

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
G. RIOS, ) OTA NO. 18042892  
 )  
 )  
 ) APPELLANT.  
 )  
 )  
 )  
\_\_\_\_\_ )

TRANSCRIPT OF VIRTUAL PROCEEDINGS

State of California

Wednesday, May 19, 2021

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
G. RIOS, ) OTA NO. 18042892  
 )  
 )  
 ) APPELLANT.  
 )  
 )  
 )  
\_\_\_\_\_ )

Transcript of Virtual Proceedings,  
taken in the State of California, commencing  
at 10:05 a.m. and concluding at 10:52 a.m.  
on Wednesday, May 19, 2021, reported by  
Ernalyn M. Alonzo, Hearing Reporter, in and  
for the State of California.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

APPEARANCES:

Panel Lead: ALJ SARA HOSEY

Panel Members: ALJ ALBERTO ROSAS  
ALJ SUZANNE BROWN

For the Appellant: STEVEN TOSCHER  
LACEY STRACHAN

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
BRADLEY KRAGEL

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

I N D E X

E X H I B I T S

(Appellant's Exhibits 1-2 were received at page 6.)

(Appellant's Exhibit 3 was received at page 7.)

(Department's Exhibits A-N were received at page 6.)

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

	<u>PAGE</u>
By Mr. Toscher	7
By Mr. Kragel	14

R E B U T T A L   S T A T E M E N T

	<u>PAGE</u>
By Mr. Toscher	23

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

California; Wednesday, May 19, 2021

10:05 a.m.

JUDGE HOSEY: We are now going on the record.

This is the appeal of Gloria Rios, Case Number 18042892. Today is May 19th, 2021, and it's 10:05 a.m. The hearing is held virtually via Webex. I'm lead Administrative Law Judge Sarah Hosey. And with me today are Judges Alberto Rosas and Suzanne Brown.

Judge Alberto Rosas would like to make a disclosure.

JUDGE ROSAS: Thank you, Judge Hosey.

Before we begin, I just want to make a brief disclosure. One of the attorneys for Respondent, Mr. Bradley Kragel and I used to work together as part of the same bureau within the Franchise Tax Board's legal division. We were both part of the Business Entities Tax Bureau. The fact that Mr. Kragel and I were colleagues more than three years ago will not in any way affect my ability to remain fair, neutral, and impartial. Thank you. And I have nothing further.

Thank you, Judge Hosey.

JUDGE HOSEY: Thank you, Judge Rosas.

Any questions before we proceed?

MR. TOSCHER: No, Your Honor.

1 MR. KRAGEL: No, Judge.

2 JUDGE HOSEY: Thank you.

3 I'll go ahead and state the issues as agreed upon  
4 in the prehearing conference minutes and orders issued on  
5 April 29, 2021. The issue is whether appellant has  
6 demonstrated that she is entitled to recognize a claimed  
7 long-term capital loss in the 2012 tax year.

8 We marked Exhibits 1 and 2 for Appellant and A  
9 through N for Respondent FTB at the prehearing conference  
10 held on April 20, 2021. No objections were raised by  
11 either party, and Exhibits 1 and 2 and A through N were  
12 admitted into the record per the prehearing conference  
13 minutes and orders.

14 (Appellant's Exhibits 1-2 were received  
15 in evidence by the Administrative Law Judge.)

16 (Department's Exhibits A-N were received in  
17 evidence by the Administrative Law Judge.)

18 Mr. Toscher, we have the full operating agreement  
19 of Agua Mansa Lot 23 Investors, LLC, 29 pages, submitted  
20 May 4th, 2021, we have identified as exhibit --  
21 Appellant's Exhibit 3.

22 Mr. Kragel, do you have any objections to this  
23 exhibit?

24 MR. KRAGEL: No objections.

25 JUDGE HOSEY: Having no objection, Appellant's

1 Exhibit 3 is now entered into evidence.

2 (Appellant's Exhibit 3 was received in  
3 evidence by the Administrative Law Judge.)

4 Mr. Kragel, did FTB have any additional exhibits?

5 MR. KRAGEL: No, Judge.

6 JUDGE HOSEY: Thank you.

7 Okay. We are ready to begin our presentation.

8 Mr. Toscher, are you ready to begin?

9 MR. TOSCHER: Yes, Your Honor.

10 JUDGE HOSEY: Go ahead.

11

12 PRESENTATION

13 MR. TOSCHER: Good morning, Your Honors. Good  
14 morning, Mr. Kragel. And I didn't get the name of your  
15 FTB colleague, but good morning to the FTB  
16 representatives. I hope everybody is well. And thank you  
17 for having this hearing electronically. It's the first  
18 time I've actually done an electronic hearing, and I will  
19 try to look into the camera. It's sort of new to me, but  
20 I'm very pleased that we're able to do this and continue  
21 business going.

22 So may it please the Court, we're here today, as  
23 the issue is framed, sort of a unique situation. Gloria  
24 Rios inherited this partnership interest from her husband,  
25 who passed away a number of years before this, received an

1 increase in basis of that partnership. And the primary --  
2 the only asset of the business was sold in 2012, and it  
3 generated a gain, and the FTB is seeking to tax Ms. Rios  
4 on that gain.

5 But she also had an economic loss on the  
6 partnership because her basis in the partnership was much  
7 greater than the gain involved. That's why as a net  
8 matter there's a net loss, and there should be no tax. So  
9 I think we should start from the economic position, is  
10 that there really was no economic gain on her interest on  
11 the asset involved. The problem which we have to deal  
12 with, and the Court has to deal with is, really, the  
13 mismatch of the gain emanating out of the partnership, and  
14 the loss emanating out of the termination or we'll say  
15 liquidation of the partnership.

16 We have a gain in 2012 -- this is the FTB's  
17 position -- a gain in 2012, and a loss in 2013 because of  
18 the difference in the years doesn't offset. It creates  
19 what I'll describe as phantom or noneconomic gain to  
20 Ms. Rios. And what this comes down to or the core issue  
21 of this mismatch is the FTB's interpretation and the  
22 interpretation of Internal Revenue Code Section  
23 708(b)(1)(a), and that is, when is there a termination of  
24 a partnership?

25 I don't think there's any dispute that if there



1 was a termination the tax, consequences as I've described,  
2 the offsetting, the capital loss, flows through under the  
3 regs. And I don't think any of this is disputed. There's  
4 a constructive liquidation, and that, basically, offsets  
5 and gets rid of the disparity. And I think one of the  
6 things we want to focus on -- we're not -- we're not  
7 talking about liquidation under state law. We're talking  
8 about a termination under 708 and whether it terminated.  
9 And if it did terminate under 708, then I don't think  
10 there's any left of an issue. So it's an interpretation.

11 And so with that being said, the other undisputed  
12 facts, we know the only business of this partnership was  
13 the holding of the real property, which was sold in 2012.  
14 But the -- the final tax return and some final -- and the  
15 final distribution was not made until 2013. But the only  
16 thing that remained in this partnership was cash to be  
17 distributed. Now, in hindsight if they would have rushed  
18 to make the distribution before year end, we wouldn't have  
19 this problem. But they didn't. Taxpayers don't always  
20 have the right guidance to get this done.

21 But the question is did it terminate under 708,  
22 and did the partnership have no further business venture  
23 or financial operations as those words are used in 708 and  
24 the regulations. So we talked before -- we believe that  
25 on the facts of this case there was nothing else other

1 than making the distribution, a final tax return, paying  
2 the accountant.

3 And, again, as I've said before, and I won't  
4 repeat myself. I got ahead of myself on my notes. If it  
5 did terminate, I think on the law it flows. Ms. Rios is  
6 entitled to the capital loss. So I think the Board,  
7 basically, is that as long we were holding the cash, that  
8 the partnership did not terminate. We think a fair  
9 reading of the statute and the regulations and other IRS  
10 regulations and the case law support our position in this  
11 case. I think what you will see these are very -- the  
12 cases that have been cited are very fact bound.

13 In other words, each one is a little different.  
14 What activities were left on the partnership? A majority  
15 of the cases the Franchise Tax Board are relying upon,  
16 there was some other business activity going on. The  
17 regulation example talks about some continuing --  
18 continuous business activity during the winding down. No  
19 examples where it's just cash ready to be finalized and  
20 distributed.

21 And I know from my point of view we want to  
22 interpret statutes to effectuate the purpose. And where  
23 there's a mismatch, that's a problem. We all know that  
24 there can be mismatches. Okay. We have the annual  
25 accounting concept. But we should go out of our way to

1 interpret a statute or regulation to cause these  
2 mismatches and taxation, which there really is no economic  
3 gain. We hear it all the time in other areas.

4 There's, you know, if there's no economic loss,  
5 you shouldn't have to deduct the loss. The same thing  
6 applies to the economic gain. So let me -- we've cited  
7 and relied upon the Sixth Circuit decision in Goulder.  
8 And it's the most analogous case. And what was left in  
9 Goulder -- it's pretty parallel -- was security deposits,  
10 okay, that needed to be returned. So they did make a  
11 final liquidation.

12 Here there weren't security deposits, but it  
13 carried over to the other year. The Internal Revenue  
14 Service in that case sort of made the same arguments that  
15 are being made here, no final distribution. And in all  
16 fairness -- I'm sure the Court is aware of it -- the Tax  
17 Court accepted that argument, but the Sixth Circuit  
18 reversed the argument saying, "No we don't" -- "we believe  
19 there was a termination. Just holding this isn't enough."

20 The Board quite -- their position is, well that's  
21 because there was a stipulation tracking the language, and  
22 that's -- I understand the argument. But the facts of our  
23 case are, was there any business going on? Was there any  
24 venture? Was there any financial operations as we would  
25 interpret that regarding, you know, business financial

1 operations, not just holding cash.

2 And so we think Goulder is the most instructive  
3 and, you know, and provides, more importantly, the correct  
4 tax result. So I, you know, we have to have a rule which  
5 is administratively workable. The Franchise Tax Board  
6 rule is any time there was final activity that needed to  
7 be done, whether it's cash or final return, the activity  
8 carries over to that year.

9 We think there's a rule, if there's just cash to  
10 be distributed, that's it. The part -- and there is a  
11 termination that went on. So I -- just hypothetically, if  
12 the situation was reversed, and we had a gain on  
13 liquidation under 731, whether there's a constructive  
14 distribution, I think, you know, the Board might  
15 reasonably take the position that everything that needs to  
16 be done is done. And it should be taxable in the earlier  
17 year, not the later year.

18 So I think we have one rule that's applicable to  
19 everybody. And I think what I describe is a workable  
20 rule, if there's no business activity. And again it's  
21 clear, the business activity of this was done. It was  
22 over. Again, I've made this point. The position -- the  
23 interpretative position advocated by the Board produces a  
24 horribly inequitable result to Ms. Rios.

25 Now having been in the tax business a long time,

1 you know, the tax administrators are not court -- or the  
2 tax are not courts of equity, but it does inform our  
3 judgement as to how we interpret it. As I said at the  
4 beginning, we -- we want to interpret the statutes that  
5 provide a fair and just result as the law applies. She  
6 didn't really have any economic gain. She had basis in  
7 these assets.

8 And what's happening here is if we have a large  
9 gain in 2012 and an almost equal, maybe a little more  
10 capital loss in 2013, because of the limitations on  
11 capital losses, they are of no use to this taxpayer. So  
12 the taxpayer is paying a tax on a gain, which really isn't  
13 there. So I think, you know, the only thing that was left  
14 at the point was to distribute the cash and clean up the  
15 dispute, finalize it between the partners, not the  
16 business of the partnership.

17 And so we think, in summary -- I'm not going to  
18 use all my time because I've learned if I'm done to stop  
19 talking. The -- there was a termination under 708 under  
20 the literal language of the statute. The example in the  
21 regs, it's a little vague but it could equally support us  
22 too. It doesn't deal with this example, and we reject the  
23 rule that as long as there is cash that -- that isn't the  
24 correct rule, and the cases -- some cases may say at a  
25 time and dictum, but that's not the rule -- the

1 administrative rule to achieve the correct result or a  
2 fair interpretation.

3 So with that, I'll reserve. Well, I'll have five  
4 minutes at the end. And I thank you for your attention  
5 and allowing us to present our case.

6 JUDGE HOSEY: Thank you, Mr. Toscher.

7 I'm going to go ahead and ask if my panel members  
8 have any questions. Judge Rosas?

9 JUDGE ROSAS: This is Judge Rosas. Thank you,  
10 Judge Hosey. I do have some questions, but I'll reserve  
11 those after Counsel's rebuttal argument. Thank you.

12 JUDGE HOSEY: Okay. No problem. Judge Brown?

13 JUDGE BROWN: I don't have any questions right  
14 now. Thank you.

15 JUDGE HOSEY: Okay. Thank you.

16 All right. Mr. Kragel, are you prepared for your  
17 presentation?

18 MR. KRAGEL: I am, Judge.

19 JUDGE HOSEY: Go ahead and begin. Thank you.

20

21 PRESENTATION

22 MR. KRAGEL: Good morning members of the panel  
23 and Appellant's counsel. As I said earlier, my name is  
24 Bradley Kragel. I'm representing Respondent Franchise Tax  
25 Board.

1           This matter raises one issue, whether Appellant  
2 has demonstrated that she is entitled to recognize a  
3 claimed long-term capital loss in tax year 2012.

4           Appellant was a member of a limited liability  
5 company that owned parcel of real property in California.  
6 The limited liability company sold the property in  
7 November 2012 and distributed the proceeds in 2013. Based  
8 on the limited liability company's ongoing activities and  
9 distribution in 2013, Respondent determined that the loss  
10 should have been reported in 2013. The evidence submitted  
11 supports Respondent's determination.

12           The evidence shows that in June 2002 Appellant  
13 and her husband as trustees of a trust formed a California  
14 limited liability company with two other members. The  
15 LLC's articles over organizations stated in part that the  
16 purpose of the limited liability company was to, quote,  
17 "Engage in lawful act or activity for which a limited  
18 liability company may be formed."

19           In July 2002, the limited liability company  
20 purchased a parcel of real property located in Riverside,  
21 California. The LLC owned the property from July 2002 to  
22 November 2012. During its ownership, the LLC leased  
23 portions of the property to several businesses. In 2004  
24 Appellant's husband passed away and his interest in the  
25 LLC passed to Appellant.

1           In March 2012 a third party offered to purchase  
2 the real property owned by the limited liability company.  
3 The other two members of the LLC wanted to sell the  
4 property, but Appellant objected to the sale. Appellant  
5 refused to sign the sale agreement, and one of the lessees  
6 refused to vacate the premises. In June 2012 the LLC  
7 filed a complaint against the lessee and Appellant seeking  
8 to terminate the lease and sell the property. In  
9 addition, the LLC sought damages against one of the  
10 lessees.

11           In November 2012 the LLC sold the property. The  
12 LLC did not dissolve in 2012, and the lawsuit remained  
13 unresolved. In February 2013 the LLC and the lessees  
14 entered into a mutual general release. The release stated  
15 in part that a distribution in the amount of \$2.7 million,  
16 approximately, would be made by the LLC to Appellant's  
17 trust no later than February 8, 2013, with the balance of  
18 the funds in the account going to the other two members of  
19 the LLC. The release also stated that as soon as  
20 practical, the LLC would take all necessary steps to wind  
21 up and dissolve.

22           Also in February 2013, the LLC issued a check to  
23 Appellant's trust in the amount of \$2.7 million. That  
24 same month the LLC filed its LLC return of income for  
25 2012, which reported the sale of the property. The LLC's



1 2012 tax return did not report any distributions to  
2 Appellant's trust or Appellant. In April 2013 the LLC  
3 filed its final return covering the period  
4 January 1, 2013, to February 28, 2013. The LLC's 2013 tax  
5 return reported interest income of \$735 and deductions  
6 totaling approximately \$25,000, which included  
7 professional fees of approximately \$15,000.

8 The LLC's 2013 reported cash assets of  
9 \$6.6 million at the beginning of tax year 2013. The LLC's  
10 2013 reported that it distributed \$6.6 million to its  
11 partners in 2013, of which \$2.7 million was distributed to  
12 Appellant's trust. In April 2013 the LLC filed its  
13 certificate of cancellation. In October 2013 Appellant  
14 filed her income tax return for tax year 2012 reporting  
15 zero taxable income. In regard to the LLC, Appellant  
16 reported long-term capital loss of \$985,000. In  
17 April 2014 Appellant filed her tax return for tax year  
18 2013 reporting zero taxable income. In regarded to the  
19 LLC, Appellant's 2013 return reported a loss of \$10,000.

20 Respondent examined Appellant's tax return and  
21 asked Appellant to explain the adjustments reported for  
22 tax year 2012. Appellant replied, stating in part, that  
23 the adjustments were based on a step-up in basis  
24 consisting of \$2.5 million related to the transfer on the  
25 death of her husband and payments of \$434,000, which

1 Appellant considered expenses on the sale of the property.  
2 Respondent accepted the basis adjustments but determined  
3 that there were not -- that there was no loss for  
4 Appellant to recognize in 2012. Instead, Respondent  
5 determined the loss occurred in 2013 when the partnership  
6 was terminated.

7 Respondent issued a Notice of Action to Appellant  
8 assessing additional tax for tax year 2012 as a result for  
9 the disallowed loss in 2012. Respondent's determination  
10 was based on California tax laws and provisions of the  
11 Internal Revenue Code. California law conforms to  
12 Internal Revenue Code Sections 701 through 761, which  
13 relate to the taxation of partners and partnerships. The  
14 Federal Treasury Regulation relating to partners and  
15 partnerships also apply in California.

16 Internal Revenue Code Section 731 sets forth the  
17 laws relating to recognition of gains and losses as a  
18 result of partnership distributions. Section 731-A states  
19 in part that "in a case of a distribution by a partnership  
20 to a partner, loss shall not be recognized through such  
21 partner. Except that upon a distribution in liquidation  
22 of a partner's interest in a partnership, loss shall be  
23 recognized to the extent of the excess of adjusted basis  
24 of partner's interest in the partnership over the sum of  
25 any money distributed. The basis of the distributee as

1 determined by 732 and any unrealized receivables as  
2 defined in 751."

3 The federal regulation state that "a partner may  
4 recognize a loss from a distribution only upon liquidation  
5 of his or her entire interest in the partnership and only  
6 if the property distributed consist of money, unrealized  
7 receivables, and inventory." The regulation state that  
8 the phrase "liquidation of party's -- partner's interest  
9 means the determination of the party's entire -- partner's  
10 entire interest in the partnership by means of a  
11 distribution or a series of distributions.

12 Section 708 subdivision (b) states that "a  
13 partnership shall be considered as terminated if only no  
14 partner -- only if no part of any part -- business,  
15 financial operation, or venture of the partnership  
16 continues to be carried on by any of the partners of the  
17 partnership." In the present case, Appellant has failed  
18 to establish that the distribution and liquidation of her  
19 entire interest occurred in tax year 2012. The evidence  
20 shows that the LLC did not make any distributions in 2012.

21 The LLC reported cash assets of \$6.0 million in  
22 the beginning of 2013. The LLC's cash was distributed to  
23 its members in 2013. The LLC reported deductions, which  
24 include professional fees in 2013. The LLC was still  
25 prosecuting a complaint, which included a claim for money

1 damages against one of its lessees during 2013. The  
2 members entered into a mutual release which stated in part  
3 that the LLC would take steps to wind up and dissolve the  
4 entity in 2013. This language indicates that the  
5 partnership was not wound up or dissolved as of  
6 February 2013. Based on the evidence presented,  
7 Respondent correctly determined that Appellant's loss  
8 occurred in 2013 because the distributions were made in  
9 2013, and the LLC was terminated in 2013.

10 The Goulder case referenced by Appellant is  
11 distinguishable from the present case because in that  
12 case, the taxing authority and the Appellants entered into  
13 a stipulation providing that during that -- the 1981, the  
14 partnership neither operated or carried on any business  
15 financial operations or venture, having ceased any such  
16 activity prior to beginning of such year. That  
17 stipulation precisely mimic the language of Section 708  
18 termination provision. The provision regarding  
19 termination uses the same phrase, no part of any business,  
20 financial operation, or venture. In the present case  
21 there was no such stipulation.

22 In addition, in Goulder the partnership sold its  
23 primary asset in 1980, and all assets were distributed  
24 except for the partnership retained -- representing tenant  
25 security deposits. In the present case, there was no

1 distribution in 2012. The distribution occurred in 2013.  
2 In Goulder the only asset retained was tenant security  
3 deposits, which were retained because the partnership  
4 believed a third party had a claim to those deposits.

5 In Goulder the IRS also stipulated that the money  
6 retained by the partnership was the tenant security  
7 deposits, which partnership assumed the Department of  
8 Housing and Urban Development would seek to collect. In  
9 the present case, the partnership still owned \$6.6 million  
10 in 2013. There was no stipulation regarding the retained  
11 assets. The partnership was still engaged in the lawsuit  
12 in 2013. It took steps to dissolve in 2013. It reported  
13 deductions in 2013. It filed its final tax return in  
14 2013, or a period during 2013. None of these other  
15 activities were present in the Goulder case.

16 Finally, common in the court's holding ruler or  
17 its statement of the rule was very precise and limited.  
18 It stated there is no per se rule providing that retention  
19 of the asset in anticipation of a debt constitutes  
20 continuation of a partnership, particularly where the IRS  
21 had stipulated that the partnership has already  
22 terminated. For those reasons, the Goulder case is  
23 distinguishable.

24 For the reasons previously given, Respondent  
25 believes the evidence demonstrates that Respondent

1 correctly determined that Appellant's loss occurred in  
2 2013 when the LLC's money was distributed, and the LLC was  
3 terminated in 2013. For those reasons Respondent request  
4 that the panel sustain Respondent's determinations. If  
5 you have any questions, I'll do my best to answer them.

6 JUDGE HOSEY: Thank you Mr. Kragel.

7 I'm going to go ahead and ask my co-panelists if  
8 they have questions at this time. Judge Rosas?

9 JUDGE ROSAS: This is Judge Rosas. Thank you,  
10 Judge Hosey.

11 I do have one question, Mr. Kragel. And my  
12 apologies if you addressed this. If you did, I did not  
13 hear you. But there was an argument that was made during  
14 opposing counsel's argument that I would like you to  
15 address, the inequitable result issue, as your friend  
16 across the aisle describe it. And I believe his words  
17 were that, "As a net matter there, there was no economic  
18 gain."

19 So I'm hoping, Mr. Kragel, that you can address  
20 that inequitable result issue.

21 MR. KRAGEL: Judge, there does not appear an  
22 inequitable result. There was a -- in 2013 the Appellant  
23 received approximately \$2.7 million as her share of the  
24 remaining funds from the partnership. Her loss derives  
25 from her alleged basis -- or her basis in the partnership.

1 And we don't have the facts or evidence demonstrating the  
2 source of that basis other than the step-up in basis due  
3 to her husband's unfortunate passing away.

4 So whether or not she actually -- there was not  
5 out-of-pocket loss. We don't know. In any event, the  
6 Respondent applied the statute as applied under  
7 Section 731, requires that a loss can be reported upon a  
8 distribution of the partners or upon liquid --  
9 distribution resulting in partners' liquidation her  
10 interest in the partnership.

11 Judge Rosas: This is Judge Rosas. Thank you,  
12 Mr. Kragel. I do have a few other questions, but I'll  
13 reserve those after rebuttal argument. Thank you.

14 JUDGE HOSEY: Judge Brown, do you have any  
15 questions before we go to rebuttal?

16 JUDGE BROWN: This is Judge Brown. No, I do not.

17 JUDGE HOSEY: Thank you.

18 Mr. Toscher, would you like to go ahead and make  
19 a rebuttal?

20 MR. TOSCHER: Sure. Just very briefly,  
21 Your Honors. Thank you.

22

23 REBUTTAL STATEMENT

24 MR. TOSCHER: I think one of the focus need to  
25 be -- I think one of the things Mr. Kragel said during his

1 presentation was that the partnership could engage under  
2 it's organization articles under any lawful act. I think  
3 the focus really needs to be on the operating agreement  
4 where it's formed for the purpose of acquiring, owning,  
5 and managing the real property. That was the business of  
6 the partnership. I think yes. The distribution wasn't  
7 made until 2013, and the lawsuit carried over in terms of  
8 final documentation. But I do think, just to respond to  
9 Mr. Kragel, there was -- there was no taxable gain if it  
10 was a termination.

11 And Ms. Rios is asked to be paying tax on a gain  
12 which really wouldn't be considered a gain under the law  
13 because she -- there's no dispute that she had basis in  
14 the partnership -- excuse me -- basis in the partnership,  
15 and there would be no taxable gain had it terminated. We  
16 believe it terminated because there was nothing left for  
17 the operations of the partnership itself.

18 Thank you, Your Honors.

19 JUDGE HOSEY: Thank you, Mr. Toscher.

20 I'm going to go ahead and finish questioning from  
21 the judges. Judge Rosas, do you have any other questions?

22 Judge Rosas: This is Judge Rosas. Thank you,  
23 Judge Hosey. I do have a few questions.

24 I want to follow up on something that Mr. Kragel  
25 mentioned. Mr. Kragel addressed the LLC's lawsuit filed



1 in 2012. I'm looking at Exhibit E, echo, the Verified  
2 First Amended Complaint, which identifies the LLC as the  
3 plaintiff in that civil action. I am now looking at  
4 Exhibit G, golf, the Mutual General Release of all claims  
5 by all parties attachment to settlement agreement.

6 I'm going to ask both sides about this civil  
7 action, which according to Exhibit E, echo, was filed in  
8 June 2012. And according to Exhibit G, golf, was to be  
9 dismissed with prejudice sometime in February 2013. My  
10 question is whether the LLC's interest in that litigation  
11 constituted an asset of the LLC.

12 And I'd like to hear from Appellant's counsel  
13 first.

14 MR. TOSCHER: Yes, Your Honor. I think the -- it  
15 may have been a potential cause of action, but I don't  
16 think it was ever considered a -- could be valued or  
17 considered an asset at that time. I think there was  
18 allegations going on, but it wasn't the business of the  
19 partnership. There were attempts to sell the property.  
20 Ms. Rios didn't want to sell the property. So the  
21 allegations go back and forth.

22 So I don't think there's anything really of  
23 substance there. Once the property was sold, the thing  
24 terminated and it was done. So I don't think  
25 realistically there was any asset there.

1           Judge Rosas: This is Judge Rosas. Thank you,  
2 Mr. Toscher.

3           Now for, Mr. Kragel.

4           MR. KRAGEL: Judge, thank you. I can't say for  
5 certain without researching it, since my general  
6 recollection from civil practice, a lawsuit seeking  
7 damages would probably be considered an asset of the  
8 person seeking the damages. But I can't say for certain.

9           Judge Rosas: This is Judge Rosas. Thank you,  
10 Mr. Kragel.

11           I do have another question on a similar topic. I  
12 want to ask about the Tax Court case Harbor Cove Marina  
13 Partners Partnership versus Commissioner. I realize that  
14 both parties cited to this case in their pleadings. An  
15 over simplified summary, the holding is that there's no  
16 termination -- I'm sorry. There's no termination. There  
17 was a pending lawsuit involving the partnership that could  
18 reasonably lead to the partnerships reporting in a  
19 subsequent year of significant income, credit, gain, loss,  
20 or deduction.

21           And, again, similar question to my first one that  
22 I want to hear from both sides. My question is this:  
23 Does the fact the LLC was plaintiff in this pending  
24 lawsuit in 2012 have any relevance to the issue of  
25 partnership termination?

1           And I'll hear from Mr. Toscher first.

2           MR. TOSCHER: Yes, Your Honor. I don't think so  
3 because I think, ultimately, the dispute -- the gravamen  
4 was being able to sell the property. And the Tax Court  
5 talked about, as I pointed out before, materiality,  
6 significant income. There really was nothing there. So I  
7 would say it doesn't follow within Harbor Marina -- Harbor  
8 Cove Marina. Excuse me.

9           JUDGE ROSAS: This is Judge Rosas. Thank you,  
10 counselor.

11           Mr. Kragel?

12           MR. KRAGEL: Thank you, Judge.

13           Focusing on just the existence of the complaint  
14 itself in comparing the two cases, if you look in the  
15 Harbor case, correct. There was nothing but a lawsuit  
16 going forward after the year of alleged termination. In  
17 this case, the lawsuit is going forward. It's still going  
18 forward in 2013. So it does show activity, and it's not  
19 just limited to the sale of the property. It's also  
20 limited to the dispute with the lessees. The LLC's  
21 business wasn't limited to owning the property.

22           Its business included leasing property to two --  
23 at least to two or three other business. And those  
24 businesses' refusal to give -- to surrender the property  
25 was part of the lawsuit. And although we can't -- that

1 appears to have continue in 2013. And the lawsuit also  
2 sought damages, which potentially could have resulted in  
3 tax effects to the LLC.

4 Now, a little bit broader that, the interesting  
5 thing about the Harbor Cove case is it was just limited to  
6 the ongoing lawsuit in the second year. The managing  
7 partner had taken steps to actually distribute the  
8 property and distribute the disputing partner's share of  
9 the property in the first year.

10 Well, our case is a little bit better. It's  
11 better than that in that we have an ongoing compliant,  
12 plus we have the distributions actually occurring in 2013,  
13 and on the efforts to dissolve in 2013.

14 So there's actually more factors in our case that  
15 would lead one to conclude that the partnership hadn't  
16 terminated than the Harbor Cove case.

17 Thank you, Judge.

18 Judge Rosas: This is Judge Rosas. Thank you,  
19 Mr. Kragel.

20 Mr. Toscher, would you like an opportunity to  
21 respond?

22 MR. TOSCHER: Just briefly, Your Honor. I'm not  
23 aware of, you know, this being a sort of multifactor test.  
24 There are facts here. There's no question the final  
25 paperwork was not done until 2013. But the business had

1 terminated and the -- that caused a constructive  
2 termination in -- or I'm sorry -- termination of the  
3 partnership and a constructive liquidation in 2012 with  
4 just sort of ministerial items: Liquidation,  
5 distribution, and finalization.

6 The business of the partnership had terminated,  
7 and that caused the tax consequences, which we are urging  
8 the Court to accept.

9 Judge Rosas: This is, Judge Rosas. Thank you,  
10 Mr. Toscher.

11 Judge Hosey, I have nothing further. Thank you.

12 JUDGE HOSEY: Thank you, Judge Rosas.

13 Judge Brown, do you have any questions at this  
14 time?

15 JUDGE BROWN: This is Judge Brown. I do not.

16 JUDGE HOSEY: Thank you. I do have a question.

17 In preparation for this hearing, the panel members  
18 discovered a recent precedential opinion from the OTA, the  
19 appeal of Davis and Hunter Davis 2020-OTA-182P regarding  
20 IRC Section 708(b)(1) in the Goulder opinion. This was  
21 published after briefing ended in this appeal. I  
22 understand these cases can be very fact-specific, as we've  
23 been discussing. But I wanted to know if the parties  
24 would like to discuss this case to see if it's applicable  
25 to this present appeal, or if we want to move forward.

1 I'll go ahead and ask Mr. Toscher.

2 MR. TOSCHER: Your Honor, I am embarrassed to say  
3 I'm not familiar with it, and we should have checked. But  
4 I would like the opportunity to address it. I can't do it  
5 right this second, but I don't know how relevant it is.  
6 And I appreciate the Court pointing it out.

7 JUDGE HOSEY: I was not aware of it as well. I  
8 was out last year for a period, so I understand.

9 Mr. Kragel, what is your opinion?

10 MR. KRAGEL: Well, if Appellant wants an  
11 opportunity to object, then I don't have any objections.  
12 We can take a look at it. That's fine. I would say that  
13 part of what -- as I was thinking over the case this  
14 morning, part of what happened -- what's going on in these  
15 cases is, we look a little -- maybe we overemphasize IRC  
16 Section 708 in deciding -- trying to determine when the  
17 partnership has terminated. When the statute where, you  
18 know, the genesis statute is Section 731, which requires  
19 that the -- that in order to claim a loss, the partner has  
20 to receive a distribution and complete liquidation of her  
21 interest in the partnership.

22 It doesn't actually use -- require the  
23 termination of the partnership. So, you know, we're  
24 looking or the Respondent is looking for that distribution  
25 and liquidation of the partnership. And when you start

1 looking at some of these cases down the line to flesh out  
2 Section 708, that can become part of the analysis, but  
3 it's not necessarily determinative.

4 So that having said, I kind of incline to, you  
5 know, accede to the Court's wishes. Maybe it's the best  
6 way to go.

7 JUDGE HOSEY: Okay. I understand. I think our  
8 concern was that since it's precedential, it's binding on  
9 our panel. And we wanted to make sure that the parties  
10 had the chance to at least look at it. What I'll do is I  
11 will issue an order for post-hearing briefing. I'll give  
12 each party 30 days to look over the appeal of Davis and  
13 Hunter Davis opinion. And if it's not relevant or you  
14 don't think it is pertinent to your case, that's fine. It  
15 was to give you an opportunity. Then I will go ahead and  
16 close the record after that, and we'll go from there  
17 issuing the opinion.

18 Mr. Toscher, does 30 days sound efficient?

19 MR. TOSCHER: Yes, Your Honor.

20 JUDGE HOSEY: All right. I will -- just so we  
21 know ahead a time it might take a few days to get the  
22 order out. We'll have 30 days from today is June 18,  
23 2021. I will go ahead and -- let's have FTB respond  
24 first.

25 Mr. Kragel, 30 days from today is June 18, 2021.

1           After that I'll give taxpayer Appellant 30 days.  
2           That's July 18th, 2021. That way we won't drag this case  
3           out any further than necessary, but the parties will have  
4           an opportunity to look at that precedential opinion and  
5           whether we are bound by it in any way.

6           Do you have any questions or concerns,  
7           Mr. Toscher?

8           MR. TOSCHER: No, Your Honor. Thank you to the  
9           Court for your attention, to all members of the Court.

10          JUDGE HOSEY: Thank you.

11          Mr. Kragel, any questions?

12          MR. KRAGEL: No questions, Judge. I also thank  
13          members of the panel.

14          JUDGE HOSEY: All right. So we will not be  
15          submitting this case today. The record will remain open  
16          for the post-hearing briefing, per the order setting forth  
17          the requirements that will be issued in a few days.

18          This hearing is now adjourned.

19          (Proceedings adjourned at 10:52 a.m.)

20

21

22

23

24

25



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

HEARING REPORTER'S CERTIFICATE

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

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

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

I have hereunto subscribed my name this 4th day of June, 2021.

---

ERNALYN M. ALONZO  
HEARING REPORTER