OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of: **S. KWON;** **J. KWON;** **Y. CHUN; AND** **N. MYUNG AND** **H. KWON**	) OTA Case Nos. 18011810, 18011811, 18011812 & 18011813))))))

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Andrew S. Je, CPA

For Respondent: David Gemmingen, Tax Counsel IV

C. AKIN, Administrative Law Judge: On April 14, 2021, the Office of Tax Appeals (OTA) issued an Opinion sustaining determinations by Franchise Tax Board (FTB). The Opinion held that appellants S. Kwon, J. Kwon, Y. Chun, and N. Myung and H. Kwon (collectively, appellants): (1) did not demonstrate error in FTB's determination that Galleria, LLC (Galleria) was, in substance, the purchaser of commercial property located in La Habra, California (the Galleria Property), and, therefore, KMC Property, LLC (KMC) did not complete a valid Internal Revenue Code (IRC) section 1031 exchange; (2) did not demonstrate error in FTB's determination that Westridge Golf, Inc. (Westridge) distributed an interest in appreciated property (the Golf Course Property) to appellant N. Myung; (3) did not demonstrate error in FTB's determination of either Westridge's basis in the Golf Course Property or appellants' resulting pass-through gains; and (4) failed to show reasonable cause to abate the late-filing penalties imposed with respect to appellant S. Kwon's 2003 tax year and appellant Y. Chun's 2005 tax year. The Opinion sustained FTB's additional tax assessments issued to appellants for the 2003 and 2005 tax years. Appellants filed a timely petition for rehearing (PFR).

A rehearing may be granted where one of the following six grounds exists and materially affects the substantial rights of the filing party (here, appellants): (1) an irregularity in the appeal proceedings, which occurred prior to issuance of the Opinion and prevented fair consideration of

the appeal; (2) an accident or surprise that occurred during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law in the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Do*, 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654.)[1]

Appellants do not specifically state the grounds upon which they seek rehearing. Instead, appellants assert that the PFR is based on the following contentions: (1) FTB "erred in calculating the correct adjustment for 2005 for [appellant N. Myung and appellant Y. Chun] as a result of 2003 appeals that will affect the basis of the KMC interest they sold in 2005;" and (2) "[t]here are proofs of tax payments that taxpayers made which have been presented to OTA multiple times." Appellants also assert for the first time that interest should be abated.

Impact of the 2003 Adjustments on Appellants' 2005 and 2012 Tax Years

Appellant N. Myung and Appellant Y. Chun

With respect to the first argument above, appellants assert that when appellant N. Myung and appellant Y. Chun subsequently sold their membership interests in KMC in 2005, their reported gains (in the amount of $1,501,852 and $900,393, respectively) were overstated because the reported gains used the "original tax basis" and were not adjusted for the additional pass-through gain resulting from the disallowance of KMC's attempted IRC section 1031 exchange in 2003. Appellants contend that appellant N. Myung's and appellant Y. Chun's 2005 gains from the sale of their membership interests in KMC should be reduced by their pass-through share of the gain KMC was required to recognize in 2003 resulting from FTB's disallowance of the IRC section 1031 exchange.

Appellant J. Kwon and Appellant S. Kwon

Appellants make a similar argument with respect to appellant J. Kwon's gain on the sale of her membership interest in KMC in 2012 (resulting in a reported gain of $46,625), asserting

[1] As provided in *Appeal of Wilson Development, Inc.*, *supra*, it is appropriate for OTA to look to Code of Civil Procedure (CCP) section 657 and applicable case law as relevant guidance in determining whether to grant a new hearing.

that this gain should be revised to a $875,238 loss. Appellants further assert that in 2005, appellant J. Kwon and appellant S. Kwon purchased appellant N. Myung's and appellant Y. Chun's membership interests in KMC. Appellants assert that based on appellant J. Kwon's purchases, her basis in KMC should have been adjusted by $1,710,199 and that FTB "failed to allocate the $1,710,199 to [appellant J. Kwon's] basis in KMC."[2] Using the "correct figures," appellants contend that appellant J. Kwon had a capital loss in the amount of $2,585,437 for the 2012 tax year. Appellants similarly assert that FTB "failed to make an adjustment to [appellant S.] Kwon's basis in KMC and therefore, her basis should be adjusted accordingly."[3]

As a preliminary matter, we note that appellant J. Kwon's 2012 tax year is not at issue in these appeals or in this PFR. At issue in these appeals and this PFR are the Notices of Proposed Assessments issued to appellants, including appellant J. Kwon, for the 2003 and 2005 tax years only. Thus, appellants' assertions with respect to the alleged miscalculation of appellant J. Kwon's 2012 gain from the sale of her membership interest in KMC are not relevant to these appeals and do not impact the proper computation of tax for the 2003 and 2005 tax years at issue here. Similarly, appellant S. Kwon's basis in KMC also is not at issue in these appeals as appellant S. Kwon did not sell her membership interest in KMC during 2003 or 2005, and any adjustment to her basis in KMC would not impact the proper computation of tax for the tax years at issue in these appeals.

Additionally, while any reduction to appellant N. Myung's and appellant Y. Chun's reported gains on the sales of their membership interests in KMC in 2005 could potentially offset their additional pass-through gain from Westridge (resulting from Westridge's distribution of an interest in the Golf Course Property to appellant N. Myung during the 2005 tax year), we note that appellants did not raise this issue during the original appeals. Instead, this new argument was raised for the first time in appellants' perfected PFR. Appellants' attempt to bring forth a new argument requiring the submission of new facts and evidence not in the original appeals' record through a PFR is not proper. There is no provision that would permit a new hearing based

[2] While appellants contend that FTB failed to allocate the $1,710,199 to appellant J. Kwon's basis in KMC, per Exhibit 8 filed with appellants' perfected PFR, appellant J. Kwon (not FTB) reported her basis in KMC at the time of the sale in 2012 as $953,375. Presumably this amount would have taken into account the $1,710,199 paid for appellant N. Myung's and appellant Y. Chung's membership interests in KMC in 2005.

[3] Appellants do not point to a sale of KMC by appellant S. Kwon for any taxable year. Presumably this is why appellants assert only that appellant S. Kwon's basis in KMC should be adjusted rather than contend that her reported gain or loss on the sale in some subsequent year is overstated.

on a new legal theory predicated on the submission of new facts and evidence that appellants failed to raise and provide prior to the issuance of the written Opinion.[4]

While California Code of Regulations, title 18, section 30604(a)(3) provides for a rehearing for newly discovered evidence that appellants could not have discovered and produced prior to the written Opinion, appellants have not explained why they could not have reasonably discovered and produced this evidence with respect to appellant N. Myung's and appellant Y. Chung's respective basis in and gains on the sales of their membership interests in KMC prior to April 14, 2021, the date of the Opinion. As noted in *Appeal of Wilson Development, Inc., supra*, "[W]e prefer a record which contains all the evidence the parties believe is relevant. However, when evidence could have been submitted before our decision, but was not, the goal of reaching the correct result must usually fall to the need to efficiently resolve matters before this board." As such, if a party attempts to submit evidence after an Opinion has been issued, they must show that the proffered evidence is material and could not have been produced prior to the issuance of the Opinion in order for us to consider the evidence when deciding whether or not to grant the PFR. (*Ibid.*) Because appellants have not demonstrated that this new evidence could not have been reasonably discovered and provided prior to the issuance of the Opinion, we cannot grant a rehearing based on this newly offered evidence.

Proof of Tax Payments

Appellants also contend that assuming the disallowance of the IRC section 1031 exchange, FTB erred in two respects: "First, [FTB] erred in its computation by using an incorrect basis in the KMC Property. Second, [FTB] failed to take notice of the fact [that] any deferral of taxes from [KMC's] like-kind exchange in 2003 is no longer an issue since the

[4] We note that there is some authority suggesting OTA may potentially consider a new legal theory on a PFR where the new theory merely presents a question of law to be applied to undisputed facts in the record. (See *Hoffman-Haag v. Transamerica Ins. Co.* (1991) 1 Cal.App.4th 10, 16 [noting that on appeal a party may change the legal theory relied upon at trial, so long as the new theory presents a question of law to be applied to undisputed facts in the record, and concluding the court should have the same ability in ruling on a trial motion under CCP section 657].) However, that is not the situation here. The proper gain to be recognized by appellant N. Myung and appellant Y. Chun on their respective sales of their membership interests in KMC in 2005 is not strictly a question of law. Rather, there remains unresolved questions of fact, including but not limited to, the sales price and basis amounts reported by appellant N. Myung and appellant Y. Chun on their respective California tax returns versus the actual amounts realized by each on their respective sales and the proper basis computations for each of them as of the dates of the sales. These questions of fact would need to be resolved through the submission of new evidence; however, appellants have not substantiated that this evidence could not have been reasonably obtained and provided prior to the issuance of the written Opinion.

replacement property in said exchange . . . was sold [on] April 28, 2005, and any deferral of taxes was paid at that time."

With respect to appellants' first contention that FTB used the incorrect basis for the property relinquished in the attempted IRC section 1031 in computing the gain on the disallowed exchange,[5] we again note that appellants did not raise this issue during the original appeals. Additionally, we note that Exhibit 1 provided with appellants' perfected PFR (and offered as support for appellants' position that FTB used the wrong basis amount in computing the gain resulting from the disallowed IRC section 1031 exchange) shows identical gain computations by appellants and FTB.[6] This does not support appellants' assertion in the perfected PFR that FTB used the wrong basis for the relinquished property in its gain computation.

Appellants' Exhibit 1 provided with the perfected PFR includes computations related to both KMC (addressed above) and Westridge. The second part of Exhibit 1 notes that FTB used a basis of $11,860,232 in computing Westridge's gain from the Golf Course Property, while appellants' computation on Exhibit 1 uses a basis of $13,596,013. Additionally, Exhibit 4, which includes Westridge's 2005 Form 1120S Schedule L, Balance Sheet, reflects buildings and other depreciable property of $11,223,589 and land of $2,372,424, which total $13,596,013, the basis used by appellants in their computation. To the extent that appellants are intending to argue here that FTB used the wrong basis in its computation of the gain resulting from Westridge's distribution of the Golf Course Property to appellant N. Myung in 2005,[7] we note that appellants raised this argument in the original appeals and OTA already addressed it in the Opinion. The Opinion specifically held that, because appellants failed to explain the joint acquisition of the Golf Course Property by Westridge and a third party, "Chapman Invest," or the IRC section 1031 exchange performed by "Chapman Invest," and failed to account for this IRC section 1031 exchange in their computation of the basis, appellants failed to establish error in

[5] This is the real property located on East 12th Street in Los Angeles, California, which appellants refer to in the perfected PFR as the "KMC Property."

[6] Both appellants' and FTB's gain computations on Exhibit 1 reflect a sales price of $7,300,000, basis in the relinquished property of $2,219,927, and a deferred gain on the exchange of $4,055,526 (after accounting for depreciation, selling expenses, and the gain already recognized on KMC's 2003 return).

[7] Appellants do not specifically argue in the perfected PFR that FTB used the wrong basis in its computation of the gain resulting from Westridge's distribution of the Golf Course Property to appellant N. Myung in 2005; however, appellants' Exhibit 4 and the bottom half of appellants' Exhibit 1 appear to be offered in support of such an argument.

FTB's determination of Westridge's basis in the Golf Course Property. Appellants' dissatisfaction with the Opinion and attempt to reargue the same issue does not constitute grounds for a rehearing. (*Appeal of Smith*, 2018-OTA-154P.)

With respect to appellants' argument that "[FTB] failed to take notice of the fact [that] any deferral of taxes from [KMC's] like-kind exchange in 2003 is no longer an issue since the replacement property in said exchange . . . was sold [on] April 28, 2005, and any deferral of taxes was paid at that time," we again note that appellants raised this argument in the original appeals and OTA rejected it in the Opinion. The Opinion noted that appellants did not demonstrate that they paid taxes on the deferred gain from the 2003 exchange when Galleria subsequently sold the Galleria Property in 2005.[8] Further, the Opinion noted that gain properly recognizable in 2003 is subject to tax in 2003, not 2005, noting that each tax year must stand on its own and be separately considered. Again, appellants' dissatisfaction with the Opinion and attempt to reargue the same issue does not constitute grounds for a rehearing. (*Appeal of Smith*, *supra*.)

Request for Interest Abatement

Appellants also contend that interest should be abated from the acceptance of the protest, in January 2009, and that FTB "abused its discretion for unreasonable delays in resolving the matters at issue in this appeal." However, appellants did not raise the issue of interest abatement during the original appeals and there is no evidence in the appeals' record with respect to the alleged unreasonable error or delay by an officer or employee of FTB. Again, appellants have not substantiated that the introduction of this new legal issue is grounds for a rehearing. Appellants are not asserting a new or alternative legal theory to show that the original Opinion made an erroneous legal determination. Instead, they are asserting a new issue of interest abatement. As there was no determination in the Opinion as to interest abatement, the raising of interest abatement as a new issue in the perfected PFR does not show the Opinion was contrary to law or that any of the other grounds for rehearing exist. (See Cal. Code Regs., tit. 18, § 30604(a)(1)-(6).) In addition, appellants have not shown that the associated evidence they

[8] The Opinion specifically found that while appellants assert that the gain was properly recognized when Galleria subsequently sold the Galleria Property (i.e., the intended replacement property in the attempted IRC section 1031 exchange) in 2005, Galleria overstated its basis in the Galleria Property by the amount of gain KMC deferred on the exchange (i.e., $4,055,526), thereby understating its gain on the subsequent sale of the Galleria Property in 2005 by the same amount.

would seek to introduce to support this new legal issue could not have reasonably been discovered and provided prior to the issuance of the written Opinion.[9] Thus, this new issue and evidence do not provide a basis for a rehearing. (Cal. Code of Reg. tit. 18, § 30604(a)(4); *Appeal of Wilson Development, Inc., supra*.)

For the foregoing reasons, we find that appellants have not established grounds for a rehearing. Consequently, we deny the PFR.

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Cheryl Akin
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Cheryl L. Akin
Administrative Law Judge

We concur:

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Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
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Andrew Wong
Administrative Law Judge

Date Issued: 10/1/2021

[9] To the extent appellants suggest that interest should be abated for alleged delays by OTA during the appeals, we note that Revenue and Taxation Code section 19104(a) permits the abatement of interest attributable in whole or in part to any unreasonable error or delay by an officer or employee of *FTB* in the performance of a ministerial or managerial act. There is nothing in the statute which would permit the abatement of interest for an alleged error or delay by an officer of employee of *OTA*.