

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
F.A.R. INVESTMENTS, INC.,) OTA NO. 19125618
ARCIERO & SONS, INC.,) OTA NO. 19125619
)
APPELLANT.)
)
_____)

TRANSCRIPT OF VIRTUAL PROCEEDINGS

State of California

Wednesday, July 28, 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,)
)
F.A.R. INVESTMENTS, INC.,) OTA NO. 19125618
ARCIERO & SONS, INC.,) OTA NO. 19125619
)
APPELLANT.)
)
_____)

Transcript of Virtual Proceedings,
taken in the State of California, commencing
at 1:18 p.m. and concluding at 4:24 p.m. on
Wednesday, July 28, 2021, reported by
Ernaly 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 JOSHUA LAMBERT

Panel Members: ALJ CHERYL AKIN
ALJ MIKE LE

For the Appellant: EDWARD I. KAPLAN
BARRY L. GUTERMAN
RUDOLPH F. SILVA
F. ARCIERO, JR.

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

CAROLYN S. KUDUK
MARGUERITE MOSNIER

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 1-21 were received at page 7.)

(Department's Exhibits A-O were received at page 7.)

(Joint Stipulation of Facts Exhibit J-1 was received at page 7.)

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

	<u>PAGE</u>
By Mr. Kaplan	7
By Ms. Mosnier	69

APPELLANT'S WITNESSES:

	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
Rudy Silva	14	49		
Frank Arciero, Jr.	36	50		

CLOSING STATEMENT

	<u>PAGE</u>
By Mr. Kaplan	97
By Mr. Guterman	103

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, July 28, 2021

1:00 p.m.

JUDGE LAMBERT: We are now on the record in the Office of Tax Appeals' oral hearing for the consolidated appeals of F.A.R. Investments, Inc., and Arciero & Sons, Inc., Case Numbers 19125618 and 19125619. The date is July 28th, 2021, and the time is 1:18 p.m.

My name is Josh Lambert, and I am the Administrative Law Judge for the purposes of conducting this hearing. My Co-Panelists today are Judge Akin and Judge Lee.

FTB, could you please introduce yourselves for the record. Do we have Ms. Mosnier or Ms. Kuduk?

MS. MOSNIER: Oh, sure. Marguerite Mosnier for Franchise Tax Board.

MS. KUDUK: Carolyn Kuduk for Franchise Tax Board.

JUDGE LAMBERT: Thanks.

And, Appellants, could you please introduce yourselves for the record.

MR. KAPLAN: Edward Kaplan for Appellants on the end.

MR. GUTERMAN: Barry Guterma n for Appellants on the -- in the middle.

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

JUDGE LAMBERT: Thank you.

The issues today are whether Appellants have shown error in FTB's determination denying Appellants' claimed deferral of gain from a like-kind exchange under IRC Section 1031; and whether gain from the sale of the sale of the property should be attributed to Arciero Wine Group, LLC, pursuant to an assignment of income theory.

Appellants, do you agree that these are the issues?

MR. GUTERMAN: Mr. Guterman speaking. Yes, we do.

JUDGE LAMBERT: And, FTB, do you agree?

MS. MOSNIER: Marguerite Mosnier speaking. Yes, we do.

JUDGE LAMBERT: Okay. And I'll just address Appellants to Mr. Guterman, and I'll talk to Ms. Mosnier for now, unless otherwise directed.

The exhibits that FTB is providing are A through O, and Appellants will be entering Exhibits 1 through 21. And also, there's a joint stipulation of facts, Exhibit J-1 and Exhibit Number 20 is the replacement for Exhibit 20 that was submitted recently.

Mr. Guterman, are there any objections?

MR. GUTERMAN: Mr. Guterman speaking. There are no objections.

1 JUDGE LAMBERT: And, Ms. Mosnier, are there any
2 objections?

3 MS. MOSNIER: This is Marguerite Mosnier. No
4 objections.

5 JUDGE LAMBERT: Okay. Thanks.

6 That evidence is now in the record.

7 (Appellant's Exhibits 1-21 were received
8 in evidence by the Administrative Law Judge.)

9 (Department's Exhibits A-O were received in
10 evidence by the Administrative Law Judge.)

11 (Joint Stipulation of Facts

12 Exhibit J-1 was received in evidence
13 by the Administrative Law Judge.)

14 So at this time we'll begin Appellants'
15 presentation. You'll have an hour and 20 minutes, and
16 please proceed when you're ready.

17

18 PRESENTATION

19 MR. KAPLAN: This is Edward Kaplan speaking.

20 This consolidated case concerns Appellants' deferral gain
21 realized from the sale of buildings and vineyards in Paso
22 Robles, California. It's referred to throughout these
23 proceedings as the Paso Property.

24 To obtain tax deferral on property sales, Section
25 1031 provides three general requirements:

1 One, is the taxpayer must have completed an
2 exchange.

3 Two, the exchange must have been of like-kind
4 property.

5 And three, both the relinquished property and the
6 replacement property must be held for qualified purpose,
7 either for investment or for use in a trade or business.

8 Parties agree that both the like-kind and holding
9 agreements have been met in this case. The question asked
10 today is a factual one, whether Appellants have met the
11 exchange requirement. The answer lies in this panel's
12 determination as to the identity of the seller.

13 Respondent agrees that in form Appellants were the sellers
14 but asserts that for tax purposes, the sale of the Paso
15 Property should be attributed to Arciero Wine Group, LLC,
16 referred to for the rest of this hearing as AWG.

17 Appellants contend the facts clearly establish
18 that they were the sellers in both form and substance.

19 There's no material dispute between the parties on the
20 chronology of events in this case and what took place.

21 The stipulation of facts and submitted documents and
22 exhibits layout that chronology and contain all the
23 documents relevant to the sale of the Paso Property.

24 Declarations have been provided by a number of individuals
25 involved in the subject transactions, and their statements

1 have never been questioned or disputed.

2 Frank Arciero Jr. and Rudy Silva, whose
3 declarations are at Appellant's Exhibits 5 and 7, are here
4 today to more fully explain the background of the sales of
5 the Paso Property and AWG's inventory and how they were
6 accounted for. The primary purpose of their presence,
7 however, is to be available to answer any questions the
8 panel may have. Unfortunately, Frank Arciero Sr., who was
9 president of both Appellants and the primary negotiator
10 and drive of the sales at issue, passed away in 2012.

11 Respondent has failed to recognize in its
12 briefing, appreciate or understand that there were two
13 sales made to Sapphire. One was a sale of the Paso
14 Property. The other was the sale of AWG's wine inventory.
15 The parties agree that AWG sold its inventory to Sapphire.
16 Those assets remain in the hands of AWG until the sale.
17 The Paso Property, however, consistent with AWGs members'
18 internal discussions and the knowledge and approval of the
19 buyer, Sapphire, was distributed to Appellants and AWGs
20 other two members to allow them to make their own sale to
21 Sapphire and follow that with their own exchanges into
22 replacement properties, if they chose to do so.

23 Exchanges were intended early in their
24 discussions of the sale. And as you will hear from the
25 witness -- witnesses, no sale of any kind would have

1 occurred in the absence of making sure it was eligible for
2 Section 1031 deferral. Again, Respondent does not contest
3 that the form of the sale of the Paso Property was a sale
4 by Appellants. It argues, however, that in substance the
5 sale should be attributed to AWG.

6 Although the parties agree that a substance over
7 form analysis is the proper tool to determine the seller
8 for these purposes, such an analysis requires
9 consideration of all surrounding facts and circumstances.
10 Respondent has purposefully ignored several key facts and
11 documents to reach its desire to an erroneous conclusion.
12 Nowhere in its opening brief, its reply brief, or even its
13 prehearing conference statement does Respondent make a
14 single mention of the Seller Substitution Agreements
15 signed by Appellants and by Sapphire, the buyer, three days
16 prior to the signing of the Asset Purchase Agreement.

17 These agreements formally put Appellants into the
18 shoes of AWG for purposes of the sale of the Paso Property
19 prior to signing of any sale agreements. And those
20 agreements are located at Appellant's Exhibits 13
21 through 16. Respondent doesn't dispute the existence or
22 contents of these agreements signed by all parties. They
23 are concluded in the stipulation of facts, yet it does not
24 attempt to explain the relevance or effect in its analysis
25 of who was the actual seller.

1 Further, no mention can be found of the exchange
2 agreements Appellants signed to initiate the process for
3 handling their deferred exchanges, as required by
4 Section 1031. These agreements evidence not just their
5 intent and desire to enter into their own exchanges but
6 are actions to move that process forward. Again, all
7 happening before the date of the -- that the Asset
8 Purchase Agreement is signed. In its favor, Respondent
9 has not completely ignored the escrow instructions signed
10 by Appellants, AWG, and Sapphire, which also make clear
11 that the Paso Property sale is being made by Appellants.

12 But it's mentioned. It's limited to only the
13 first page, Respondent's Exhibit L. The one page that
14 deals only with mortgages and lease liabilities. The
15 remaining 59 pages of the instructions, which are included
16 as Appellant's Exhibit 18, address each of Appellants'
17 individual exchanges and ensure that the proceeds were
18 properly allocated between the inventory and the Paso
19 Property and that the proceeds from their individual sales
20 were placed directly into their accommodator's exchange
21 accounts.

22 These errors of omission by Respondent are not
23 simple oversights. Respondent's position can only succeed
24 in this case if a substance over form analysis is done on
25 an incomplete set of facts and ignoring of all the

1 documents, especially, those executed so closely in time
2 prior to the Asset Purchase Agreement. Appellants'
3 position on each of the facts and applicable law as it
4 applies to these facts is completely laid out and stated
5 most succinctly in their supplemental brief filed last
6 September. Rather than repeat its contents, I'll simply
7 say, as we sit here today equally as firmly on that
8 position, when all the facts are considered, the substance
9 is clearly shown.

10 AWG, Appellants, and AWG's other members,
11 Sapphire, the escrow officer, the exchange accommodator,
12 the title insurance company, all acted and reported
13 consistently throughout. There's no cross pollination in
14 this case where AWG received any portion of the sale or
15 proceeds from the Paso Property. There's no altering of
16 the transaction after the fact. There's no action taken
17 that is not completely aligned with the sale of the Paso
18 Property by Appellants for the interest it received by
19 only changing their form of its ownership, not by changing
20 any substance of their ownership.

21 In short, there was never a crystallized plan for
22 AWG to be the seller of the Paso Property of Sapphire.
23 From the outset, Appellants were not going to let that
24 happen. Appellants planned a drop and swap transaction of
25 the Paso Property and fully executed it.

1 There's a second issue involved here that
2 frankly, we do not understand. Respondent has argued that
3 even if Appellants are found to be the sellers of the Paso
4 Property for Section 1031 purposes, they must still report
5 income from AWG under an assignment of income theory.
6 Putting aside the questions of whether the assignment of
7 income doctrine can override the statutory requirements of
8 Section 1031 with the form of the transaction dictates its
9 tax consequence and whether the doctrine's principles
10 appropriately apply to flow-through entities, Appellants
11 do not understand how, if they are determined to have sold
12 the property for 1031 purposes, AWG would have any income
13 from that same sale that could be assigned to them.

14 As the sellers, Appellants received the sale
15 proceeds and realize the gains, not AWG. AWG is not the
16 seller. It has no income to assign. Further, we do not
17 understand how such an assignment would affect their 2007
18 tax returns even if Respondent's theory made sense.
19 Appellants cannot be required by Section 1031 to defer
20 their gain and, yet, the subject current tax on the exact
21 same dollars that Respondent asserts should be assigned to
22 them.

23 Any flow-through of additional income from AWG
24 not deferred would simply be double counting the same
25 dollars. There can only be one seller of the Paso

1 Property. The facts clearly establish this was the
2 Appellants. They are entitled to their claim of deferral
3 gain from their sales as valid tax-free exchanges or
4 tax-deferred exchanges under Section 1031.

5 And I think at this point we're going to ask Rudy
6 Silva to provide a little more information. Mr. Guterman
7 will be handling the bulk of the questions to Mr. Silva
8 for the benefit of the Reporter, so she knows who is
9 talking.

10 JUDGE LAMBERT: Okay. This is Judge Lambert. I
11 can swear in Mr. Silva.

12 Mr. Silva, can you please raise your right hand.

13

14 RUDY SILVA,

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

18

19 JUDGE LAMBERT: Thank you. Please proceed.

20 MR. GUTERMAN: Yes. This is Mr. Guterman who
21 will be doing a questioning of Mr. Silva.

22

23 DIRECT EXAMINATION

24 BY MR. GUTERMAN:

25 Q Mr. Silva, can you explain to the panel, and

1 state what your professional experience is?

2 A I'm a Certified Public Accountant licensed in
3 1962.

4 Q And --

5 A And I had practiced as a CPA the entire time.

6 Q Is it your own practice?

7 A I have a partner. My daughter is also a CPA.

8 Q How long did you know Frank Arciero, Sr.?

9 A I met Mr. Arciero about 1962. And since then,
10 I've been his outside CPA for all of his businesses.

11 Q Did you and Mr. Arciero, Frank, become good
12 friends?

13 A Yes. We were very good friends. I knew him very
14 well.

15 Q Did you see him on a regular basis?

16 A I would probably see him two to three times a
17 month, normally, in his office at Foothill Ranch. We
18 would meet for half an hour to 45 minutes to discuss
19 business, and then we would have lunch and continue.

20 Q Is it fair to say that you're the Arciero Family
21 tax adviser and accountant?

22 A Yes, it is fair to say that.

23 Q Which members of the family do you prepare the
24 tax returns or advise?

25 A All of the members, even the grandchildren of --

1 Q So you --

2 A -- of Mr. Frank Arciero, Sr.

3 Q So did you prepare the tax returns for Arciero
4 Wine Group?

5 A Yes, I did.

6 Q Arciero Winery and General Partnership?

7 A Yes.

8 Q For Arciero & Son, Inc.?

9 A Yes.

10 Q F.A.R. Investments, Inc.?

11 A Yes.

12 Q Frank Arciero, Sr.?

13 A Yes.

14 Q Frank Arciero, Jr.?

15 A Yes.

16 Q Philip Arciero?

17 A Yes.

18 Q Did you also prepare the tax returns for Kerry
19 Vix?

20 A No, I did not.

21 Q Okay. Did you advise Frank Arciero, Sr., or
22 other members of the family in a 1031 or like-kind
23 exchange transaction prior to the sale in 2007?

24 A Yes. We had entered into other 1031 exchanges, I
25 would say, three or four times before this one.

1 Q Were there any -- did any of those transactions
2 involve what we call a "drop and swap" transaction?

3 A There was one involved in a drop and swap on a
4 property in Lancaster that was owned by Arciero & Sons and
5 one in Roissy [sic].

6 Q And what happened in that transaction? Do you
7 recall?

8 A Yeah. It went through as a 1031 exchange.

9 MS. KUDUK: Hi. I'm sorry. We didn't -- we
10 weren't able to hear that last five minutes. The video or
11 the audio cut out. Can you please repeat that?

12 MR. SILVA: Repeat five minutes' worth?

13 MR. KAPLAN: The last five minutes?

14 MR. GUTERMAN: Five minutes?

15 JUDGE LAMBERT: Well, I had no problems hearing
16 the audio. But, FTB, you had problems with audio?

17 MS. KUDUK: Yeah, especially, 'cause he's
18 speaking down. So we can't even see what he's saying.

19 JUDGE LAMBERT: You're saying --

20 MS. KUDUK: So I'm sorry. I -- I could not hear
21 what he just said about --

22 JUDGE LAMBERT: Oh, like --

23 MS. KUDUK: -- from the drop and swap onward.

24 JUDGE LAMBERT: So speak up louder.

25 MR. SILVA: Yeah, I did a -- this is Mr. Silva.

1 I did a drop and swap for --

2 MS. KUDUK: Okay. Is it --

3 MR. SILVA: -- Arciero & Sons.

4 MS. KUDUK: Is it possible to look into the
5 camera, because I -- I don't see you, actually. Yeah, it
6 would be helpful if I could see what you're saying. Thank
7 you.

8 MR. KAPLAN: We'll spin him around.

9 MR. GUTERMAN: Yeah. Come over here.

10 MR. SILVA: Yeah, I did a drop and swap for
11 Mr. Arciero -- or Arciero & Sons and their partner
12 probably 10 years before this one on a property in
13 Lancaster, California.

14 BY MR. GUTERMAN:

15 Q Did there become a time in April or May of 2007
16 when you met with Frank Arciero, Sr., and discussed an
17 offer he received from Sapphire Advisors LLC?

18 A Yes, I did discuss that with Mr. Arciero.

19 Q And do you recall the nature of that
20 conversation? What was discussed?

21 A What I discussed is the potential tax in the
22 event that the sale was made by the LLC. Potentially,
23 federal and state tax would be a substantial amount.
24 Mr. Arciero would not have sold that property on that
25 basis. He hated paying taxes as many, many businesses do,

1 and he would not have written that check. I can guarantee
2 you.

3 Q Did you offer him a tax planning solution to --
4 to paying all those taxes?

5 A Well, I did mention the drop and swap again. And
6 I told him that was a way out, a way of deferring the tax
7 on this gain.

8 Q And what was his reaction to it?

9 A Well, he said that sounded like a plausible
10 solution.

11 Q And as a result of that, was he going to continue
12 the negotiations with possibly the Sapphire group?

13 A Yes, he said he would continue on that basis.

14 Q Did there come a time in mid-July of 2007 that
15 you participated in a discussion or a meeting involving
16 the sale -- the sale of the property and the winery?

17 A Yes. There was a meeting at the Arciero offices
18 with all of the partners of -- or members of the LLC
19 except for Youngs. They were all present. And we
20 discussed the 1031 exchange at that time and explained to
21 them how it works, and they all understood.

22 Q The president at that meeting was Frank
23 Arciero, Sr.?

24 A Kerry Vix.

25 Q And who is Mr. Vix?

1 A Mr. Vix was a general manager of the winery.

2 Q Did he own interest in Arciero Wine Group or
3 Arciero Winery, I should say?

4 A Yes. He owned a five-percent interest in the
5 Arciero Wine Group.

6 Q Do you recall at that meeting if the terms of the
7 sale to Sapphire Wines was fully negotiated at that time?

8 A I'm not sure if it was fully negotiated, but they
9 had gone a long way towards that.

10 Q Did you explain a like-kind exchange transactions
11 to the other members during that meeting?

12 A Yes, I did.

13 Q And had all the members -- were all the members
14 familiar with doing like-kind exchanges?

15 A No, they were not familiar with it. I think
16 Frank, Sr., was probably the only one at that meeting that
17 was familiar with that.

18 Q Did you explain to them how a drop and swap
19 transaction would save them taxes?

20 A Yes, I did. I explained that it would be a
21 deferred tax. It would eventually be payable when the
22 up-laid property was sold.

23 Q And did you discuss how that transaction had to
24 be structured?

25 A Yes, I did.

1 Q And what was the key -- do you recall the key
2 requirement?

3 A Well, the key requirement was that the property
4 had to be meted out to the individual members first before
5 it was transferred to the buyer.

6 Q So who had to be the sellers of the property?

7 A The sellers had to be the individual members.

8 Q And that was discussed during that meeting?

9 A Yes, it was.

10 Q Was there -- in the course of that meeting, was
11 there an agreement that they would -- that the individual
12 members would be willing to sell the property?

13 A There was an agreement, yes.

14 Q Did any of them indicate a consensus or that they
15 wish to also participate in 1031, a like-kind exchange?

16 A They all did. Youngs Market was not present
17 there. So I had no idea if they would do that or not.

18 Q What was your understanding of what -- at the end
19 of the meeting as to where the structuring or negotiations
20 of the sale had to proceed from there?

21 A Well, my understanding was that they had to
22 verify that the money was there, that the buyer had the
23 funds available to close the deal.

24 Q Did they want you to proceed with -- or so the
25 members could sell their -- a proportionate interest in

1 the property and do like-kind exchanges if they so choose?

2 A Yes, they did.

3 Q What did you do or after that meeting to
4 facilitate that transaction?

5 A Well, we prepared the exchange agreements and the
6 Seller Substitution Agreements for each member to sign and
7 for the buyer to sign.

8 Q Before that, did you have conversations or sent
9 e-mail correspondence to the attorney for the transaction
10 and advise him they were going to -- the individual
11 members were going to sell?

12 A Yes. I sent Jon Cantor, the attorney for Arciero
13 Group, an e-mail the very next day advising him of the
14 intent to do a 1031 exchange.

15 Q Who was the driving force or the decision maker
16 regarding the sale of property?

17 A Well, it would have been Frank, Sr. Without
18 Frank, Sr., the approval of the sale would not go through.

19 Q What did Frank -- and Frank, Sr., he would only
20 sell the -- if he was the seller of the property is the
21 only way the transaction would have gone through?

22 A That's correct.

23 Q Your implementation was first you spoke to Mr. --
24 you e-mailed Mr. Cantor and told him that he had -- you
25 were doing a 1031 exchange, and the members would be

1 selling the property; is that correct?

2 A That's correct, yes.

3 Q Did you read -- and the next thing was you
4 prepared an exchange agreement and the Seller Substitution
5 Agreements for each of the partners for Arciero and for
6 the two Appellants; is that correct?

7 A That's correct.

8 Q In doing so, did you reach out to Mr. Vix or
9 ascertain whether the buyers had agreed to this type -- to
10 do the individual selling of the property?

11 A They had agreed to do that. Yes.

12 Q And you knew that because?

13 A Because Mr. Vix told me that.

14 Q And did you need that information to complete the
15 Seller Substitution Agreements or the exchange agreement?

16 A I needed that for the seller substitution. And I
17 needed the name of the responsible party for the buyer,
18 which was Jeff Hopmayer, I believe.

19 Q And do you recall about when you received that?

20 A Not exactly, no.

21 Q If I showed you -- take a look at Exhibits 13,
22 14, 15, and 16. Exhibit 13, that's the seller
23 substitution, an exchange agreement involving Arciero &
24 Sons, Inc., and a company called CPA Exchange Corp. Who
25 is CPA Exchange Corp.?

1 A That was a company that was owned by another
2 party. I did not own it.

3 Q And what did it do?

4 A They just did 1031 exchanges.

5 Q It was called -- what's called a qualified -- act
6 as a qualified intermediary or an accommodator?

7 A That's correct.

8 Q Okay. So I ask you again, by looking at this
9 document, does it refresh your recollection as to when it
10 might have been signed?

11 A It was dated the 23rd of July. So it's probably
12 the date.

13 Q Okay. And I have you look at the Seller
14 Substitution Agreements, which is behind it. Who are the
15 parties that were selling it for this one particular one?

16 A True Sellers, Arciero & Sons, Inc.

17 Q And you thought you signed on behalf of CPA
18 Exchange Corp.?

19 A Correct.

20 Q And Mr. Hopmayer payer signed on behalf of
21 Sapphire Wines, LLC?

22 A That's correct.

23 Q And they signed it because?

24 A He was the, I guess, the managing member of that
25 LLC.

1 Q So is it fair to say at this point he knew that
2 Arciero & Sons was selling its interest in the Paso
3 Property to this company?

4 A Well, yeah. I mean, it's right next to his
5 signature. So I'm sure he knew that.

6 Q And he prepared each of these other agreements as
7 well, the one for Appellants?

8 A Yes.

9 Q Item Number 14. And you did also prepare the --
10 this is the seller substitution that you prepared?

11 A Yes.

12 Q And you prepared this after meeting with the
13 Arciero family in Tustin on or about mid-July?

14 A About a week later, yes.

15 Q What did you do with the agreements once you got
16 them signed?

17 A I gave a copy to the escrow officer handling the
18 sale. And her name was Frances Martin.

19 Q And did you discuss the nature of the transaction
20 with her?

21 A Yes, I did.

22 Q Did she --

23 A She understood that the sellers were going to be
24 the individual members of the LLC.

25 Q Did she have experience in documenting or

1 handling escrows involving, if you will, drop and swap
2 transactions?

3 A She said she had done them before, yes.

4 Q In addition to talking to Mr. Cantor, having him
5 execute exchange agreements and seller substitution of
6 these, were there anything else you did as part of this
7 exchange transaction and acting as an accommodator? For
8 example, did you open up bank accounts?

9 A Oh, yeah. We opened up individual bank accounts
10 for each seller in the name of CPA Exchange where the
11 funds were held at Pacific Western Bank.

12 Q Did you work regularly with the appeals
13 officer -- no, excuse me -- work regularly with the escrow
14 officer to move the transaction forward to document the
15 exchange transaction?

16 A Yes. I had many conversations with her.

17 Q And did you work on issues involving title or
18 anything like that?

19 A There weren't any issues involving title, that I
20 was aware of.

21 Q In addition to the sale of Paso Property, were
22 any assets -- other assets of Arciero Winery being sold?

23 A They were also selling the inventory and the
24 equipment.

25 Q They, meaning the --

1 A On a separate basis, yes.

2 Q And who was the seller of those assets?

3 A That was Arciero Wine Group, is the seller of
4 those assets.

5 Q Were you involved in the sale of those assets?

6 A No.

7 Q You were involved strictly within the context of
8 the sale of property; is that correct?

9 A That's correct.

10 Q Did you have an opportunity to review the escrow
11 instructions in the transaction?

12 A Yes.

13 Q In that regard, you're acting as qualified
14 intermediary; is that correct?

15 THE STENOGRAPHER: I'm sorry. I did not get an
16 answer to that last question.

17 MS. KUDUK: Yeah.

18 MR. SILVA: I said, "Yes."

19 MS. KUDUK: I'm also wondering if we could have
20 the witness look into the camera. It gets really muffled
21 when he's looking down, and I can't understand it either.
22 Sorry.

23 THE WITNESS: Okay. No problem.

24 MR. KUDUK: Thank you.

25 MR. GUTERMAN: You should understand that the

1 microphone is not where the camera is. The microphone is
2 right here. When he looks down, he's looking into the
3 microphone.

4 MR. KUDUK: Sorry.

5 JUDGE LAMBERT: Also, if anyone has technical
6 issues, try to bring them up as soon as possible, you
7 know, so we can address them right away. Thank you.

8 BY MR. GUTERMAN:

9 Q Do you recall when the sale of the Paso Property
10 was deeded from Arciero Wine Group to its members?

11 A I believe it's either the end of July or
12 beginning of August.

13 Q Okay. If I show you -- I think it's Exhibit 17.
14 I refer you to Exhibit 17. Is that the deed that you were
15 discussing?

16 A Yes, it is.

17 Q And see what date -- do recall or see the date
18 that it was signed on?

19 A It was dated July 30th, and it was notarized on
20 July 31st of '07.

21 Q Do you recall when the sale of the Paso Property
22 closed?

23 A I believe it closed the 3rd of August.

24 Q Okay. I'm referring you to Exhibit Number 20.
25 Does that look familiar? And what is that document?

1 That's the grant deed, and it's transferring the property
2 from the individual members to Sapphire Wines; is that
3 correct?

4 A That's correct, yes.

5 Q And can you see the date that it was recorded on
6 or signed?

7 A It was signed July 31st, 2007, recorded on
8 August 2nd, 2007.

9 Q So that would have been at the close of the
10 transaction; is that correct?

11 A Yes.

12 Q In conjunction with the closing of the sale, did
13 you receive any funds from the proceeds from the sale of
14 the property?

15 A Yes. All of the funds was received by the
16 exchange corporate and deposited in the exchange accounts
17 for each member.

18 Q And at that time you were acting as an
19 accommodator for who?

20 A For all of the members except Youngs Market or
21 Youngs Holding.

22 Q And what did you do with those funds?

23 A I --

24 Q Well, let me ask you this. What did you do with
25 Appellants' funds?

1 A They stayed in an account until they found their
2 replacement property, and then the monies were wired to
3 those escrows, and they acquired the uplands.

4 Q As you sit -- you were the accountant for Arciero
5 Wine Group; is that correct?

6 A Yes.

7 Q And do you prepare the tax returns for Arciero
8 Wine Group?

9 A Yes, I do.

10 Q I'd like us to go through how you went about
11 preparing the tax returns? Did you -- can you explain to
12 the panel how the sale was recorded in the general ledger
13 of Arciero Wine Group?

14 A Well, I made an adjusting journal entry that came
15 off of the escrow closing statement to record the sale and
16 also, to record the distribution of real estate to the
17 individual members. That adjusting entry was then posted
18 by the in-house accountant on the general ledger of the
19 Arciero Wine Group. And then from that general ledger, I
20 prepared the tax return.

21 Q So I ask you to look at Exhibit 19, which is the
22 Chicago Title final closing statement. Is this, when you
23 said you made the adjusting journal entry off the closing
24 statement, is this the document you were referring to?

25 A Yes, it is.

1 Q Are those your initials?

2 A Yeah, those are my notes.

3 Q And then you took this information. And now I
4 refer you to page 48 and 49 of Exhibit 5, which is your
5 declaration. Can you explain to the Judges what this is?

6 A Yeah. That is a journal entry that I prepared to
7 record the sale of assets and withdrawal of real estate
8 from partnership by members.

9 Q And does this tell you what date you reflected
10 the withdrawal of the property by the members?

11 A Well, the adjusting entry dated August 2nd, which
12 is the date of the sale.

13 Q But that was the sale, but did you -- so that's
14 the date you made the adjusting journal entry; is that
15 correct?

16 A Yes.

17 Q But the property was distributed out before that?

18 A Yes, that's correct.

19 Q Then after you did that, then next what did you
20 do?

21 A Well, then I waited for the in-house accountant
22 to record the journal entry on the general ledger so that
23 I could prepare the tax return.

24 Q And, again, I refer you to Exhibit 5 and probably
25 starting at page -- it's Exhibit 3 of Exhibit 5. Can you

1 tell the panel what this is?

2 A That's a balance sheet of Arciero Wine Group
3 dated July 31st, 2007.

4 Q And what does it show?

5 A It shows the assets and liabilities as of that
6 date.

7 Q Did their assets and liabilities include the
8 property?

9 A No, it did not.

10 Q So then effective July 31st this balance sheet
11 shows that the property had been distributed to the
12 members?

13 A That's correct.

14 Q And what's behind the balance sheet?

15 A The income statement of the Arciero Wine Group.

16 Q Again, as of July --

17 A 31st.

18 Q I'm referring you to Exhibit 4. What is that?

19 A That's the balance sheet as of August 31st, 2007.

20 Q And what does it reflect?

21 A It reflects that all the property is gone, the
22 land is gone. It still shows inventory, some cash.
23 That's about it.

24 Q How did you take this information and use it to
25 prepare the tax returns for Arciero Wine Group?

1 A Well, pretty much these numbers are reflected on
2 the final tax return or the year-end tax return.

3 Q And what did that year-end tax return for Arciero
4 Wine Group show?

5 A Well, it shows the distribution of the real
6 estate and the sale of the equipment and inventory by the
7 Arciero Wine Group.

8 Q Do you recall how the expenses related to the
9 property were recorded as a result of the sale between the
10 time that the property was deeded out and when it was sold
11 to Sapphire Wines?

12 A Yeah. They were paid by the Arciero Wine Group.
13 We didn't make a special calculation to figure how much of
14 that belonged to the individual members.

15 Q And when you say "they," you're referring to what
16 kind of expenses?

17 A Well, utilities, minor stuff.

18 Q I refer you back to the closing statement, which
19 is Exhibit 19. There are entries on the closing statement
20 related to proration of mortgage interest, expenses and
21 debt, title cost, property tax payoffs. How were these
22 expenses recorded?

23 A Well, those are all borne by the individual
24 members, not the LLC.

25 Q So Arciero Wine Group did not pay the prorations

1 through -- and from what date did the prorations were
2 effective as of?

3 A Well, they were effective as of the 2nd of
4 August.

5 Q But they started from what date?

6 A July 1st, 2007.

7 Q So the mortgage interest expense from July 1st
8 through August the 2nd was deducted from the Arciero --
9 the Appellant's share of the closing proceeds?

10 A Right. They were.

11 Q And were these other title charges -- were the
12 title charges deducted from the Appellant's share of the
13 closing statement?

14 A Yes, they're all deducted.

15 Q Okay. How about expenses related -- how about
16 payoffs related to the inventory?

17 A I don't see any payoffs related to the inventory.

18 Q But those would have been expenses that have been
19 recorded on --

20 A By the LLC, yes.

21 Q I refer you to Stipulation of Fact -- let me get
22 that -- in particular, the Stipulation of Fact Number
23 16. The Stipulation of Fact is how you recorded the
24 closing expenses on the books of Arciero Wine Group and
25 the Appellants. Take your time and take a look.

1 A So what's the question?

2 Q It would appear, and you had verified, that of
3 the \$4 million of the purchase price is allocated to the
4 inventory?

5 A And equipment.

6 Q And inventory?

7 A Yeah.

8 Q And that there were certain expenses taken off
9 though, deducted from the allocation to the inventory, and
10 the net sum that was paid to Arciero Wine Group was this
11 figure of \$99,400. Is that your understanding?

12 A Yes, it is.

13 Q Turn to the second part of the Stipulation which
14 is on page -- would you take a look at that?

15 A Yes.

16 Q Does that reflects your understanding as to how
17 the balance of expenses and prorations were used and
18 offset the proceeds to be paid to the Appellants?

19 A Yes.

20 MR. GUTERMAN: We have no further questions.
21 Thank you, Mr. Silva.

22 I would like at this time to call Frank Arciero
23 as a witness and seek his testimony.

24 Your Honor, do you want to swear him in?

25 JUDGE LAMBERT: Yes. Thanks.

1 Mr. Arciero, could you please raise your right
2 hand.

3
4 FRANK ARCIERO, JR.,
5 produced as a witness, and having been first duly sworn by
6 the Administrative Law Judge, was examined and testified
7 as follows:

8
9 JUDGE LAMBERT: Thank you.

10 MR. GUTERMAN: Again, it will be Mr. Guterman
11 doing the questioning and Mr. Frank Arciero will be
12 responding to the questions.

13
14 DIRECT EXAMINATION

15 BY MR. GUTERMAN:

16 Q What's your current position with Arciero & Sons?

17 A Currently I think I'm the secretary of
18 Arciero & Sons. And just to clarify I'm Frank Arciero,
19 Jr.

20 Q Jr. That is right. Frank Arciero, Jr. That's
21 true. And your position, Frank Jr. -- I guess your
22 nickname is Bush. Can I call you Bush for the purposes of
23 this questioning?

24 A That's fine.

25 Q What's your position with F.A.R. Investments,

1 Inc., now?

2 A I'm an officer there too. And I don't know
3 exactly, to be honest with you. I mean, it's the family
4 deal. So I think -- I think I'm secretary there also.

5 Q Okay. Then back in 2007 who was the president of
6 Arciero & Sons?

7 A In 2007 it would have been my dad Frank, Sr.

8 Q And with F.A.R. Investments, Inc., was it your
9 dad?

10 A Yes, sir.

11 Q Okay. I'd like to refer you to Respondent's
12 Exhibit E. It's a chart. It's an organizational chart.
13 Do you have it there before you?

14 A Yes, sir.

15 Q When I look at this chart, it looks like the
16 entire family is involved in these companies, except for
17 two; one individual and one company. And you said that --
18 who is Mr. Kerry Vix?

19 A Kerry Vix was the general manager of the winery.

20 Q Was he also a partner in Arciero Winery too?

21 A He was one of the members of the Arciero
22 Winery -- the Wine Group, yes.

23 Q Right. Right. So he had an interest in the
24 property as well?

25 A Yes, he did.

1 Q How did Youngs holdings become involved with the
2 Arciero family?

3 A I met Mr. Underwood, who was the president and
4 CEO of Youngs Market years ago. Right after, we were
5 looking for another distributor, because the distributor
6 we had just said they wanted -- they said they were going
7 to close their doors, and we needed to find another home.
8 And I happened to meet him through a friend of mine. And
9 from that day forward, I mean, we became very good friends
10 over the years, and sometime -- and I don't recall the
11 exact date.

12 But, I mean, at one time me and Kerry Vix got
13 together and talked about how are we going to grow the
14 case good sales for the winery. And I was in charge of
15 sales and marketing. And so we made a decision then to go
16 with Youngs Market. And through the years with Youngs
17 Market things were going fairly decent, but we needed to
18 grow a lot more rapidly than -- than what we anticipated.
19 And especially with my dad hammering down on us all the
20 time as to grow the business.

21 I approached Youngs Market and asked them if they
22 would like to be a partner hoping that if they said yeah,
23 that that would really help me expand the business. And
24 they said yes, and so we made an agreement. And we had --
25 you know, after that point, you know, had the attorneys

1 write up the agreement and stuff, and they became a
2 partner of ours.

3 Q So the formation for Arciero Wine Group was to
4 merge the property owned by the Arciero family with Youngs
5 in a joint enterprise at that point?

6 A That's correct.

7 Q And do you recall how much Arciero Wine Group you
8 owned -- the family owned collectively?

9 A Well, the family -- when you say the family, my
10 immediate family, which would be Arciero & Sons, which I'm
11 a stockholder and my brother is. And then F.A.R., which
12 is owned by the grandchildren as well as me and my
13 brother, and my dad was there. I think we probably owned
14 close to 75 percent, if I'm not mistaken, or more.

15 Q And did your Uncle Phil --

16 A I'm sorry.

17 Q Excuse me. And did your Uncle Phil own part of
18 it?

19 A Yes. My Uncle Phil, I think, owned 17 percent
20 plus or minus of the winery.

21 Q Could you take a few minutes and tell the panel
22 about your father, what he was like then and how he ran
23 the family and ran his businesses?

24 A Yes. My dad, I get emotional every time I talk
25 about it. But anyhow, long story short, he came from

1 Italy when he was 14 years old and lived in Detroit. And
2 by the time he was 18 him and my grandfather didn't get
3 along, so he moved out to California and went to work for
4 an Italian fella here building -- doing concrete, and then
5 decided to start his own company. He was kind of a
6 self-made man and built up a concrete company in Southern
7 California.

8 And then he decided during the late -- in the
9 60s, that he wanted to be an alfalfa farmer. So he bought
10 4,000 acres up in the High Desert. He farmed alfalfa, and
11 then he sold the ranches. And then after that he wanted
12 to build a winery. So he -- he was, you know, the head
13 honcho, if you want to say it. Everything went through
14 him. If he said no, then we didn't do anything. If he
15 said yes, then we all put our thoughts and hard work
16 together and did what he said. So he was kind of a
17 leader, you know, with the family business.

18 Q How was Arciero Wine Group managed? I mean, was
19 there weekly meetings? I mean, how were different family
20 members, such as yourself for example, involved in the
21 management of Arciero Wine Group?

22 A Okay. Well, in 19 -- I think it was the early
23 80s, '81. He bought land up in Paso Robles and decided he
24 wanted to build a winery. So we had a meeting, a family
25 meeting. And he just sat there and says okay, we're going

1 to build a winery. And he looked at his brother, my Uncle
2 Phil who was a year -- a couple years younger than my
3 dad -- and says, you're going to be in charge of the
4 construction.

5 And he looked at me and told me I'm going to be
6 in charge of sales and marketing, which I had no idea what
7 I was doing. So that's kind of how we started. And he
8 started planting grapes, and then the winery opened in
9 1984. So in about 1982 we started the groundbreaking to
10 build the winery to be able to make our own wines and
11 market it.

12 Q That history, is that the same property and the
13 same history that was contributed to the Arciero Wine
14 Group when you formed the business relationship with
15 Youngs?

16 A Yes, it is.

17 Q Did you and your father go on a regular basis to
18 the winery?

19 A Yes. My dad was up there in the beginning for
20 the first 10, 12 years maybe two days a week, and I would
21 go up one day a week every week. And then we would have
22 family meetings. When I say family, the family as well as
23 the department heads at the winery. We would have a
24 monthly meeting. And then Rudy Silva would also come up
25 with us.

1 And then my dad would go over all the issues that
2 he wanted to talk about in regard to cost, you know, why
3 are we not selling more wines. And that -- that happened
4 on a monthly basis. And then later on, I'd say probably
5 before he passed away in 2012, I say probably about in
6 2000, he started going up there three to four days a week.
7 He would be down here one day on Monday and then leave on
8 Tuesday morning to go up there and come back on Friday.

9 Q Directing your attention to 2007, was the winery
10 being marketed for sale?

11 A No. No. We never marketed the winery for sale.

12 Q Were there any discussions about selling them
13 independent -- ever discussions about selling the winery?

14 A No, not at all.

15 Q So there have been no discussion regarding
16 selling the market -- the winery. And so you got a phone
17 call from Jeffrey Hopmayer; is that correct?

18 A Kerry Vix got the phone call from Jeffrey
19 Hopmayer.

20 Q And then when -- okay. I'm sorry. Go ahead.

21 A So Kerry and me worked real close together. I
22 mean, just a side point is most of the people up there
23 were afraid of my dad. He was -- not because he was mean,
24 but he had that -- I mean, he had a very deep voice and
25 everything else. So people were kind of a little afraid

1 of him. Kerry after a while became -- you know,
2 understood. So anyhow, long story short, Kerry got a
3 phone call and called me and says, "I had a call that
4 somebody is interested in purchasing the winery."

5 And I says, "Well," I says, "You know what
6 Kerry," I says, "What you need to do is you need to try to
7 vet this guy to find out who he is, where he's from, and
8 if, in fact, he has the wherewithal to purchase it, even
9 if we thought about selling it. And then when you find
10 that out let me know, and we'll tell my dad and my uncle."

11 And that's kind of what happened. He vetted them
12 out and found out that there was an interest, that he had
13 the wherewithal to purchase it. So that's when we sat
14 down with Kerry and my dad up at the winery. And then we
15 had another couple of meetings up there and then the
16 subsequent meeting that we had in Tustin at our main
17 offices at that time.

18 Q And when you said, "meeting in Tustin," you're
19 talking about the meeting in mid-July of 2007?

20 A Yes.

21 Q And you were at that meeting?

22 A Yes, I was.

23 Q Do you recall what was discussed at that meeting?

24 A I -- I think the main thing that was discussed
25 was the fact that -- I think my dad asked the questions of

1 Rudy as to, you know, what are our liabilities if we do
2 sell and questions like that. And Rudy gave him the
3 explanation as to what would happen if we sold and stuff.
4 So at that point in time, my dad, you know, in his mind
5 told the family that, hey, if we're going to sell this,
6 we're not going to sell it unless we have an opportunity
7 to go buy another piece of property someplace. And if we
8 don't, then I'm going to squash the deal. I'm not going
9 to sell it.

10 I mean, his intent all the time was to keep that
11 winery in the family.

12 Q Did your father like paying taxes?

13 A Well, I mean, he paid taxes. I don't want to --
14 I don't want a bad, you know, image to go out here. But
15 no, he did not like -- he worked -- he worked his entire
16 life. Okay. And he -- every penny he made went towards
17 either improving his business or helping people out. And
18 he just didn't like giving money away to people, you know,
19 that weren't going to use it properly.

20 Q You heard during the hearing about Mr. Silva's
21 testimony at the July 27th meeting where we talked about
22 maybe the members having to sell the property to do a
23 like-kind exchange and the consequences of that. That's
24 something you wanted to participate in too? You thought
25 it was a good idea to participate in?

1 A Well, I mean, to be honest with you I had no say.
2 So, I mean, I went along with it only because that's what
3 my dad wanted, and we thought it was a good idea.

4 Q We're talking about the meeting in mid-July of
5 2007; correct?

6 A Yes, we are.

7 Q What was your involvement in the sale of the
8 winery after that meeting or even throughout the process?
9 How involved were you?

10 A I mean, I was involved. Every meeting that we
11 had, you know, I was involved with. But in regard to once
12 we knew that we were going to go forward with the deal and
13 have the partners sell their interest in the winery, you
14 know, I was just there to support my dad at the meetings.
15 So if there were any questions, you know, that he needed
16 answers in regard to what's going on with the winery and
17 stuff like that, I was there to answer them as well as
18 Kerry.

19 But I didn't have any -- how do you say it? I
20 wasn't directly involved to tell my dad, no, don't do it
21 or, yes, do it. He was going to do it, and we just needed
22 to go along with him.

23 Q And during this process, were you in
24 communication with Youngs Holdings about the sale?

25 A Well, I mentioned to Vern that there was an offer

1 for our part of the winery, and I just told him. And he
2 took it from there and turned it over to his people. And
3 I think Dennis Barnett or somebody from Youngs Market or
4 Youngs Holdings Company is the one that contacted Rudy and
5 then also probably contacted Kerry and talked to them.
6 But he wasn't in on a day-to-day basis, no.

7 Q Focusing your attention on the closing of the
8 sale. And, really, the period between the Tustin meeting
9 and when the transaction closed. Did anything come to
10 your attention or understanding that the property was
11 going -- the Paso Property was going to be sold -- was
12 going to be sold by AWG, Inc., entity?

13 A No. I'm sorry. I thought you got cut off. Go
14 ahead. One more time.

15 JUDGE LAMBERT: I think we have some reverb going
16 on. Is everyone muted?

17 MR. GUTERMAN: Is it from us?

18 JUDGE LAMBERT: It's gone now. Can you still
19 hear it? Okay. I think maybe it's gone. Thanks.

20 THE WITNESS: Okay.

21 MR. GUTERMAN: Maybe we need to move the
22 microphone.

23 BY MR. GUTERMAN:

24 Q During the period from mid-July 2007 to when the
25 transaction closed, do you recall any conversation or any

1 understandings or changes in the structure of the deal so
2 that Arciero Wine Group was going to be the seller of the
3 Paso Property?

4 A No. I mean, my understanding was that we had to
5 have each member of the LLC sell their interest. And
6 that's the way I had it from that time forward.

7 Q Is that because that's the way your father wanted
8 the deal done?

9 A That's the way he wanted the deal done, and we
10 went along with it.

11 Q "Them" being the individual members selling the
12 property; correct?

13 A That's correct.

14 MR. GUTERMAN: I have no further questions.

15 MR. ARCIERO: Okay.

16 MR. GUTERMAN: Thank you, Judge Lambert.

17 JUDGE LAMBERT: Okay. Thank you everyone and
18 Mr. Arciero and Mr. Silva.

19 We'll just take a 10-minute break now. So we'll
20 come back at 2:30, and while we're on break just mute your
21 microphones and stop your video. Thanks.

22 (There is a pause in the proceedings.)

23 JUDGE LAMBERT: We're going to go back on the
24 record now.

25 And we're going to ask -- give FTB the

1 opportunity to ask the witnesses questions. FTB, maybe
2 take 20 minutes, and then I'll check with the ALJs if they
3 have any questions, and then we can go back to you, if we
4 have some after that.

5 So please proceed with your questions of the
6 witnesses at this time. Thanks.

7 MR. GUTERMAN: Is the FTB speaking? I can't hear
8 them.

9 MS. KUDUK: Hi. Can you hear me now?

10 MR. GUTERMAN: Yes.

11 MS. KUDUK: Okay. Great. Yeah. My name is
12 Carolyn Kuduk, and I'm with the Franchise Tax Board. And
13 I just wanted to ask Mr. Silva and Mr. Arciero a couple of
14 questions, but first I think Mr. Silva. And I'll keep it
15 very brief. Okay.

16 MR. SILVA: Okay.

17 MS. KUDUK: The only thing I ask, Mr. Silva, is
18 for whatever reason your voice is slightly soft. So we're
19 having trouble hearing it. So if I ask you to repeat an
20 answer, please don't get offended.

21 MR. SILVA: Go ahead. I'll try to speak louder.

22 MS. KUDUK: Okay. Great. Thank you.

23 ///

24 ///

25 ///

1 CROSS-EXAMINATION

2 BY MS. KUDUK:

3 Q So you were the president of the CPA Exchange in
4 2007, is that correct, when this deal was done?

5 A Yes.

6 Q Okay.

7 A That is correct.

8 Q That is correct. So and then you -- would you
9 personally review the paperwork with the qualified
10 intermediary and Appellants signed, or would somebody else
11 review that paperwork?

12 A I don't understand the question.

13 Q As in your capacity as the president of CPA
14 Exchange, did you review the qualified intermediary
15 paperwork? Like --

16 A Yes, I did.

17 Q Yes. Okay. And so the exchange agreement is a
18 common agreement in a 1031 exchange; is that correct?

19 A Yes.

20 Q Okay. So probably every 1031 exchange needs to
21 have an exchange or agreement; is that correct?

22 A Yes.

23 Q Okay. And the Seller Substitution Agreement is
24 also common in any 1031 exchange; isn't that correct?

25 A In most of them, I think.

1 Q Okay.

2 A I've seen some done without it.

3 MS. KUDUK: Okay. Okay. Those were the only
4 couple of questions that I wanted to ask Mr. Silva. And
5 then I have one question for you, Mr. Arciero.

6

7

CROSS-EXAMINATION

8 BY MS. KUDUK:

9 Q So you testified that you were at the July 15th
10 meeting where -- where your father and Philip Arciero and
11 Kerry Vix met. Is that correct you were at that meeting?

12 A Yes, ma'am.

13 Q Okay. And then at that meeting you -- so the
14 partners and Arciero Winery and you, who was not a partner
15 in Arciero Winery, decided to accept Sapphire's offer and
16 to purchase the assets. And then you were going to divvy
17 up the Paso Robles Property in -- to do a 1031 exchange
18 via tenant-in-common interest; is that correct? So it was
19 at that time on July 15th you decided to accept the offer
20 and then distribute the property?

21 A Well, at that time it was -- the understanding
22 was the property was going to be distributed because of
23 the exchange. In regard to a final negotiation with
24 Sapphire, I don't -- to be honest with you, I don't recall
25 if we -- if that was the final say to say this is what the

1 amount was going to be and, you know, and talking about
2 opening the escrow and all that stuff, I don't recall
3 that.

4 Q Okay. But, certainly, by the time on July 27th,
5 when the Asset Purchase Agreement was signed, everything
6 was finalized; right?

7 A By the 27th, yes, because the escrow closed five
8 or six days later, seven days later. Something like that.

9 MS. KUDUK: Okay. All right. That was the only
10 three questions. I appreciated your testimony about your
11 father. That was -- that gave us a lot of insight into
12 your dad.

13 MR. ARCIERO: Thank you. I appreciate it.

14 MS. KUDUK: Okay. Thank you.

15 JUDGE LAMBERT: Okay. Thank you.

16 And now I'll turn to the panel to ask if they
17 have any questions of Appellants or the witnesses or
18 Mr. Guterman or Mr. Kaplan.

19 Judge Akin, do you have any questions?

20 JUDGE AKIN: Thank you. I do have a couple of
21 questions, and I'm not entirely sure who best to direct it
22 to. So let me ask the question, and Appellants can decide
23 who may be the best person to answer it. My first
24 question is, since you've made it clear that the
25 individual members intended to sell the Paso Property and

1 intended to do like-kind exchanges, I'm wondering why the
2 July 27th, 2007, Asset Purchase Agreement didn't reflect
3 them as sellers and instead reflected Arciero Winery Group
4 as the seller of everything, including the Paseo
5 Property -- the Paso Property.

6 MR. KAPLAN: Well, I think that if you look at
7 the -- if you look through the Asset Purchase Agreement,
8 you'll see that it is primarily concerned with the sale of
9 AWG's wine inventory. There's virtually nothing in there
10 related to the Paso Property. In everyone's mind, buyer,
11 sellers, whether it's the LLC members, or the LLC;
12 everyone understood that the property was not part of the
13 asset sale with respect to what AWG was doing. Everyone
14 knew that piece was already moved out.

15 And that's what the Seller Substitution
16 Agreements from three or four days before said. There
17 certainly wasn't anything that happened in that three to
18 four-day period in between those events to alter the terms
19 of the deal. And there's certainly -- you know, and
20 similarly there's nothing that happened in the four or
21 five days after the signing of the purchase -- the Asset
22 Purchase Agreement until the deal closed where everything
23 does, you know, reflect clearly that these are
24 tenant-in-common interest that were sold.

25 The deal didn't suddenly change back to

1 tenant-in-common interest. It was that way all the time.
2 The Asset Purchase Agreement deals almost exclusively with
3 the sale of the winery, and it appears to me that not a
4 great deal of attention was paid to that document. It
5 was -- it was not -- it was not as specific as it could
6 be. There are blanks in there for certain numbers. I
7 think there were still questions as to everything
8 regarding the wine inventory other than a \$4 million
9 figure applicable to that.

10 But it's just -- it dealt with the wine
11 inventory. And I think I'm speaking -- I should not
12 probably be the one to answer this, but Frank, Sr., is not
13 here to answer it. But I think in everyone's mind with
14 the Seller Substitution Agreements and the acknowledgment
15 of all the parties that with respect to eight -- the
16 tenants that the members stood in the shoes of AWG with
17 respect to the Paso Property.

18 So if AWG was signing an agreement, the part of
19 the agreement that related to the Paso Property was really
20 the members. The document does not make that as clear as
21 it could be.

22 MR. GUTERMAN: Barry Guterma speaking. If I
23 may, I have just one point. When you look at the Asset
24 Purchase Agreement, look at the fact in the initial
25 articles of that agreement. The purchase -- the amount in

1 consideration and when the consideration is to be paid for
2 the Paso Property is not mentioned. There's no closing
3 date mentioned. The signature page deals with an
4 agreement, a draft, that was done seven times earlier
5 where it referred to a purchase of partnership inter --
6 membership interest.

7 There was no real -- as much effort as they put
8 into that agreement, no one gave it any mind. It was the
9 inventory. If you want to ask, Mr. Arciero can answer to
10 it, even Mr. Silva. They didn't even spend any time but
11 looking at the agreement. No one gave it any time to that
12 agreement. That agreement dealt with the inventory. That
13 was something that attorneys had to deal with in terms of
14 representations and warranties. But that was the point of
15 that agreement. It's not in isolation. You have to take
16 all of it into account. And all of the accounts shows a
17 bifurcated sale; sale of inventory and other assets, for
18 inventory and a sale of the Paso Property by the
19 individuals.

20 JUDGE AKIN: Okay.

21 MR. KAPLAN: And I think -- I think to a great
22 extent -- this is -- this is Mr. Kaplan speaking. And
23 again, I apologize for stepping on your toes, Judge Akin.

24 I think that -- that the transaction, although,
25 it involves a large amount of money, is not terribly

1 complex. Once you agree upon a value for the property,
2 the paperwork is the paperwork. It will get done. And
3 once you agree on the valuation of the inventory, it gets
4 done. And what the agreement is concerned with primarily
5 is what are the checks and balances on determining the
6 value of the inventory, in case once title is transferred
7 to that, are adjustments in that purchase price going to
8 need to be made.

9 But it's not a terribly complex transaction. The
10 property, here's how much. Fine. Move it over there.
11 What's left? We got the inventory. That's more of a
12 moving target just in terms of trying to determine its
13 true value because it -- it fluctuates. I mean, the
14 business was still operating. There was -- what is in the
15 inventory today may not be in the inventory tomorrow.
16 Things when title transfers, we thought we had, you know,
17 100 cases here. It turns out they've all gone bad. So
18 they're going to be taken out of -- you know, that's where
19 adjustments would be made.

20 But it's not a terribly complicated transaction,
21 and it's not all that surprising that nobody paid quite as
22 much attention to the documents, you know, as consequence
23 of that. And I think what Mr. Guterma n pointed out, if
24 you look at the signature page, it talks about the sale of
25 an interest. It doesn't talk about the sale of -- you

1 know, it's -- it's language that came from the original
2 draft, which was always related to -- you know, it flowed
3 from the original offer, which was for the membership
4 interest of AWG.

5 JUDGE AKIN: Okay. Thank you. That does answer
6 my question. I did have one additional question which
7 is -- so the grant deed that conveyed the tenant-in-common
8 interest in the Paso Property to the individual members.
9 Looking at it, it was dated July 30th. But then it looks
10 like it was notarized on July 31st, 2007, but was not
11 recorded until August 2nd, 2007. I guess I'm just
12 wondering why the delay in recording it.

13 MR. SILVA: No -- no reason that I can think of.
14 It was given to the escrow officer when it was signed.

15 MR. GUTERMAN: Were there any instruction to
16 withhold recording it?

17 MR. SILVA: No. We did not ask her to withhold
18 recording.

19 MR. KAPLAN: I'm not sure what day of the week.

20 MR. GUTERMAN: It's the middle of the week.

21 MR. KAPLAN: Let's see. The 2nd of August in
22 2007 was a Thursday. So I guess that means the 31st was
23 Tuesday, so two days later.

24 JUDGE AKIN: Okay. Thank you. That answers my
25 questions, and I don't have any additional questions at

1 this time.

2 JUDGE LAMBERT: Thank you, Judge Akin.

3 Judge Le, do you have any questions?

4 JUDGE LE: This is Judge Le. I have no questions
5 for Appellant's rep at this time.

6 JUDGE LAMBERT: Okay. Thanks.

7 I think I have a couple of questions. And maybe
8 it's related to what you already, so you don't have to
9 repeat what you already said. But you were stating that
10 their sales agreement was a sale of assets. When I look
11 at it, I can see that there's attachments stating what
12 assets were included. There are buildings included there.
13 So I'm not sure. Maybe you could point to how we can make
14 it clear that, like, your argument that this is a
15 bifurcated sale.

16 You know, when I look at the Seller Substitution
17 Agreement, I can see how it's facilitating the 1031
18 exchange, but it doesn't look like, necessarily, a sales
19 agreement between, you know, Sapphire and the parties. So
20 can you please just comment on those issues, maybe explain
21 how it's bifurcated and what evidence we have about that.

22 MR. GUTERMAN: So Barry Guterman speaking. When
23 we make the reference to bifurcated, we meant that there
24 are two different -- two set of sellers. One was the
25 seller of the -- the entity was the seller of the

1 inventory, and the individual members were the seller of
2 the Paseo [sic] Property. But you can't look at the Asset
3 Purchase Agreement and the Sellers Exchange Agreement
4 necessarily, it was a combined package. It reflects two
5 transactions going along on the same track moving in the
6 same -- in the same direction but with different sellers.
7 That's what we mean by the bifurcation.

8 There were different sellers. The asset -- the
9 seller of the inventory was different than the seller of
10 the real property. True, there are representations of
11 the -- in warranties. That was buyer's representative
12 knew about the bifurcated sale. It seems to me the buyers
13 entered with the one that was controlling the drafts of
14 the agreement. If they were concerned about who was
15 making representations and warranties, it would have been
16 to buyer's own counsel to, you know, to make adjustments.

17 It's clear that the buyers' attorney, we weren't
18 drafting this. The Appellants weren't drafting these
19 agreements. It was the buyers. We were making comments,
20 but it doesn't reflect an exclusion. It reflects that
21 there are two different -- two type -- two sales going on
22 at the same time that are closing at the same time. And,
23 again, that's evident by the seller closing -- escrow sale
24 closing instructions. It reflects the separate interest
25 of the entity and the Appellants.

1 If you look at it closely, first to the entity
2 Arciero Wine Group as the seller. It refers to the
3 individuals dealing with the property as the exchangers.
4 It takes into consideration of \$23,750,000 and allocates
5 it into two buckets. One bucket, \$4 million for the
6 industry. Another bucket, the \$19,750,000 to other assets
7 in the Paseo [sic] Property. Deductions and prorated
8 expenses are attributable to the inventory, is allocated
9 to the \$4 million of consideration that was set forth in
10 the agreement for the inventory.

11 The \$500,000 holdback came out of the entities'
12 portion of the proceeds. It didn't come out of the
13 seller -- the members' portion of the proceeds. What did
14 the members pay -- bear in the expenses? They bear the
15 property tax prorations. They bear the lien, FCA West
16 Mortgage, the interest proration through the date of
17 closing. They paid for the title insurance. They paid
18 for escrow insurance. They paid all those costs,
19 including -- Mr. Silva can confirm it -- including the
20 cost of the accommodator out of their proceeds before it
21 was divided up amongst the five owners.

22 It reflects two transactions going along on
23 parallel tracks closing at the same time. And that's why
24 I called it -- why we refer to it as a bifurcated sale.

25 JUDGE LAMBERT: Thank you, Mr. Guterman. I had a

1 couple of other questions. FTB's argued that intent is
2 not reflect to this matter that is at issue on the true
3 seller or substance versus form. And I know that your
4 arguments have involved around intent as well. And could
5 you please address that and also provide any authorities
6 or anything we should know regarding intent and its
7 relevance to this matter of substance. Thanks.

8 MR. KAPLAN: Mr. Kaplan speaking. I think
9 that -- I mean, Appellant certainly agreed that whether --
10 whether you intend to do a like-kind exchange or not does
11 not mean whether you have. Intending to do is a great
12 thing. It's not going to happen unless you intend to, but
13 the fact that intention alone is not there. You know,
14 it's not there to take you over the finish line. If you
15 go back to *Magneson*, which is the keystone case for
16 Section 1031, it deals with -- directly deals with the
17 question of intent in holding a piece of property.

18 It takes a piece of property and says if you
19 merely change the form in which you hold that property,
20 hasn't increased in value, decreased in value. It is
21 still the same identical owner who simply changes it from
22 this form to that form. The intent in holding that
23 property, the intent to hold it for investment or use in a
24 trade or business does not change. It carries over. It
25 is not possible to have the intent in holding the property

1 carry over if the ownership of the property doesn't carry
2 over.

3 It makes -- it simply makes no sense. Magneson
4 cannot mean, oh, if you change the form, you're okay. But
5 you changed the way you held it, so you now have a
6 different party and 1031 does not apply. That, to my mind
7 is an egregious misreading of Magneson, and it simply does
8 not make sense to me.

9 The -- you have to take certain steps to
10 effectuate a like-kind exchange. It's purposeful. There
11 are things that need to be done. You cannot mistakenly
12 engage in a 1031 transaction. Business considerations
13 dictate when certain things can happen in that stream of
14 events. Franchise Tax Board has always expressed its
15 concern the things that happened right before the closing
16 should not count because benefits and burdens didn't pass.
17 Again, I go back to Magneson that, of course, the benefits
18 and burdens passed because it's the same owner. Nothing
19 has changed other than the form in which the property is
20 held.

21 So I'm not sure if I'm answering your question
22 completely, but I -- I -- I think that the question of
23 intent in the sense of did you intend to hold the property
24 for investment is what's paramount, whereas the -- I would
25 readily agree that the intent to do a like-kind exchange

1 gets you part of the way there, because you have to had
2 the intent, but it does not -- you know, I'll readily
3 acknowledge that that doesn't mean you've met all the
4 requirements just because you intended to.

5 I think here they did meet all the requirements.
6 And, again, I think going to your question about the
7 meaning or what is or isn't in the July 27th Asset
8 Purchase Agreement, and that it is not as clear as it
9 could be. I think what's much more unclear is what do you
10 do with the Seller Substitution Agreements that each of
11 the members of AWG signed, that Sapphire the buyer signed
12 acknowledging that it was aware of and approved of the
13 fact that the Paso Property is going to be bought from the
14 members. There's nothing in the Asset Purchase Agreement
15 other than its -- its boilerplate language that -- that
16 indicates that the parties changed the deal somehow.

17 I mean, we've heard, you know, from both
18 Mr. Silva and Mr. Arciero. This deal was not going to
19 happen with the sale of the property by AWG. It just
20 wasn't going to happen. No one was interested in selling
21 the winery and -- until there was a knock on the door, and
22 they received an offer too good to refuse. They thought,
23 okay, if we're going to sell, how do we -- how do we do
24 this? Well, I'm not going to sell it if I've got to pay,
25 you know, 30, 40 percent of it in tax. If there's a way

1 to do this without, you know, without incurring that
2 immediate cost, that's what we'll do.

3 Mr. Silva reminds Mr. Arciero, Sr. You remember
4 1031. It defers the tax. You don't pay it today. You
5 can reinvest the entire amount of proceeds in similar
6 property. You can buy other property. And that's what
7 they chose to do, and what every step that everyone took
8 was towards that -- that goal. And -- and I see nothing
9 in the July 27th agreement that -- that somehow overrides
10 every other fact and document and action that took place
11 that clearly indicates everybody knew what was going on.

12 JUDGE LAMBERT: Thank you, Mr. Kaplan. I just
13 have one more question, and it is kind of related to what
14 we've talked about. But, you know, there's multiple
15 individuals here, you know, Mr. Arciero, Jr., you know,
16 and Mr. Kaplan. They were owners or worked for all the
17 entities involved. So I guess, you know, there's always a
18 question of when you're negotiating it's hard to tell if
19 you're negotiating on behalf of AWG or maybe F.A.R.
20 Investments. And maybe you can say these exchange
21 agreements, you know, kind of show that -- you know, I'm
22 sure you would say that kind of per evidence that there
23 was some -- something going on in these e-mails.

24 At the same time, we have the sales agreement,
25 the sale from AWG to Sapphire. First, it was from the

1 partnership. Then it was changed to be to the LLC. And I
2 was -- I wonder if there's anything else we could point
3 to. You know, we don't have an agreement, I don't think,
4 that mentioned what was originally planned according to
5 Mr. Silva that they were going to sell the members'
6 interest. So is there anything else that we could look to
7 kind of know -- have evidence that the members were being
8 negotiated for, or that they were part of the
9 negotiations?

10 MR. KAPLAN: I mean, I think -- this is
11 Mr. Kaplan talking. I think the simple answer to that
12 is -- and we've asked ourselves throughout, you know, this
13 very lengthy process. This transaction was 14 years ago.
14 You need to know what happened in a situation like this
15 where -- where there is an overlap. The person who is
16 directing AWG is also directing each of the Appellants.
17 So you need to know which hat is he wearing when
18 negotiations are going on.

19 Legitimate question. Sometimes you just don't
20 know and it's confusing. There's no confusion here. You
21 know that he is negotiating on behalf of himself with
22 respect to his tenant-in-common interest, not with respect
23 to trying to sell AWG. That was never going to happen.
24 What hat Frank Jr. was wearing was never -- never in
25 doubt.

1 MR. GUTERMAN: Senior. Excuse me.

2 MR. KAPLAN: I mean, it's -- it's -- if you -- if
3 you look at the case and, you know, most closely analogous
4 with this, which has been discussed, you know, at great
5 length in the briefs, Appeal of Mitchell. That is a case
6 where there is a very legitimate question as to which hat
7 is the general partner wearing. Is -- is he representing
8 the partnership in the sale of that piece of property, or
9 is he representing the partnership and one of the partners
10 with respect to their slice of the bill.

11 Much more difficult question than what we have
12 here. And, yet, even with that difficulty, Office of Tax
13 Appeals determined that the negotiation was equally on
14 behalf of the individual, because the individual had
15 always made it crystal clear, I'm not going to agree to
16 this unless it's done -- unless I'm allowed to have it
17 structured as a tax-deferred exchange. And I think that's
18 exactly -- I mean, it's so much clearer here as to what
19 hat was being worn. But it's a very legitimate question.

20 MR. GUTERMAN: Judge Lambert, may I add one point
21 to that. This is Mr. Guterma speaking. For the Asset
22 Purchase Agreement, to have -- to be given the weight that
23 the Respondent wants, you'd have to go back from saying --
24 from the beginning. Frank Arciero, Sr., had in its mind
25 the way the transaction is going to be done, and that's

1 the way it proceeded. And there's an oops, I'm going to
2 go ahead and do everything that I wanted to do and undo it
3 by signing an Asset Purchase Agreement that makes my
4 company the seller. That wouldn't -- that makes no sense.

5 And then after the fact they do an escrow sale of
6 instructions that reflects the different interest.

7 There's a clear point from point A all the way through,
8 there's a clear intent and an action by the individuals to
9 effectuate separate sales. You can go from the -- before
10 anything is signed or written off, there's discussions.
11 These are not discussions that are happening just before
12 its closing. These are discussions that went on before
13 anything was finalized.

14 MR. KAPLAN: Discussions wouldn't happen.

15 MR. GUTERMAN: It wouldn't have gone -- and you
16 heard from Frank Arciero, Jr. talk about his father. You
17 heard from Mr. Silva and his relationship. This
18 transaction could only go one way. The parties didn't
19 make an oops and go ahead and have the company sign it.
20 And who goes ahead and signs the purchase agreement
21 thinking it's going to involve their sale, when they don't
22 even put in the purchase price for the -- for the asset
23 and don't even demand and say when the purchase price for
24 the assets to be paid.

25 Look at those blanks. Those are just not little

1 blanks about missing a date. Look in Article I. There's
2 a huge blank where it talks about the payment of the
3 purchase price for the property. There isn't. You only
4 get that in the sales agreement -- in the sale and escrow
5 instructions words to find. And what do you get? You get
6 the fact that \$4 million had been allocated indicated to
7 the inventory and everything else got allocated to the
8 property.

9 Okay. That's a continual through. It's like if
10 you -- one of my guesses, I'd call it maybe a speed bump
11 or something or mistake, you know. But it's the attorneys
12 who are involved in it, it's not the clients. And again,
13 the attorneys who are drafting this are buyers' attorneys.
14 And it's not -- none is giving any effect. There's nobody
15 in this transaction, other than maybe counsel doing a poor
16 job of documenting, that understood anything different.

17 Everyone understood the individuals were selling
18 it. There's nothing inconsistent with that. There's no
19 single fact other than an execution of a poorly drafted
20 document that caused issues -- that may cause one to pause
21 in understanding it. Thank you.

22 MR. KAPLAN: I think if I can jump in for one
23 last comment on this. This is Mr. Kaplan again.

24 I think there's an irony into -- into the
25 question and the issue because we start in the normal 1031

1 disputes. You start with the issue of you meet the form,
2 you didn't meet the substance. We need to look at the
3 substance. Look at everything that happened, not just the
4 document that can say whatever it wants to say, but we
5 need to look at everything. If you look at everything
6 here, there is one piece that does not fit perfectly into
7 the jigsaw puzzle. It's the Asset Purchase Agreement.

8 If the Asset Purchase Agreement obliterates all
9 the other facts and circumstances, all the other
10 documents, suddenly you've just elevated -- now we're back
11 to form trumps substance. It turns it completely on its
12 ear. It's necessary to look at everything. Look at the
13 story. Look at the actions, and look at all of the
14 documents. Where did the money go? Why are they opening
15 exchange accountants? Why did the escrow, you know, the
16 instructions say what they say?

17 It's all -- you know, the things that mattered
18 were done correctly. Oddly enough, the thing that
19 mattered the least was the actual sale agreement. But you
20 cannot elevate a single form to override all the fact and
21 circumstances. The irony of doing that in a substance
22 over form analysis is ironic.

23 JUDGE LAMBERT: Okay. Thank you, Mr. Kaplan and
24 Mr. Guterman. I appreciate it. And, of course,
25 Mr. Arciero Jr. And Mr. Silva, thank you so much for

1 making your presentation and answering the questions.

2 Now, let's go to FTB. And Ms. Mosnier and
3 Ms. Kuduk, you'll have 60 minutes to give your
4 presentation. You may proceed when you're ready. Thanks.

5

6 PRESENTATION

7 MS. MOSNIER: Okay. Great. Thank you.

8 Good afternoon. This is Marguerite Mosnier for
9 FTB.

10 And I think one thing that Franchise Tax Board
11 certainly agrees with the Appellants about is what
12 happened matters. So in this case, the Appellants have
13 not established that they made IRC Section 1031(a)(1)
14 requirements. And they can't, because they are not the
15 true seller or what we call the sellers in substance of
16 the property. So let's talk about what happened here.

17 The stipulated facts tell us that AWG was the
18 owner of the Paso Robles Property since 1999, that in
19 May 2007 AWG received an offer to purchase the property
20 and the business assets for \$20 million. That's in Kerry
21 Vix's declaration and the e-mail, the May 2007 e-mail he
22 forwarded to the partners is in the record in several
23 places. One of them would be Exhibit 6.

24 And, you know, for the numbered exhibits, the
25 individual page numbers in each exhibit are not numbered.

1 But what's been marked as from the PDF copy of the
2 Appellant's reply brief that has all those exhibits
3 attached. And so I can give you -- because this is a
4 500-page document -- I can give you PDF pages for ease of
5 reference because I think OTA sent that document to FTB.
6 So I presume you are working with the same PDF pages. So
7 you'll see that on Exhibit 6, PDF page 160.

8 And then what also happened is there was a
9 meeting in mid-July, partner meeting in Fountain Valley,
10 and sounds like AWG is good. Sell the property. And they
11 would like their attorney, Jon Cantor, to revise the
12 contract regarding the Section 1031 transactions. On
13 July 23rd, the tenant-in-common holders, who are not yet
14 tenant-in-common holders, signed Seller Substitution
15 Agreements. Four days later on July 27th, AWG, as the
16 sole seller, signed a contract to sell both the real
17 property and inventory, and I think some equipment,
18 personal property, for almost \$24 million.

19 We know from Mr. Arciero Jr.'s declaration that
20 almost \$20 million of that amount was allocated to the
21 real property, to the Paso Robles Property. On July 30th,
22 AWG signed a tenant -- signed a deed granting
23 tenant-in-common or TIC interest to the one actual owner
24 of AWG, which was Youngs Holdings Incorporated, and then
25 to, quote, "the owners" of the other owner of AWG. AWG

1 was not owned directly by the Appellants.

2 And I would like to -- if the technology will
3 help me this time -- share with you -- let's see. Okay.
4 Share. I would like to show you -- do you see a power
5 point slide on your screens? Thumbs up anybody? Yes?
6 Okay. Thank you.

7 This is the property that is the subject of the
8 appeal. It was owned 100 percent by AWG an LLC. In turn
9 the LLC was owned in round numbers 9 or 10 percent by
10 Youngs Holdings, a corporation, and by a partnership,
11 Arciero Winery. Arciero Winery in turn was owned by Kerry
12 Vix, Philip Arciero, and our two Appellants, Arciero &
13 Sons, Incorporated, and F.A.R. Investments. So the TIC
14 deed from AWG down here, did not go to the owners of
15 Arciero -- it did not go to its owner, Arciero Winery.

16 It went right through the winery to the four
17 holders partnership partners of Arciero Winery. And then
18 the last TIC interest was granted directly to the
19 approximate 9 percent owner, Youngs Holdings. So that was
20 the structure.

21 Okay. I'm going to stop sharing here if I can
22 figure out how to do that. Oh, wait. Hang on. How do I
23 get out of this? I know this is -- this is it. Okay.
24 Here. Oh, thank you. I know. This is it right here.
25 Sorry. I'm working on getting back to -- okay. Just a

1 minute here. Where are options? I don't know how to. --

2 JUDGE LAMBERT: If I could interject for a
3 second, I don't --

4 MS. MOSNIER: Yes, please.

5 JUDGE LAMBERT: We didn't discuss previously that
6 we'd have a power point presentation, and I'm not sure
7 what is going to be in these slides.

8 MS. MOSNIER: That was it.

9 JUDGE LAMBERT: Okay.

10 MS. MOSNIER: It was just a visual of the
11 structure that is set out in the -- in the thing. But I
12 tell you, honestly, the problem I'm having is I can't get
13 back to the big screen to get out of the -- to get out
14 my -- of this -- of the power point.

15 JUDGE LAMBERT: It's in upper right-hand corner.

16 MS. MOSNIER: That's what everybody says. Ah,
17 here we go. No. It's right here. Okay. Share. Thank
18 you. Stop sharing. Yes, thank you.

19 JUDGE LAMBERT: I just want to make sure that --

20 MS. MOSNIER: I apologize for that -- yes, my
21 understanding was that -- that FTB had communicated, was
22 talking to OTA about that. And I apologize that --

23 JUDGE LAMBERT: Okay.

24 MS. MOSNIER: -- it wasn't -- that you didn't
25 know ahead of time. I just thought the visuals would be

1 easy to understand facts that were not at issue. There
2 are no new facts. There's no argument presented there.

3 JUDGE LAMBERT: Okay. I just want to make sure
4 Appellants have the opportunity to be aware of anything
5 beforehand, or if they have any objections or disagree
6 with the information. That's all.

7 MS. MOSNIER: Okay. If you would, like, right
8 now to check with them if they disagree with the
9 information shown, that was shown on these power points,
10 that's just fine.

11 MR. KAPLAN: This is Mr. Kaplan speaking. From
12 what I could see on the screen, it did not look like we
13 had anything that we would object to. It looks very
14 similar, if not identical, although more nicely drawn up
15 and in color, the organizational chart that's already in
16 the record. No one has ever disputed who owns what and
17 how the -- how the family tree spreads.

18 JUDGE LAMBERT: Okay. Thank you.

19 MR. KAPLAN: I have no reason to believe that
20 what was just shown to us is -- is not exactly what is
21 correct. So --

22 MS. MOSNIER: Right.

23 JUDGE LAMBERT: Thanks.

24 Ms. Mosnier, please proceed.

25 MS. MOSNIER: Okay. Thank you.

1 See on July 31st, AWG had a TIC deed, a grant
2 deed deeding interest in the Paso Robles Property to the
3 owners of Arciero Winery and to Youngs Holdings. That
4 deed wasn't recorded until August 2nd. So into escrow all
5 \$24 million come in, and all 20 of it was allocated to the
6 real property. Although, the Appellants argue that at
7 this point the Asset Purchase Agreement was almost
8 something we really shouldn't pay attention to, it was a
9 document that solidified a \$24 million contract.

10 It was the contract that was the subject several
11 months later after escrow closed of state court
12 litigation, not having to do with the real property, with
13 other assets that were sold. So I will say that the
14 parties, in particularly Arciero Wine Group, which was the
15 plaintiff in the state court action -- and that
16 information in our briefs. And Arciero Wine Group did
17 rely on the Asset Purchase Agreement as a final document.
18 Paragraph 7.8 of that agreement indicates that it is the
19 entire agreement.

20 And page -- in the description of assets that are
21 conveyed pursuant to the Asset Purchase Agreement is the
22 assignment of AWG's lease-hold interest in a singular
23 cellular tower that's located on the real property. Now,
24 under my understanding of real property law, that would be
25 considered a fixture. You wouldn't just sign your

1 lease-hold interest in that contract, unless you were, in
2 fact, conveying the real property on which that fixture
3 was located.

4 The list of inventory and assets attached as
5 schedules to the Asset Purchase Agreement, also includes,
6 as you know to Judge Lambert, buildings and including, I
7 presume, the winery building. Again, those are fixtures.
8 If they were not -- if the real property were not conveyed
9 through that agreement, there's no other agreement that
10 has been put into the record pursuant to which anyone, any
11 entity, or individual, sold that property to the
12 purchaser.

13 So we have more or less a swap and drop. Usually
14 with a swap and drop, you see the property dropped
15 directly from an entity to its owner, not to an owner of
16 an owner. But this follows, generally, a drop-and-swap
17 fact pattern. So to defer gain under Section 1031 of the
18 Internal Revenue Code, you have to show three things. You
19 have to show that you meet the exchange requirement, which
20 is that the same taxpayer must relinquish the property and
21 acquire replacement property. You have to meet the
22 holding requirement, which is that the property must be
23 held for investment or productive use of business. And
24 you have to meet the like-kind requirement that you have
25 exchanged property for like-kind property.

1 We agree with the Appellants that the holding
2 requirement and the like-kind requirement are not at
3 issue, only the exchange requirement. Whether the same
4 taxpayer relinquished the Paso Robles Property and
5 purchase replacement property has been satisfied, on that
6 issue the taxpayer has the burden of proof. So they -- it
7 is not on FTB to show that the Appellants were not -- were
8 the true sellers of the property. It is on the Appellants
9 to show, in fact, that they were.

10 And they have that burden because the issue of
11 who the true seller is an issue of fact. And we know that
12 from Bolker versus Commissioner and from Waltham Netoco
13 Theatres versus Commissioner, First Circuit case. And
14 this gets us to the general concept of taxation. We
15 agreed with Appellants that taxation follows the substance
16 not the form. In some cases, the substance is the same as
17 the form. It was in this case. Let's start with the U.S.
18 Supreme Court case, Court Holding versus Commissioner, all
19 the way back to 1945, I think.

20 In that case the court refined the concept of the
21 substance over form doctrine. You determine who the
22 seller in substance is. In that case, a corporation
23 negotiated to sell its property, determined it would have
24 pretty high tax consequence if it did so. And that might
25 sound familiar. And so it decided to liquidate,

1 distribute the property to the owners, to its
2 shareholders, and let them complete the purchase. And so
3 that's what they did.

4 The Internal Revenue Service said no corporation.
5 You're the true seller. You bear the -- you negotiated
6 the contract. There was nothing left for the shareholders
7 to do but put their deeds into escrow. And, you know, the
8 U.S. Supreme Court agreed with them and said, yes, you
9 follow the substance not the form. You may have one form
10 of legal document, but the substance of the transaction is
11 what dictates the tax consequence.

12 We know from Chase versus Commissioner and from
13 Appeal of Brookfield Manor that the seller in substance
14 doctrine applies in 1031 transactions. And you always
15 have to determine that first before you reach the other
16 requirements. Because until you know who the real seller
17 is, you wouldn't know who to analyze, for example, to see
18 if they had met the holding requirement. And so the
19 Appellants are not the true sellers or sellers in
20 substance under cold holding -- excuse me -- Court
21 Holding, Chase versus Commissioner, Bolker versus
22 Commissioner, Brookfield Manor, or under a
23 non-precedential opinion, FTB cited in its reply brief,
24 Giurbino, Appeal of Giurbino.

25 So I'd like to start with -- we discussed Court

1 Holding. And in that case the court considered the
2 following in its determination that the sale was really a
3 sale by the corporation rather than an exchange or a sale,
4 frankly, by the shareholders. The court considered the
5 terms of the sale between the shareholders and the
6 purchaser were substantial the same as the terms between
7 the corporation and the purchaser. The court also
8 considered the short time period between the transfer of
9 assets of the property to the shareholders and their
10 subsequent transfer to the purchaser.

11 So let's apply those to this case. Appellants
12 are not even listed as sellers in the Asset Purchase
13 Agreement. And I believe it was Mr. Vix's declaration --
14 in one of the declarations, the declarant stated that
15 there were many, many drafts of this agreement. In other
16 words, there were many opportunities to identify
17 Appellants and the other TIC holders as sellers. And they
18 didn't do that. There were less than two days between the
19 transfer of the tenant-in-common interest to Appellants
20 and their transfer to the purchaser.

21 And when they were recorded, when those deeds
22 were recorded, there was less than one minute between the
23 recording of the tenant-in-common deed to Appellants and
24 other TIC holders and the recording of the deed from the
25 TIC holders to the purchaser. Under a Court Holding

1 analysis, AWG and not Appellants was the true seller.
2 Years later in -- or about five years later in Cumberland,
3 the U.S. Supreme Court went the other way and said, no,
4 really, these shareholders, they are the true holders.

5 And let us tell you why. Let us tell you why
6 it's not like Court Holding. Because in Court Holding --
7 because in Cumberland the power company, Cumberland Power
8 Company couldn't compete against a rival offered to sell
9 assets. The purchaser wasn't interested. So Cumberland
10 just dissolved. It didn't have anything left to do. It
11 dissolved, and it distributed the assets to the
12 shareholders who subsequently independently negotiated
13 their own contract with that same entity, the same
14 purchaser, and completed the sale.

15 And the Supreme Court said, well, look at that.
16 The entity dissolved having nothing to do with the sale.
17 They simply decided to dissolve and distributed the
18 assets. There was independent negotiation by the new
19 owners of the property with the purchaser. So when we
20 apply those facts and that analysis to the facts of this
21 case, they don't meet the standards of Cumberland to be
22 determined a true seller.

23 And we'll move forward to Bolker versus
24 Commissioner 1983 case. There are two opinions: The
25 first at the Tax Court level; the second at the Ninth

1 Circuit level. In the Tax Court judge considered both the
2 exchange requirement, whether Mr. Bolker himself was the
3 true seller and the holding requirement, whether he held
4 the property for investment or for profit in a business,
5 and held that Mr. Bolker had satisfied both requirements.

6 On appeal to the Ninth Circuit, only the holding
7 requirement was at issue. And in that -- in the Ninth
8 Circuit case, in the Ninth Circuit opinion, and in
9 Magneson also, the court discussed what Mr. Kaplan, what
10 Counsel has alluded to, as a reason to determine that the
11 Appellants are the true sellers, and that is that there's
12 no change in economic position. It's merely a change in
13 the form of ownership. And that is what the court said in
14 Ninth Circuit in Bolker, and it's what the court said in
15 Magneson. But that has to do with the holding
16 requirement.

17 We have a stipulated fact that the holding
18 requirement is not at issue in this case. So the Ninth
19 Circuit Bolker decision and Magneson are simply not
20 applicable to this appeal. I will note that in Giurbino
21 Opinion, the non-precedential opinion by the Board of
22 Equalization and very similar facts in Giurbino, the Board
23 of Equalization said Magneson and Maloney, they were not
24 relevant to an exchange requirement analysis.

25 Let's move on to Chase versus Commissioner, a

1 1989 Tax Court case. The facts in this appeal are
2 remarkably similar to the facts in Chase versus
3 Commissioner. An entity signed a sales contract, even
4 though it was the taxpayer who was an owner of that
5 entity, signed in his capacity as an owner of the entity
6 and not individually, received a TIC distribution early.
7 And that sale fell through, but he held on to, never
8 recorded. Several months later found another buyer. The
9 entity found another buyer. The entity signed the sales
10 agreement. And when he knew that escrow would close, he
11 recorded his deed, and the property was transferred.

12 When the Chase court -- when the Tax Court looked
13 at that transaction, the court said that the substance
14 over form doctrine, when it is a fiction and it does not
15 reflect the economic realities of the transaction, we're
16 going to disregard it. So the economic reality in Chase
17 was that the entity, the partnership owned the building,
18 the partnership signed the sales agreement, and only when
19 there was no risk, the partnership acted like the owner
20 for months, the time period that Mr. Chase held the deed
21 but did not record it, he did not act as an owner.

22 He didn't collect rents. He wasn't responsible
23 to pay cost. He didn't notify whoever the lien holder
24 was, the insurance companies. He acted just as a partner
25 in a partnership, and the entity continued to behave as

1 the owner. Only when it was clear that escrow would close
2 that he did record the deed. In fact, in that case, the
3 Tax Court said -- and this is instructed -- petitioner's
4 final argument regarding the substance issue is that the
5 general parties acted as their agents, as the taxpayer's
6 agent in negotiating the disposition of the property.

7 This, they say, explains why they did not appear
8 individually as parties in most of the documents to the
9 transaction. We find petitioner's argument in this regard
10 both self-serving and unsupported by the record. And the
11 record shows us that there were many drafts, three at
12 least, including the one that was signed of the Asset
13 Purchase Agreement in the record. There was ample
14 opportunity for Appellants to be named as sellers, and
15 they weren't. There was an opportunity for them to
16 negotiate their own sale, and they didn't. They sold the
17 property pursuant to the terms set out in the Asset
18 Purchase Agreement.

19 Under a Chase analysis, AWG and not Appellants
20 are the true sellers. That's also true in the press -- if
21 you look at the analysis in the precedential decision in
22 the Appeal of Brookfield Manor, Brookfield owned and
23 operated a mobile home park, started negotiations to sell,
24 setup an escrow, listed itself as seller, and then
25 decided, wow, that would be an expensive tax bill. So it

1 substituted its shareholders in escrow as the seller, and
2 dissolved, distributed the property. And shortly after it
3 did so, the shareholders completed the sales transaction.

4 When the Franchise Tax Board determined that
5 Appeal of Brookfield was the true seller, we ended up
6 before the Board of Equalization, the Office of Tax
7 Appeals' predecessor, which said, gee, we start with court
8 holding, and we need to look at the substance over form
9 doctrine. The Board of Equalization said -- look to see
10 was the sale -- whose terms was the sale completed on?
11 Was there any new negotiations? And the answer was no.
12 It was completed on the same terms that the corporation
13 had negotiated for.

14 In this case, there are no other terms in the
15 record. There's no evidence of any agreement independent
16 of the Asset Purchase Agreement by which the real
17 property, the Paso Robles Property, would be conveyed to
18 the purchaser. Under a Brookfield Manor analysis, AWG and
19 not Appellants are the true seller. And then I touched
20 just for a minute on the Giurbino Opinion. FTB has --
21 it's a non-precedential opinion, much the way that
22 Mitchell is.

23 Although, FTB believes that the Office of Tax
24 Appeals should not follow the majority opinion in
25 Mitchell, that any opinion where three ALJs could not

1 agree on the application of the law to the facts of that
2 case, is not an appropriate opinion to follow for an
3 analysis and application for the fact of this case.
4 Additionally, that opinion rested on certain specific
5 factual determinations that have not been made in this
6 appeal.

7 What we do see is that in the Appeal of Giurbino,
8 very similar fact pattern. Entity negotiated to sell the
9 property. There was -- there were tenant-in-common
10 interest that were granted to the taxpayers, and they
11 completed a sale. And the Board of Equalization said,
12 well, we start with Court Holding and under the facts that
13 the sale that was complete was started by Giurbino, that
14 the terms were the same, that there was no recording of
15 the Appellant's interest until shortly before escrow
16 closed. Those all indicate that the substance of the
17 transaction was a sale by the entity, not an exchange by
18 the entity's owners.

19 And BOE went on to analyze this case under an
20 assignment of income doctrine. And I will get to that in
21 just a minute in a little more detail. But I will note
22 that the Board of Equalization in Giurbino said two
23 things. First, it said that the Giurbinos were not the
24 true seller, that the LLC was. And second, it said that
25 because the entity was the true seller, that there had

1 also been a prohibited assignment of income. So if you
2 were to follow -- and the FTB would urge that the OTA
3 follow the analysis in Giurbino and apply it to this case.
4 And if you follow that, you would determine that AWG and
5 not the Appellants were the true sellers of the property.

6 We would also note that with respect to testimony
7 and declarations that were submitted in this appeal, we
8 would point out the number of years between the
9 transaction, which occurred in 2007, the declarations in
10 the record, which were submitted in 2019 and we are two
11 years after that, this is a long time since the
12 transaction, the conversations occurred. The fact that
13 self-serving statements may be made now should be
14 considered when analyzing this case.

15 And I would like to go then to the assignment of
16 income doctrine. And I think this doctrine can be used
17 two ways. The first is as a means to determine who the
18 true seller is. And secondly, as simply a standalone
19 doctrine. Which if the entity is determined to have made
20 an improper assignment of income, then you have to think
21 that from a tax perspective, all the income is assigned to
22 the entity. And then there's no income in the hands of
23 the entities' owners that could be deferred from gain from
24 recognition taxation.

25 So as far as back as 1930 in the U.S. Supreme

1 Court Lucas v. Earl -- we are probably all familiar with
2 it -- the case that says that income has to be attributed
3 to the person who earned the income. And notably that
4 the, quote, "The fruits of that could not attributed to a
5 different tree from that on which they grew."

6 In Salvatore, which were both -- there are two
7 opinions of the Tax Court and, I think, it's the First
8 Circuit -- is really the case we look to when we're
9 talking about assignment of income. In that case
10 Mrs. Salvatore, who owned a gas station, was considering
11 an offer to sell it. And she met with her children -- her
12 adult children, and they agreed this is a good sale. Try
13 to negotiate a good deal and to ameliorate tax
14 consequences if she alone were the seller and had to
15 report all the gain.

16 They agreed to distribute -- she agreed -- they
17 agreed she would distribute a 50 percent interest in the
18 property to among her children. Shortly after that a
19 contract was negotiated and signed. And anywhere from a
20 few hours to two days before escrow closed, she deeded
21 interest to her children, who then conveyed to the
22 purchaser.

23 And the court said, well, wait a minute. Who had
24 title to the property when the contract was sold -- or
25 excuse me -- when the contract was signed? Well,

1 Mrs. Salvatore did. And the court noted, well, her kids
2 had no interest in the property at all. And let's stop
3 right there and think about the facts in this case. On
4 July 23rd, 2007, the Appellants and Mr. Vix and Philip
5 Arciero signed seller substitution agreements -- exchange
6 agreements and seller substitution documents. I think
7 they are Exhibits 13 through 16 in the record.

8 As of the date those documents were signed, no
9 one signing them had any interest in the Paso Robles
10 Property. It was owned only by AWG on July 23rd until
11 July 31st when the deed conveying the interest in the
12 property were delivered to the tenant-in-common holders,
13 the TIC holders. It would not have been until then that
14 those documents would have had any meaning. So from a
15 practical and legal standpoint, you have to consider that
16 those documents were meaningless until July 31st, which
17 was four days after the property was -- the sale for
18 the -- contract for the sale of the property was signed.

19 So Salvatore would tell us that AWG made an
20 improper anticipatory assignment of income for all of the
21 tenant-in-common holders. And then when you look at
22 Giurbino, Giurbino tell us the very same thing. When the
23 entity has negotiated a sale and subsequently deeds out
24 interest in the property that is to be sold, it has made
25 an anticipatory assignment of income that is prohibited.

1 So AWG owned the property. It contracted to sell
2 it. And from a tax perspective 1031 and assignment of
3 income, respective, it did not meet the standards. AW --
4 ASI and F.A.R. Investment did not meet the standards to be
5 considered sellers. And so we end where we started, which
6 is with the U.S. Supreme Court, which required FTB and now
7 requires the OTA to determine who the true seller of the
8 property was.

9 As the Supreme Court noted in the Moline
10 Properties way back in 1943, taxpayers, like Appellants,
11 who choose to structure their business affairs with
12 entities and receive advantages that are offered by the
13 entities, must also accept the disadvantages of their
14 entities. In this case, Appellants chose to structure
15 their business affairs with an LLC, a general partnership,
16 and corporations. And they were free to do so. The LLC,
17 which was AWG owned the real property and sold it. And
18 the tax consequences must follow the substance of that
19 transaction.

20 Thank you.

21 JUDGE LAMBERT: Thank you, Ms. Mosnier.

22 At this time, then, we'll take a break for 10
23 minutes.

24 We'll go off the record now. Please turn off
25 your monitor and mute. We'll be back at 3:55.

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

Thanks.

(There is a pause in the proceedings.)

JUDGE LAMBERT: All right. We'll go back on the record now.

And at this time, I'm going to turn to the panel and ask if they have any questions for FTB.

So, Judge Akin, do you have any questions?

JUDGE AKIN: Judge Akin speaking. I don't have any questions for Franchise Tax Board at this time.

JUDGE LAMBERT: Thanks.

And, Judge Le, do you have any questions?

JUDGE LE: This is Judge Le. I have a few questions. My first one is whether FTB believes in form whether Appellants are the seller of the property?

MS. MOSNIER: In form?

JUDGE LE: Yeah.

MS. MOSNIER: Well, yes. I think in terms in form means that, you know, the legal documentation, then yes.

JUDGE LE: Okay.

MS. MOSNIER: And I think that's one reason the Court Holding and its progeny are important because it sets out the difference between what happens legally and what happens from a tax perspective, that they don't always line up. And they didn't in this case.

1 MS. KUDUK: Well, I would say that the form -- I
2 mean, the -- the Asset Purchase Agreement was the contract
3 that sold the Paso Robles Property. Because it -- through
4 the Asset Purchase Agreement, property was distributed.

5 THE STENOGRAPHER: I'm sorry. Ms. Kuduk, can you
6 please get closer to the mic? I cannot hear you. Thank
7 you.

8 MS. KUDUK: Sure. The buildings --

9 JUDGE LAMBERT: Also, Appellants, maybe Mr.
10 Kaplan and Mr. Guterman, maybe you could mute your
11 microphone to see if that could help. Thanks.

12 MS. KUDUK: Hi. Are we all settled now? Okay.

13 So the buildings were part of the fixtures that
14 were sold in the Asset Purchase Agreement. The lease
15 where the cellular tower that was located on the property
16 was also transferred through that Asset Purchase
17 Agreement, and AWG signed that agreement. So this is a
18 little different than Court Holding because here the
19 entity signed the contract. So in that regard the form
20 and the substance are the same.

21 I think what Marguerite is talking about is that
22 the TIC deeds were transferred on -- on the 31st, right
23 after the purchase agreement was signed and then recorded
24 on August 2nd, and a minute later that they were recorded
25 to being transferred to Sapphire. So I mean, I think

1 according to state law because that minute the TIC holders
2 had the property, and then it was transferred. But it's
3 clear that AWG signed the contract. They signed the
4 instrument that transferred the property.

5 JUDGE LE: Thank you. I have no further
6 questions.

7 MS. KUDUK: Okay. Thank you.

8 JUDGE LAMBERT: Okay. Okay. I guess, yeah,
9 let's see if I have any questions. So did you just say
10 that you think that the sellers are Appellants because of
11 the deeds? Or what was -- can you clarify that, because
12 that was something maybe you could explain.

13 MS. KUDUK: So I think under state property law
14 the person who holds the deed and transfers the property
15 is the seller, right. But that's not the case for tax
16 law.

17 JUDGE LAMBERT: Okay.

18 MS. MOSNIER: Right. If it were, for example, we
19 wouldn't have Court Holding. Because we would say, well,
20 the sellers weren't the shareholders. They were the one
21 who conveyed the deed to the purchaser. And, in fact,
22 they were the ones who conveyed the deed to the purchaser.

23 MS. KUDUK: But only for a minute.

24 MS. MOSNIER: Well, I'm talking --

25 JUDGE LAMBERT: Okay.

1 MS. MOSNIER: -- like -- and so right. That from
2 a tax perspective, the U.S. Supreme Court said, well, no.
3 You're not the seller for tax purposes, that the
4 shareholders were not. You may be were the sellers for
5 purposes of conveying legal title to the property, but you
6 were not the sellers for tax purposes. It's a really
7 important distinction that Court Holding and its progeny
8 make.

9 JUDGE LAMBERT: Okay. Thank you. I guess then
10 that's interesting that you say that. So moving on -- on
11 this assignment of income theory, I guess, are you saying
12 that the tax result would be the same if AWG has to
13 recognize the gain, and it would flow down? The
14 Appellants were mentioning something that would cause
15 double taxation. Maybe you could address these issues,
16 because I'm not sure how much legal authority there is out
17 there of applying assignment of income to 1031 exchanges.
18 So maybe could you just address, like, Appellants'
19 arguments on that matter, please?

20 MS. MOSNIER: It was addressed by the Board of
21 Equalization in the Giurbino Opinion. That was a failed
22 1031 transaction. And the Board of Equalization said both
23 that the entity was the true seller and that there had
24 been a prohibited assignment of income. So there -- you
25 know, there -- as I noted, it's not a precedential

1 opinion. Although, we feel the facts are similar to the
2 facts in this appeal and that the analysis is spot on
3 under law concerning 1031s.

4 And so under -- assignment of income probably
5 historically was used as it was in Court Holding to tag
6 the entity the seller -- that the entity that distributed
7 the property with the tax consequences. So but it's two
8 sides of the same coin. Because if for tax purposes, the
9 entity made a prohibited assignment of income, then it was
10 the seller of the property if it has to recognize --
11 realize and recognize all the income.

12 And if that's the case, if it is the seller under
13 an assignment of income theory, then the owners -- the
14 technical legal owners of the property who deeded it to
15 the purchaser cannot be the, quote, "true sellers" under a
16 1031 analysis.

17 JUDGE LAMBERT: Thanks. And there's, like, some
18 cases I think was discussed in the briefing a little bit,
19 like Ferguson and whether it has to be a fixed right to
20 incomes. Would you say in this case when they -- when
21 that agreement was signed, it became a fixed right to
22 receive the income?

23 MS. KUDUK: I believe when the offer was
24 accepted, which would have been July 15th, around there,
25 when they all met and said, we're accepting this offer,

1 and then we're going to distribute the property. I -- I
2 think that that was the actual date when the offer was
3 accepted and then -- but, I mean, as you read these
4 assignment of income cases, it could also be the July 27th
5 date when the agreement was signed. That's why I made it
6 very clear when I asked Mr. Arciero, "When did you agree
7 to sell the property?"

8 JUDGE LAMBERT: And what if the deal doesn't go
9 through, you know? You know, they liquidated damages.
10 Anything could happen. So is it really fixed, or is it
11 just an expectation?

12 MS. MOSNIER: Well, I think contract law would
13 govern there if you have a fully executed contract. If a
14 party to the contract doesn't meet its obligations, then
15 there are rights and remedies under the law. So I think
16 in that way, yes, it is fixed.

17 MS. KUDUK: The assignment of income isn't only
18 used in property to determine property. It's also used in
19 gifts and trust law. So I would think it's the
20 anticipation of income. So when, you know, whether or not
21 they've received that income maybe is a moot point in this
22 case because they did receive it. The contract did go
23 through.

24 JUDGE LAMBERT: Okay. And I just noticed these
25 expenses that AWG paid for during this small period of

1 time. I think if you allocate it to three days, it's only
2 like \$2,000. And, you know, in the briefs it was
3 discussed that, you know, they took these benefits and
4 risks of the property because they paid these different
5 expenses. Do you think it matters that the amount is very
6 low? And, you know, like in the Appellants' briefs, you
7 know, its' kind of like very minimal and so small, maybe
8 it's not really material. Could you address, like,
9 whether the fact it's only \$2,000, you know, has an effect
10 on that point.

11 MS. MOSNIER: I don't think that the -- I don't
12 think that the amount matters, Judge. I think what, for
13 example, what the Chase court looked at was who acted as
14 the owner. And whether you were the owner for two days,
15 two weeks, or two months, you are still the owner.
16 Someone slipped and fell. You could be sued. So it is
17 incumbent on the owners then to behave as owners.

18 And I'm glad that you asked that question because
19 one thing I forgot to mention earlier is I think there's a
20 distinction between owning up to the fact of ownership and
21 taking responsibility to pay these expenses up front,
22 rather than reimbursing someone else on the back end
23 through escrow. AWG was evidently reimbursed for these
24 costs. That's different from never having had to pay them
25 to start with. Do you see what I mean?

1 Technically, if it was a cost that ran with
2 ownership by AWG, then it was born by AWG and simply
3 reimbursed in the escrow. I think that's a -- it's a very
4 fine distinction, but I do think it's an important one.

5 MS. KUDUK: Maybe it would be the principle of
6 the matter, right, who -- AWG really operated and owned
7 this property until the day it was sold.

8 JUDGE LAMBERT: Okay. Thanks. Let me think if I
9 have one more question. Oh, I think, Ms. Kuduk, you
10 mentioned that -- you asked the witnesses if the Seller
11 Substitution Agreements were common. And maybe -- did you
12 want to, like, elaborate on that? Do you think that they
13 don't outweigh the sales agreement that's signed by AWG,
14 you know, whereas the Appellants kind of argue that -- are
15 arguing that there's bifurcated contracts here? Maybe
16 could you -- if you could elaborate, I mean, would you do
17 that? Or, Ms. Mosnier, you could do it too. Thanks.

18 MS. KUDUK: I'm on mute. Sorry. So I think it's
19 important that the Seller Substitution Agreements were
20 common in 1031 exchange, and I -- they were not an
21 amendment to the Asset Purchase Agreement. And they were
22 assigned for -- when this ASI and F.A.R. didn't even have
23 title to the property. So they were technically not a
24 contract. They could not really contract something they
25 didn't have. So I don't think it's very relevant to show

1 who the true seller was.

2 JUDGE LAMBERT: Okay. Thanks. I think that's
3 all the questions I have for now.

4 So let's allow Appellants to give their closing
5 remarks for 10 minutes, and you can address FTB's remarks
6 or say whatever you want to say to conclude your
7 presentation. Thanks.

8

9

CLOSING STATEMENT

10

MR. KAPLAN: Thank you, Your Honor.

11

12

13

14

15

16

17

18

19

20

21

22

I do have a few comments about the FTB's
presentation. Before i get into the specifics, there were
a couple of comments made that are more general that would
apply to more than this case that I find very troubling.
First, I'm now being educated that only unanimous opinions
from the Office of Tax Appeals should be looked at and
used as any kind of guidance for future -- for future
decisions, that a two to one decision as you found in
Mitchell should simply be ignored because it was not
unanimous. That's an interesting notion to me and
something, I guess, for the Judges to think about in the
future.

23

24

25

The second sort of overall general comment is the
seeming attack on the witness' memory. To hear testimony
from 2 people who have waited 14 years to be here to

1 provide it, and then say it should be discounted because
2 it can't be trusted due to the passage of time, is also
3 troubling to me.

4 The fact of the matter is that all of this
5 information has been in the hands of the Franchise Tax
6 Board since the very outset of the audit. There's nothing
7 new that has been presented. There have been no facts
8 that has been refuted. There is nothing that was heard
9 today that is inconsistent with what has been told to the
10 Franchise Tax Board from day one. The story hasn't
11 changed.

12 Is it possible that over time memory diminishes,
13 and you can't quite remember with -- with the level of
14 specificity you could, you know, as opposed to something
15 that happened yesterday? Absolutely. But here we have a
16 number of touchstones in time where this information
17 continually is being presented to the Franchise Tax Board
18 and has continually been consistent and was continually
19 consistent today. So the notion of attacking a witness'
20 testimony because it relates to events that happened a
21 long time ago is bothersome to me.

22 The -- I won't take the time to address the
23 multitude of cases that were mentioned by the Respondent.
24 All of those have been addressed fully in the briefs that
25 we filed. In each case there may be one or two exceptions

1 to this, but I think we're in agreement with the holdings
2 with every one of the cases cited. We think they were
3 cited correctly. We also recognize they were cited on
4 their own facts. Facts which are not facts. Close to
5 what we have here today.

6 A number of those cases involve two parties. One
7 is a corporation. One is a shareholder. The economics of
8 the determination of who owns something is significant
9 when you got the two -- the two tax obligations of the
10 corporation and its shareholder. It is less so when you
11 have flow-through entities where the economics are -- are
12 essentially identical. The reliance on Giurbino, which
13 seem to be mentioned more than any other case, is strange
14 to me. I think a lot of things about this case is strange
15 to me, but that's -- that's one of the strangest.

16 The facts in Giurbino are an LLC sold a property,
17 and the LLC reported itself that the sale was its own and
18 was a taxable sale. There was an individual member -- I
19 don't remember if it was a membership, an LLC, or
20 partnership. But one flow-through investor in Giurbino
21 filed their own tax return, inconsistent with what the
22 partnership had reported on the K-1 and claimed that it
23 received the proceeds from the sale of its
24 tenancy-in-common agreement.

25 This is not our case. This is but another in a

1 long line of cases where parties are playing different
2 games. And Giurbino is one of the most abusive in the
3 sense that the entity reported the transaction. How do
4 you report something inconsistent with -- with how the
5 entity reported? You're obligated to report it the same
6 way. So the notion that -- that there's anything in that
7 case that has any relevance here is -- is an odd one to
8 me.

9 Again, the case that is most like this one is
10 Appeal of Mitchell. The fact that only two judges out of
11 the three decided in favor of upholding the claimed
12 exchange treatment, well, it would have been nice to have
13 had a unanimous decision. Maybe it would have been
14 precedential. Although, the more I thought about it, the
15 more I realize it shouldn't be precedential because it's
16 based on facts. It doesn't create new law. It simply
17 applies to existing law to the particular set of facts
18 presented there. The same as this case does.

19 This case is not about the drop and swap. Is
20 this allowable? Is it not allowable? This is simply a
21 factual determination under the law us using the substance
22 over form analysis, which we heard at length from,
23 Respondent, as if Appellants did not agree that that was
24 the proper test. The descent in Mitchell, which is really
25 what, you know, the Respondent was hoping for. If you

1 read the descent, I personally disagree with it, but I
2 think it's at least well-reasoned.

3 They key difficulty that Judge Rosas had in the
4 descent was the fact that the buyer never knew of the
5 existence of one of the -- of Ms. Mitchell. At no point
6 did she enter into the negotiations. She was just not --
7 she was not a player. She had no influence over the
8 transaction in any way shape or form. All she did was
9 inform the general partner; I want to do a 1031 with my
10 portion of the property. She had no ability to stop the
11 transaction, if that wasn't going to happen as would
12 happen here.

13 The general partner accommodated her.
14 Distributed out a tenancy-in-common interest, and that
15 little slice was transferred, was sold along with the
16 remaining interest still held by the partnership. It was
17 bothersome to Judge Rosas that the buyer did not know who
18 they were buying from, that Ms. Mitchell was not a part of
19 the negotiations. Was nowhere. Was just not a player in
20 the transaction at all. And yet even two of the three
21 judges decided that all the requirements of the 1031 were
22 met, and the concerns of Judge Rosas disappeared when
23 looked at the facts in this case.

24 The buyer knew who they were buying from. Even
25 if you agree -- which I strongly do not -- that the Seller

1 Substitution Agreement should not be given any effect at
2 all because it resigned at a time that they couldn't be
3 effective. What they were effective for at an absolute
4 minimum, is informing the buyer who they were acquiring
5 the property from. Whether it turns out at the end of the
6 day, oops, nope. It's not from them. It's from AWG.
7 It's irrelevant. The buyers knew it was the
8 tenancy-in-common.

9 The tenants-in-common did all the negotiations
10 for this transaction. There is no difference between the
11 tenant-in-common off to the side and what the general
12 partner is doing. This is Frank Arciero, Sr., who is
13 saying this is the deal I will agree to. If we can do
14 this deal, we're going to do this deal. If we can't, it's
15 not going to happen. And the touchstone of this deal was,
16 I need to do a 1031 transaction. And the only way to do
17 that is to get the asset distributed out to the individual
18 members to allow them to -- to effectuate their own
19 exchanges.

20 We went through. I discussed previously. The
21 questions is what hat was he wearing. Again, there is no
22 question what hat he was wearing. There's no question who
23 was negotiating on whose behalf he was negotiating. So I
24 think that even if Judge Rosas were on -- on -- if our
25 facts were presented to the same panel, I do believe we'd

1 have a unanimous decision, and maybe something that the
2 FTB could rely on.

3 I think that the comment that --

4 JUDGE LAMBERT: Mr. Kaplan, by the way, it's been
5 10 minutes. Did you want to take extra time to wrap up?
6 Maybe five minutes or so?

7 MR. KAPLAN: Could I -- I think -- I think I'll
8 probably shut up now and let Mr. Guterman take over
9 because I could go for a long time and --

10 JUDGE LAMBERT: We're ahead of schedule. So if
11 you want to take some -- like, five minutes to give some
12 closing remarks.

13 MR. GUTERMAN: Your Honor, I wanted to just make
14 one point before we sum up our closing remarks and focus
15 on one thing. Respondent's position is that the escrow
16 agreements and the seller substitution needs have no legal
17 effect because they were signed and executed by the
18 parties prior to the parties owning the property. If you
19 go -- that's just wrong as a matter of law, and that's
20 proven by the sales agreement.

21 If you'll -- I draw your attention to Exhibit 18.
22 The second page of Exhibit 18, which is the seller
23 instructions, and I read the following to you. "Please be
24 informed that Sapphire Wines LLC buyer has opened an escrow
25 in Chicago Title Company for the concurrent resale of all

1 or a portion of the property that is subject to this
2 escrow."

3 The buyer had already contracted to sell the
4 property before it ever acquired it. The buyer had
5 already committed to selling to this somebody. So why is
6 this -- why is our Seller Substitution Agreements
7 nonbinding and illegal but, yet, in the same contract in
8 the sale escrow instructions, which are entered into after
9 we have title, which talk about all the terms for
10 conveyance of the property by our individual clients and
11 recognize that the buyers also entered into the contract
12 to sell the property.

13 They are binding. The seller substitute must
14 have been -- had to be given legal effect at the
15 concluded -- at the -- included on the sale and just like
16 in this transaction. That's a false narrative that they
17 don't have any legal effect because, quote, "Legal title
18 to the Paso Property hadn't passed until a few days
19 later."

20 Thank you.

21 JUDGE LAMBERT: Thank you, Mr. Guterman and
22 Mr. Kaplan.

23 At this time, I'm going to ask my co-panelist if
24 they have any final questions of either party.

25 Judge Akin, do you have any questions?

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

JUDGE AKIN: Thank you, Judge Lambert. I don't have any questions at this time.

JUDGE LAMBERT: Thanks.

And, Judge Le, do you have any questions?

JUDGE LE: This is Judge Le. No questions from me. Thank you.

JUDGE LAMBERT: Thanks.

I don't have any questions either at this time. No more questions. So if there's nothing further, I'm going to close the record and conclude the hearing. I want to thank everyone for appearing today, including the witnesses, Mr. Arciero, Jr., and Mr. Silva.

We will issue a written opinion within 100 days. Thank you. This hearing is now closed.

(Proceedings adjourned at 4:24 p.m.)

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 16th day of August, 2021.

ERNALYN M. ALONZO
HEARING REPORTER