OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeals of:	OTA Case Nos. 19095228, 19095246
LOVINCK INVESTMENTS N.V. AND STAR PROSPECT INTERNATIONAL LIMITED	

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellants: John J. O'Neill

For Respondent: Kim L. Akin, Specialist

For Office of Tax Appeals: William Stafford

T. LEUNG, Administrative Law Judge: On June 2, 2021, the Office of Tax Appeals (OTA) issued an Opinion sustaining respondent Franchise Tax Board's action imposing additional tax and accuracy-related penalties[1] as the result of an admittedly failed like-kind exchange under Internal Revenue Code (IRC) section 1031.

On July 2, 2021, appellants petitioned for a rehearing with OTA on the basis that the Opinion was contrary to law and there was insufficient evidence to justify it. We conclude that the grounds set forth in this petition do not constitute a basis for a new hearing.

OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the proceedings that prevented the fair consideration of the appeal; (2) an accident or surprise that occurred, 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

[1] The Notice of Action (NOA) issued to appellant Lovinck Investment N.V. ("Lovinck") for the taxable year ended (TYE) June 30, 2012, imposed additional tax of $1,005,550 and an accuracy-related penalty of $201,110. The NOA issued to appellant Star Prospect International Limited ("Star Prospect") for the TYE May 31, 2012, imposed additional tax of $430,950 and an accuracy-related penalty of $86,190. Each NOA stated that interest would accrue on any unpaid additional tax, measured from the due date of the original return.

contrary to law; or (6) an error in law that occurred during 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.)[2]

A petition for rehearing (PFR) on the ground that our decision was contrary to law cannot be granted unless, after indulging in all legitimate and reasonable inferences to uphold our decision, we conclude that our decision was, as a matter of law, unsupported by substantial evidence. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 907 [interpreting California Code of Civil Procedure (CCP) section 657].)

Appellants make the following arguments:

1. Appellants did not attempt to avoid the related party provisions of IRC section 1031 because the gain from the failed exchange was recognized on their tax return;
2. Even if appellants attempted to avoid the related party provisions of IRC section 1031, neither they nor their limited partnership (FSP) had actual or constructive receipt of the $19.5 million from the sale of the relinquished property, but only received the replacement property;
3. The qualified intermediary (QI) was not their agent.

While footnote 5 (and the accompanying text) of the Opinion notes that appellants apparently failed to address whether their transactions were structured to avoid the related party prohibitions contained in the IRC section 1031 exchange provisions, that was not the sole rationale for our ruling. To reiterate, we opined: "Simply put, IRC section 1031 is an exception to the general rule requiring recognition of gain or loss upon the sale or exchange of property. (See IRC, § 1001(c).) * * * It is undisputed that the purported exchange failed to qualify as a like-kind exchange under the provisions of IRC section 1031." Once appellants admitted that the exchange failed to qualify for IRC section 1031 treatment, the general recognition rules upon the disposition of property contained in IRC section 1001 are applicable. (See *Teruya Brothers Ltd. v. Commissioner* (9th Cir. 2009) 580 F.3d 1038.)

Moreover, IRC section 1001 contains no safe harbor rule of the type prescribed in Treasury Regulation section 1.1031(k)-1(g)(4)(i), and appellants cannot rely on provisions of an IRC section that no longer applies to them.

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

Furthermore, we ruled that "FSP was able to control and direct [the title company] and [the] QI with respect to the use of the $19.5 million received from the sale of the [relinquished property]. Accordingly, [the title company's] and QI's receipt of funds from the sale of the [relinquished property] is imputed to FSP (see *Lucas v. Earl* [(1930) 281 U.S. 111]) and, therefore, FSP" must recognize gain "on the difference between (1) the $19.5 million sales price set forth in the Asset Purchase Agreement and (2) FSP's adjusted basis in the [relinquished property] at the time of sale (plus selling expenses)..... (IRC, § 1001(a), (c).)"

In summary, we find that the arguments raised by appellants in their PFR were already addressed and disposed of in our Opinion. Appellants' dissatisfaction with the Opinion and attempts to reargue the same issues do not constitute grounds for a rehearing. (See *Appeal of Smith*, 2018-OTA-154P.) Thus, appellants' rehearing request is denied.

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Tommy Leung
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Tommy Leung
Administrative Law Judge

We concur:

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Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
Cheryl Akin
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Cheryl L. Akin
Administrative Law Judge

Date Issued: 9/28/2021