

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 19105335  
M. GRANT AND )  
D. EICHHORN GRANT )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellants: John M. Wunderling, Attorney

For Respondent: Desiree Macedo, Tax Counsel

For Office of Tax Appeals: David Kowalczyk, Tax Counsel

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Grant and D. Eichhorn Grant (appellants) appeal an action by the Franchise Tax Board (respondent) proposing additional tax of \$81,437, and applicable interest, for the 2012 tax year.

Appellants waived their right to an oral hearing; therefore, we decide this matter based on the written record.

**ISSUE**

Whether appellants have provided some reasonable evidentiary basis to estimate the cost of improvements to real properties to determine appellants’ adjusted basis.

**FACTUAL FINDINGS**

**Campbell Property**

1. In 1988, appellants purchased a house in Campbell, California (Campbell Property) for \$403,996, and, in 1996, appellants sold the Campbell Property for \$520,000 and incurred \$31,200 of selling expenses.

2. Appellants reported a basis of \$438,996, which included the purchase price of \$403,996 and alleged landscaping costs of \$35,000.
3. Appellants deferred the \$49,804 gain (\$520,000 sales price - \$31,200 of selling expenses - \$438,996 basis) on the Campbell Property pursuant to Internal Revenue Code (IRC) section 1034.<sup>1</sup>

#### Saratoga Property

4. In or around 1994, appellants purchased a vacant lot in Saratoga, California (Saratoga Property) for \$440,000.
5. Appellants received a \$1,140,000 construction loan and hired Owen Signature Homes to construct a house on the Saratoga Property.
6. In 1996, Owen Signature Homes completed the construction of appellants' house.
7. Subsequently, appellants landscaped the Saratoga Property.
8. In 2012, appellants sold the Saratoga Property for \$3,784,000.

#### 2012 Tax Return

9. Appellants filed a joint 2012 California Resident Income Tax Return. They reported a long-term capital gain of \$975,628 as calculated: \$3,784,000 sales price minus \$2,107,500 adjusted basis, \$200,872 selling expenses, and a \$500,000 exclusion for the gain from the sale of a principal residence.<sup>2</sup>
10. Appellants calculated the \$2,107,500 adjusted basis as follows: \$440,000 purchase price, increased by \$1,442,500<sup>3</sup> in construction costs and \$225,000 in landscaping costs.

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<sup>1</sup> Prior to 1997, IRC section 1034 allowed for the deferral of gain recognition if a taxpayer purchased a new residence within two years of the sale of the old residence, and the new residence cost at least as much as the selling price of the old residence. (IRC, § 1034(e), repealed by Pub. L. No. 105-34, § 312(b) (Aug. 5, 1997) 111 Stat. 839.) Under IRC section 1034(e), the taxpayer must reduce his or her basis in the new residence by the amount of deferred gain.

<sup>2</sup> IRC section 121 provides that a taxpayer may exclude up to \$500,000 from the sale of a house owned and used as a principal residence for at least two of five years before the sale if the taxpayer files married filing jointly. (IRC, § 121(a), (b)(2)(A); R&TC, §§ 17131, 17152.)

<sup>3</sup> Appellants state that they took a conservative return position in estimating construction cost to be \$1,442,500.

Audit

11. For the Campbell Property, respondent determined that appellants did not substantiate their landscaping expenses. Thus, respondent determined the gain from the sale of the Campbell Property as \$84,804, which consists of a \$520,000 sales price, minus \$403,996 purchase price and \$31,200 selling expenses. Respondent applied the \$84,804 deferred gain to reduce appellants' basis in the Saratoga Property.
12. For the Saratoga Property, respondent estimated appellants' homebuilding and landscaping expenses to be \$1,140,000 based on appellants' construction loan. Thus, respondent estimated basis in the Saratoga Property to be \$1,495,196, which includes \$440,000 for the purchase price and \$1,140,000 for appellants' construction loan minus \$84,804 from the deferred gain from the Campbell Property.

NPA and Protest

13. Respondent issued a Notice of Proposed Assessment (NPA) proposing \$81,437 of additional tax. Respondent proposed \$612,304 of additional capital gains from the sale of the Saratoga Property because respondent allowed \$1,495,196 of appellants' reported \$2,107,500 adjusted basis.
14. Appellants protested the NPA. Subsequently, respondent issued a Notice of Action affirming the NPA.
15. Thereafter, appellants timely filed this appeal.
16. To support their estimated costs for the Campbell Property landscaping, appellants sole supporting evidence is a declaration from themselves stating they paid \$35,000 for landscaping.
17. To support their estimated costs for the Saratoga Property home construction and landscaping, appellants provide the following evidence:<sup>4</sup>
  - a. A declaration from the Vice President of Owen Signature Homes stating that the company built appellants' custom home on the Saratoga Property and that appellants paid approximately \$1,800,000 at the time of completion in November 1996.

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<sup>4</sup> Appellants also provide a declaration from C. Burns, which states the declarant loaned \$100,000 to appellants.

- b. An itemized list of construction costs from the Vice President estimating appellants paid \$1,807,854.31 to build their home. The Vice President generated this itemized list based on his recollection from managing appellants' home construction project, reviewing photographs of appellants' home, meeting with the general contractor of appellants' home construction project, and reviewing home construction costs circa 2016 and extrapolating the costs to 1996.
- c. Photographs of the house and landscaping.
- d. A declaration from T. Douglass of Douglas Landscape Construction, Inc. stating he inspected appellants' landscaping improvements in 2016, he created a list of expenses estimating the costs for appellants' landscaping expenses to be \$493,790 based on prices in 2016.
- e. A declaration from appellants stating they paid \$225,000 for landscaping expenses.

### DISCUSSION

Whether appellants have provided some reasonable evidentiary basis to estimate the cost of improvements to real properties to determine appellants' adjusted basis.

#### Burden of Proof

Respondent's determination is generally presumed correct, and the taxpayer bears the burden of proving otherwise. (*Appeal of Chen and Chi*, 2020-OTA-021P.) Generally, the applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Chen and Chi*, *supra*.)

#### Basis

California conforms to federal rules computing the basis of property for the purpose of determining the gain on the sale of such property. (R&TC, § 18031.) Gain on the sale of property shall be the excess of the amount realized over the adjusted basis of the property. (IRC, § 1001.) The adjusted basis shall be the cost of property with proper adjustments made for various items including the costs of improvements and betterments made to the property. (IRC, §§ 1011(a), 1012(a), 1016(a); Treas. Reg. § 1.1016-2(a).)

### The Cohan Rule

If a taxpayer with inadequate records proves improvements were made to the property, but cannot substantiate the exact amount, in certain circumstances, the cost of the improvements may be estimated under the rule in *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540 (*Cohan*) to determine adjusted basis.

The *Cohan* rule was adopted when the famous theatrical producer George M. Cohan testified that he had spent substantial sums of money on travel and entertaining actors, employees, and drama critics in furtherance of his theatrical production business. Mr. Cohan could not substantiate by records his actual expenditures but instead estimated the amounts in his testimony. The court held that, where a taxpayer has established that he or she has incurred an expense for which a deduction may properly be claimed but is unable to document the exact amount of the expense, a court may make a reasonable estimate of the deduction in certain circumstances, “bearing heavily” against the taxpayer whose inexactitude is of his or her own making. (*Cohan, supra*, 39 F.2d at pp. 543-44.)

The *Cohan* rule or similar principles have been applied to estimate a taxpayer’s basis in property. (*Huzella v. Commissioner*, T.C. Memo. 2017-210.) But to estimate basis, “the taxpayer must provide some ‘reasonable evidentiary basis’ for the estimate.” (*Wheeler v. Commissioner*, T.C. Memo. 2014-204.) When the taxpayer presents no evidence at all that would permit an informed estimate of basis, the *Cohan* rule is inapplicable. (*Ibid.*)

Here, appellants made improvements to two properties: the Campbell Property and the Saratoga Property. However, appellants do not have clear records to substantiate the costs of the improvements. This is understandable given that decades have passed since appellants made the improvements. (See *Shank v. Commissioner*, T.C. Memo. 2018-33 [the absence of a clear documentary record is understandable after 20 years have passed].) Thus, we look to whether appellants have provided some reasonable evidentiary basis for us to estimate the costs in their property improvements.

### Campbell Property

The parties agree that appellants purchased the Campbell Property for \$403,996, sold it for \$520,000, and incurred selling expenses of \$31,200. However, the parties dispute whether appellants have provided some reasonable evidentiary basis to estimate their landscaping costs.

Appellants' sole evidence is their declaration stating they paid \$35,000 for landscaping costs. However, appellants' unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Chen and Chi, supra.*) Thus, because appellants have not provided some reasonable evidentiary basis to estimate the landscaping costs, the *Cohan* rule is inapplicable. Accordingly, appellants' gain on the Campbell Property is calculated as follows: \$520,000 sales price, reduced by the \$403,996 adjusted basis and \$31,200 real estate commission, resulting in \$84,804 gain. This \$84,804 gain was deferred under IRC section 1034 and reduces appellants' basis in their Saratoga Property.

### Saratoga Property

After appellants purchased the Saratoga Property as a vacant lot in 1994, they indisputably constructed a house and completed landscaping. However, the parties dispute the estimated cost of the house and landscaping to determine adjusted basis. Respondent has allowed \$1,140,000 of total costs for both the house and landscaping based on appellants' construction loan for that amount. Appellants argue the evidence supports a reasonable evidentiary basis for a higher estimated cost.

As to landscaping, appellants submit a declaration from a licensed contractor who inspected the Saratoga Property and estimated the landscaping cost to be \$493,790.<sup>5</sup> However, the contractor is not an impartial third party. The contractor is the son of appellants' friends and saw appellant-wife over the years at family events. Thus, given the relationship between the contractor and appellants, we give little evidentiary weight to the contractor's declaration and estimate. Accordingly, even though appellants also provide their own declaration and photographs of the landscaping, we have no reasonable evidentiary basis to estimate appellants' landscaping costs in the Saratoga Property.

As to the cost of the home, appellants submit credible evidence in the form of a declaration from the Vice President of Owen Signature Homes—the same company that built appellants' custom home on the Saratoga Property. The Vice President managed appellants' home construction project himself from start to finish. Because Owen Signature Homes did not

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<sup>5</sup> Since the estimate is not based on amounts in 2000 (when the landscaping work was completed) but instead is per 2016 costs, appellants argue we can adjust the estimate for inflation, resulting in an inflation-adjusted value of \$360,806.12 as of December 2000.

keep records that date past 20 years, the Vice President estimated that appellants paid \$1,807,854.31 to build their home. The Vice President included an itemized list of construction costs based on his recollection from managing appellants' home construction project, reviewing photographs of appellants' home, meeting with the general contractor of appellants' home construction project, and reviewing home construction costs circa 2016 and extrapolating the costs to 1996. Appellants also submit photographs of the home to corroborate various items from the itemized list of construction costs. Accordingly, we believe the evidence as a whole provides a "reasonable evidentiary basis" to estimate the cost of building appellants' home to be \$1,807,854.31. Thus, appellants' adjusted basis in the Saratoga Property shall be calculated as follows: purchase price of \$440,000, increased by construction costs of \$1,807,854.31, reduced by deferred gain from the Campbell Property of \$84,804, resulting in an adjusted basis of \$2,163,050.31.<sup>6</sup>

Respondent argues that it has already allowed \$1,140,000 for improvements to the Saratoga Property based on appellants' construction loan. Respondent urges that this allowance is reasonable because the County Assessor's Office determined that the assessed value of appellants' improvements was only \$677,363, which respondent argues corroborates its \$1,140,000 allowance. However, the assessed value of the property for property tax purposes is based on fair market value while a taxpayer's basis in property is based on the taxpayer's costs. (See R&TC, § 110(a); IRC, §§ 1012(a), 1016(a).) Thus, to determine basis in this case, we give greater weight to the reasonable estimated cost of construction over the valuation of the County Assessor's Office.

Accordingly, we find that appellants have provided a reasonable evidentiary basis to estimate the cost of home construction improvements to the Saratoga Property to be \$1,807,854.31.

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<sup>6</sup> Appellants note that they adopted a conservative figure when they reported an adjusted basis of \$2,107,500 on their return. Although our determination here estimates basis higher than what appellants reported, the appeal before us is based on a proposed assessment, not a denied claim for refund, and therefore this Opinion shall only reduce or eliminate respondent's proposed assessment for the 2012 tax year.

HOLDING


Appellants have failed to provide a reasonable evidentiary basis to estimate the landscaping costs for the Campbell Property and the Saratoga Property. However, appellants have provided a reasonable evidentiary basis to estimate the home construction costs on the Saratoga Property to be \$1,807,854.31; thus, appellants’ adjusted basis in the Saratoga Property is \$2,163,050.31.

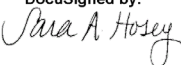
DISPOSITION

We reverse respondent’s determination as to appellants’ adjusted basis in the Saratoga Property. Respondent’s proposed assessment shall be reduced or eliminated in accordance with our Opinion.<sup>7</sup>

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Administrative Law Judge

We concur:

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Josh Lambert  
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Sara A. Hosey  
Administrative Law Judge

Date Issued: 1/5/2022

<sup>7</sup> Appellants did not provide a calculation of gain based on allowing \$1,807,854.31 for the cost of constructing a home on the Saratoga Property. We decline to perform that calculation ourselves and direct respondent to make the appropriate calculation.