OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of: **L. NEWELL AND** **K. NEWELL,** **NEW CITIES LAND COMPANY, INC.**	) OTA Case Nos. 20076384, 20086427

OPINION

Representing the Parties:

For Appellants: Edward I. Kaplan, Attorney

For Franchise Tax Board (FTB): Michael R. Laisne, Tax Counsel III

For Office of Tax Appeals: Grant S. Thompson, Tax Counsel IV

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, L. Newell and K. Newell (collectively, the Newells), and New Cities Land Company, Inc. (NCLC) appeal actions by FTB proposing: for the Newells, additional tax of $556,468, plus interest, for the 2010 tax year, and additional tax of $75,972, plus interest, for the 2011 tax year; and, for NCLC, additional tax of $57,141, plus interest, for the 2013 tax year.[1] In addition, for the 2013 tax year, the Newells also appeal FTB's Notice of Action – Affirmation (NOAA) making corresponding adjustments to the Newells' net operating loss carryover amounts.

The Newells and NCLC (collectively, appellants) waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Whether appellants have shown error in FTB's denial of their claimed losses.

[1] On appeal, FTB agrees to revise the Newells' proposed assessment of tax for 2010 to $501,081, and NCLC's proposed assessment of tax for 2013 to $20,716.

FACTUAL FINDINGS

1. The Newells were the sole owners of NCLC, an S corporation. NCLC held interests in Larkspur Housing Partners, LLC (LHP), a Limited Liability Company (LLC) taxed as a partnership, and New Cities Development Group (NCDG), a general partnership.

2008 Abandoned Option Losses

2. For 2008, FTB denied $1,956,605 in losses reported by NCLC from the abandonment of options to purchase real property referred to as the Salida and Stevinson/Gallo projects, due to a lack of substantiation.[2]

2010 Flow-Through Loss from LHP and 2011 Distribution from LHP

3. For 2010, FTB denied NCLC's reported flow-through loss of $3,673,164 from LHP due to a lack of substantiation of NCLC's reported capital contributions to (and resulting basis in) LHP totaling $4,216,172 for tax years 2006 through 2010, which included $525,000 for 2010. FTB decreased NCLC's 2010 net operating loss and increased the Newells' 2010 taxable income due to the disallowed flow-through loss of $3,673,164.
4. For 2011, FTB also determined that NCLC must recognize additional income of $494,135 due to a distribution by LHP in excess of NCLC's basis in LHP (i.e., $705,158 less basis of $211,023). FTB decreased NCLC's 2011 net operating loss and increased the Newells' 2011 taxable income due to the additional flow-through income of $494,135.

2010 Flow-Through Losses from NCDG

5. For 2010, FTB denied NCLC's reported flow-through loss of $1,833,813 from NCDG due to a lack of substantiation of NCLC's reported basis in NCDG. Due also to a distribution in excess of basis in that year, FTB determined that NCLC must recognize additional income of $2,432,415 from NCDG. FTB decreased NCLC's 2010 net

[2] Also in 2008, NCLC reported $14,490,970 in losses from the write-off of its worthless investment in the Cannon Ranch project. NCLC originally reported the loss related to Cannon Ranch in the 2013 tax year. The IRS audited this loss in 2013 and determined that it should have been reported by NCLC in 2008 instead of the 2013 tax year. As a result, NCLC filed an amended California return reporting this loss in 2008, which FTB allowed in full, and the loss was removed from the 2013 tax year. Appellants do not contest the movement of this loss from the 2013 tax year to the 2008 tax year.

operating loss and increased the Newells' 2010 taxable income due to the additional flow-through income of $2,432,415.

Protest and Appeal Proceedings

6. FTB issued Notices of Proposed Assessments based on the adjustments described above and for corollary adjustments to appellants' carryover and carryback losses.[3]
7. Following protest proceedings, FTB issued Notices of Action to the Newells for the 2010 and 2011 tax years and to NCLC for the 2013 tax year affirming its Notices of Proposed Assessment. FTB also issued an NOAA affirming its adjustments to the Newells' net operating loss carryover amounts for the 2013 tax year.
8. This timely appeal followed.
9. Based on documentation submitted by appellants on appeal, FTB agrees to allow the 2008 abandoned option losses in the amount of $1,956,605. In addition, FTB agrees to allow $525,000 for NCLC's basis in LHP, based on capital contributions made in 2010, and a corresponding amount of flow-through losses from LHP.

DISCUSSION

FTB's determination of tax is presumed correct, and the taxpayer bears the burden of proving error. (*Appeal of GEF Operating, Inc*, 2020-OTA-057P.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Ibid*.)

As noted above, the Newells were the sole shareholders of NCLC, which owned membership and partnership interests in LHP and NCDG. As NCLC is an S corporation, the Newells generally must take into account their pro rata share of NCLC's income or loss. (Internal Revenue Code (IRC), § 1366(a)(1); R&TC section 17087.5 [generally conforming to federal provisions for S corporations, unless otherwise provided].) As a member of LHP (an LLC taxed as partnership) and a partner of NCDG, NCLC generally must take into account its

[3] While the parties dispute the amount of loss that appellants may recognize, which will affect the amount of carryover and carryback losses, they do not dispute the mechanics of the carryover and carryback provisions.

distributive share of each partnerships' income or loss, pursuant to IRC section 702.[4] However, NCLC's distributive share of partnership losses from LHP and NCDG is allowed only to the extent of its adjusted basis in the partnerships. (IRC, § 704(d).)

IRC section 705 generally provides that the adjusted basis of a partner's interest in a partnership is the partner's original basis, as determined under IRC section 722 (relating to contributions to a partnership), increased by: (1) the amount of money and the partner's basis in property subsequently contributed to the partnership; and (2) the partner's distributive share of the income of the partnership. The partner's adjusted basis is decreased (but not below zero) by: (1) the amount of money and the partnership's adjusted basis in property distributed to the partner in a nonliquidating distribution to the partner; and (2) his or her distributive share of partnership losses and expenditures. (IRC, §§ 705(a), 722, 732(a), 733.) As relevant here, the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution. (IRC, § 722; Treas. Reg., § 1.722-1.)

On appeal, FTB has allowed the abandoned option losses for 2008, as well as the additional basis of $525,000 for NCLC's contributions to LHP in 2010 and a corresponding amount of flow-through losses from LHP in 2010. FTB states that the 2010 proposed tax assessment for the Newells is reduced from $556,468 to $501,081, and the 2013 proposed tax assessment for NCLC is reduced to from $75,972 to $20,716. In addition, FTB states that the 2014 net operating loss carryovers are $5,662,413 for the Newells and zero for NCLC.

Appellants provide documentation related to the abandoned option losses, which FTB has allowed in full. Appellants do not provide any documentation to substantiate NCLC's basis in NCDG and, therefore, FTB's determination of that basis must be upheld. Appellants provide documentation related to LHP for the 2010 and 2011 tax years. Appellants do not provide any specific guidance as to how the documentation supports their contentions. However, based on this documentation, FTB has allowed the entire $525,000 claimed capital contribution to LHP reported in 2010.

While not indicated by the parties, it appears that FTB's adjustment is based on the equity section in LHP's General Ledger indicating NCLC's transfer of funds totaling $525,000 to LHP

[4] As relevant to the issues here, California generally conforms to the IRC provisions relating to partners and partnerships referenced herein, unless otherwise provided, pursuant to R&TC section 17851.

in 2010, and a 2010 loan agreement and promissory note with a third party for $500,000, for the purpose of loaning funds to appellants to make capital contributions to LHP.[5] The agreement identifies that existing loans used for capital contributions total $250,000 with an additional request having been made for $125,000. These amounts match up with the amounts on the General Ledger, which includes an additional $150,000, totaling $525,000. Accordingly, we find that FTB has accounted for this documentation and appellants have not shown that there is error in FTB's determination of NCLC's basis in LHP, including the concession on appeal.

The equity section of the 2011 General Ledger indicates only the distribution by LHP to NCLC of $705,158. This distribution was accounted for, as shown by FTB's increase of $494,135 to the Newell's flow-through income for 2011, as the distribution was in excess of NCLC's basis of $211,023. (See IRC, § 731(a)(1).) Notwithstanding the concessions made by FTB on appeal, appellants provide no other evidence to show error in FTB's determinations.[6]

[5] The agreement states that a third party is "willing to loan funds to Newell and NCLC…which Newell and NCLC shall utilize to make the additional capital contribution to LHP." The agreement also states that "[a]s of the date hereof, NCLC has contributed an amount equal to the Existing Loans to LHP as an additional capital contribution under the terms of the Operating Agreement."

[6] Appellants stated that they were trying to find addition documentation, but no additional documentation has been provided.

HOLDING

Appellants have not shown error in FTB's denials of their claimed losses beyond those conceded by FTB on appeal.

DISPOSITION

FTB's actions are modified to reflect FTB's concessions on appeal to allow the abandoned options losses of $1,956,605 for 2008 and flow-through losses of $525,000 from LHP for 2010. FTB's actions are otherwise sustained.

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Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

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Andrea LH Long
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Andrea L.H. Long
Administrative Law Judge

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

Date Issued: 3/22/2022