
23 They come to the U.S. At the time they leave the property
24 is only worth \$5 million. And so they pay -- they claim a
25 \$5 million loss on their departure tax return. They come

1 to the U.S. and then the next day they sell it in the
2 U.S., and they claim another \$5 million loss. I mean, you
3 know, are you really going to give them the same loss a
4 second time?

5 MR. AMBROSE: Probably not. But I would think
6 that would be consistent with our position. You would
7 treat them -- I mean, if they had taken the loss there,
8 they've got the benefit of that. I don't know. I
9 guess -- if I could offer just one -- if I could offer a
10 hypothetical myself just to kind of illustrate --

11 JUDGE MARGOLIS: Sure.

12 MR. AMBROSE: -- you know, what my position is.
13 Okay. So -- and I'm not saying this was -- you know,
14 we've all agreed more or less. Although that wasn't the
15 Appellants' initial position that this didn't qualify as
16 tax-free under 351, right. Okay. I mean, that's just
17 kind of been resolved.

18 So what if it did -- okay. But -- and then --
19 but the thinking is that if it did qualify as a 351
20 tax-free exchange then -- then we would treat it as
21 nontaxable. The Appellants even would treat it as a
22 nontaxable event in Canada, you know, when it occurred,
23 when the Westwind was stock exchanged for the TWPA stock.

24 And in that event, I assume that, you know, their
25 conclusion is -- the result is that then they wouldn't get

1 the step-up in basis for California tax purposes, right.
2 I mean, is that -- everybody agrees with that, I think.
3 Okay. Okay. So what -- I mean, what if that -- what if
4 those were the facts, okay. And then they get to
5 California and -- okay but -- but -- okay. I'm sorry let
6 me back up.

7 So let's say that is the case. Let's say that
8 isn't through Canadian tax law. What if in Canada it was
9 taxable, and they didn't do the Section 85 election or,
10 you know, that deferral election under Canadian law, and
11 they had actually paid the tax on it there. Okay. Let's
12 just suppose that. And if they came to California, would
13 we say well, no, it wasn't taxable under 351 in Canada.
14 Therefore, we're not going to acknowledge that you
15 recognize gain there.

16 We would -- we're going to treat you as though it
17 was tax-free. It happened here. It was nontaxable. So
18 we're not going to give you that step-up in basis. I
19 don't think we would do that. I don't think that we would
20 take that position. I think we would give them -- we
21 would recognize, or we would, you know, treat it as they
22 did as, you know, because they had recognized the gain and
23 paid the tax in Canada.

24 JUDGE MARGOLIS: Well, I would hope that would be
25 the case.

1 MR. AMBROSE: Yeah. Okay. Well, that's what I'm
2 saying. I mean, yeah, you are right. We don't have
3 anything in writing. We don't have any policy, you know,
4 written policy on that. But, you know, that's my
5 assumption.

6 JUDGE MARGOLIS: Okay. I have a question for
7 Mr. Dakessian. Mr. Dakessian, it seems like, you know,
8 you're asking us to ignore what happened in Canada and
9 look at it as if it happened in the United States. And
10 when I looked at your power point, I think you mentioned
11 Section 1001, which says the sale or disposition of
12 property you recognize gain, I don't understand why the
13 tax transaction that's a deemed sale and reacquisition of
14 the property. Why isn't that a sale or other disposition
15 of the property under U.S. tax law? That was the theory
16 of the facts.

17 From my understanding the Notice of Action that
18 forms the basis of this case said we're going to give you
19 basis on your departure tax, the fair market value at the
20 time you departed. And that makes things relatively clean
21 here.

22 MR. DAKESSIAN: Yeah. I don't think so because
23 there wasn't an election made that would have created that
24 effect for U.S. tax purposes.

25 JUDGE MARGOLIS: Well, I think let's ignore the

1 treaty. You know, the treaty gives you an election where
2 you can guarantee that you're going to get the departure
3 tax will be treated as a disposition. But why is it even
4 without the treaty, a sale or disposition of the property?

5 MR. DAKESSIAN: Because it wasn't sold. Because
6 it wasn't sold.

7 JUDGE MARGOLIS: But then there's the term "other
8 disposition". Why doesn't that possibly be included in
9 other disposition?

10 MR. DAKESSIAN: It wasn't disposed. I don't
11 agree with that. I think -- look, I think that, you know,
12 all of this discussion what it's doing for me, you know,
13 because, you know -- you know, with present company
14 accepted, we have a lot of really smart tax lawyers in
15 this group, and we're grappling with this issue. And all
16 this is highlighting to me is that to the extent that
17 there's any ambiguity, this could be resolved in favor of
18 the taxpayer.

19 Our resort needs to be just statutory text, and
20 I'm not seeing any resort to the statute text by the FTB.
21 And when I look to the statutory text, I see a clear
22 definition of what basis is, of what recognized gain is.
23 I am not -- I'm not seeing anything other than that. I'm
24 not seeing any congressional attempt expressed, implied,
25 otherwise, certainly not in the text of the statute.

1 So, you know, I don't know what to say, Your
2 Honor. I feel very strongly that if the FTB wanted to
3 remedy this situation, it sounds like to me, given their
4 lack of guidance on it, this is kind of a one-off. Or
5 it's, you know, it may occur in from different contexts.
6 The fix is easy.

7 JUDGE MARGOLIS: Here you're asking for a loss
8 for California tax purposes and, yet, you know, in your
9 brief and even in your presentation today, you say that,
10 you know, California has got basically no right to tax
11 anything that happened in Canada. But here the facts show
12 that whatever loss occurred, occurred by the loss in value
13 before the taxpayer moved to the U.S.

14 So it just seems so inconsistent with your
15 position here when you're saying that, hey, the gain here
16 is taxable to Canada, but now you're claiming the losses.
17 You know, the gain is taxable in Canada, but you're saying
18 the loss should be claimable in the U.S. And I'm just
19 having trouble with this inconsistency.

20 MR. DAKESSIAN: You make a good point, Your
21 Honor. I mean, I think that my point regarding the loss
22 and the actual stock loss compared to the position that
23 Mr. Conacher was in at the time of the Westwind sale where
24 he had just left was just sort of a general equitable
25 point. I talked about that on the slide where I discussed

1 equitable issues. I don't think we need to resort to any
2 of that because I think we have a statute that's clear on
3 its face.

4 I mean, I don't know how many different ways I
5 can say it. You're probably sick of me saying it, but I
6 really think that's the beginning and ending of this
7 discussion. And to the extent there's any confusion on
8 this, this fix is very simple you know, from a legislative
9 perspective. They can learn from federal law and they can
10 pass a California specific statute and resolve the matter
11 that way.

12 But we have to -- you know, there's a reason why
13 this maximum of statutory construction exists, and there's
14 a reason why the language in the statute is not clear and
15 explicit. Then the tie base goes to the taxpayer. It's
16 because a bunch of very smart tax lawyers at this moment
17 are staying in a room and are trying to figure out the,
18 you know, the equitable factors and the other factors in
19 play.

20 You know, Judge Gast make these really
21 interesting, you know, comments about, you know, BOE
22 decisions on depreciation and recomputation basis. I
23 would submit to you that the taxpayer does not go through
24 that. The taxpayer ask that you read the words of the
25 statute and determine and determine whether the activity

1 in question is taxed, and that's our position.

2 JUDGE MARGOLIS: Okay. You know, well even
3 ignoring let's say the statutory issues, there are
4 judicial concepts that apply. And I'm just -- so for
5 example, if you had a U.S. taxpayer that engaged in a
6 taxable event and should have reported but he didn't; and
7 in your theory, he sells the stock and he claims a loss.

8 You would say, you know -- you would say, wait a
9 second. You can't deduct the loss even though you didn't
10 report it. I mean, you wouldn't give them a loss that's
11 not recognized. And so that's a judicial concept that
12 might be applicable here, not even with going to the
13 statutory concepts.

14 MR. DAKESSIAN: I disagree. I very vehemently
15 disagree. I think that, you know, the statutory texts
16 controls. And we have a specific listing of what's going
17 to be a non-recognition transaction for U.S. purposes.
18 Judicial construct should not trump the text of the
19 statute.

20 If there's a specific case that you're referring
21 to, I'd like to know about it. But we have a statute here
22 that says that basis is going to be computed with
23 reference to cost unless there's an exception. The
24 Canadian transaction isn't one of the listed exceptions.
25 I mean to me judicial, you know, constructs don't enter

1 into it unless you want to talk about -- well, you know,
2 that enters into it, which is, you know, Biddle that talks
3 about -- which is sort of derivative of going and looking
4 at the statutory tax to begin with.

5 I mean, you know, U.S. tax principles apply. In
6 this case, the U.S. rules on what is going to be treated
7 as a non-recognition transaction apply. And I just don't
8 think all this other stuff really should enter into it.
9 The fix is easy for the government. The government can do
10 and change the statute. It's very easy for them.

11 The question is who should be bearing the burden
12 here? And to me that's the real sort of equity question
13 here is when you have statutory text that says something
14 very clearly. Why should we be, you know, grafting on
15 other concepts or, you know, imputing, you know, judicial
16 decisions that don't apply directly to this issue that
17 hold the taxpayer's feet to the fire. I don't agree with
18 that.

19 JUDGE MARGOLIS: I have one more question for the
20 FTB. You know, I asked you earlier about the possibility
21 of inconsistent treatment. And in this case, you allow
22 the taxpayer increase basis for the departure tax paid,
23 which was the theory of the Notice of Action. Yet, in one
24 of your -- in a subsequent brief, you said that because
25 they didn't make the election that -- that maybe the

1 deficiency should be larger, and they should not be
2 entitled to that increase in basis.

3 You know, what is your position, you know, in
4 a -- as to whether or not -- are they entitled to the tax
5 paid on the departure tax? Are they entitled to the basis
6 increase for the departure tax or not?

7 MR. AMBROSE: Yes. We were just pointing out
8 that under the treaty, you know, the procedure is that
9 they're supposed to make an election. They didn't do
10 that. The auditor looked at it and decided, I suppose,
11 you know, it was fair to give them the step-up in basis,
12 you know, based on the -- on what was paid in departure
13 tax. So but technically, they didn't follow the steps
14 that you need to follow to have that benefit.

15 JUDGE MARGOLIS: So --

16 MR. AMBROSE: I mean, we're not -- I'm sorry to
17 interrupt. You know, I mean, the NOA stand as it is. You
18 know, we wouldn't make any move, you know. We're not
19 thinking about or, you know, certainly wouldn't try to,
20 you know, issue another -- I mean, I don't think we could
21 at this point, you know, issue an NPA or something like
22 that. You know, the NOA stands as it is.

23 JUDGE MARGOLIS: Okay. Do any of my fellow
24 judges have any more questions at this point?

25 JUDGE GAST: This is Judge Gast. I don't have

1 any more questions.

2 JUDGE Le: This is Judge Le. I have no more
3 questions.

4 JUDGE MARGOLIS: Okay. We covered a fair amount
5 of territory with the questioning. Does the FTB want to
6 make any further statement before Mr. Dakessian gives his
7 rebuttal? I just want to offer that opportunity.

8 MR. AMBROSE: Do you have anything, Kamal?

9 MS. KHAIRA: No. No further statements.

10 JUDGE MARGOLIS: Okay. Mr. Dakessian, you can
11 give your rebuttal.

12 MR. DAKESSIAN: You know I think we've covered
13 most of the points during the question and answer section.
14 I'm trying to think of going down my list. Can I have
15 about 30 seconds just to take a look at what I have? I
16 might end up stating --

17 JUDGE MARGOLIS: Take your time.

18 MR. DAKESSIAN: Okay.

19 JUDGE MARGOLIS: Take your time.

20 MR. DAKESSIAN: Your Honor, I think we covered
21 all the points that we needed to cover on rebuttal during
22 the question and answer section.

23 JUDGE MARGOLIS: Okay. Any questions before we
24 close the record in this matter from either party? Okay.

25 Thank you both for -- I thank everyone for your

1 argument today as well as your prehearing cooperation.
2 This now -- I will now close the record, and this will
3 conclude the hearing. The matter will be submitted for
4 decision. We will deliberate and get back to you with our
5 decision within 100 days, unless for some reason before
6 that time we request additional briefing on any issue.

7 Thank you again.

8 (Proceedings adjourned at 5:15 p.m.)

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I have hereunto subscribed my name this 21st day of August, 2020.

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