

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:)
)
M. MACLEOD (DEC'D) AND K.) OTA NO. 18093762
MACLEOD,)
)
Appellant.)
)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

SACRAMENTO, CALIFORNIA

WEDNESDAY, SEPTEMBER 21, 2022

Reported by:

SARAH M. TUMAN, RPR
CSR No. 14463

Job No. :
38487 OTA(C)

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TRANSCRIPT OF PROCEEDINGS, taken at
400 R Street, Sacramento, California,
commencing at 2:15 p.m. and concluding
at 3:58 p.m. on Wednesday, September 21, 2022,
reported by Sarah M. Tuman, RPR, CSR No. 14463,
a Certified Shorthand Reporter in and for
the State of California.

1 APPEARANCES :

2
3 PANEL LEAD :

ALJ SARA HOSEY

4
5 PANEL MEMBERS :

ALJ MIKE LE
ALJ AMANDA VASSIGH

6
7 FOR THE APPELLANT :

MICHAEL HAMERSLEY

8
9 FOR THE RESPONDENT :

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
CIRO IMMORDINO
MARGUERITE MOSNIER

I N D E X

E X H I B I T S

(Appellants Exhibits 1-22 were received at page 7)
(Appellants Exhibits 23-30 were received at page 7)
(Department's Exhibits A-DD were received at page 7)
(Department's Exhibits EE-FF were received at page 8)

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1 Sacramento, California; Wednesday, September 21, 2022

2 2:15 p.m.

3 -- oOo --

4 JUDGE HOSEY: We are opening the record in the
5 Appeal of MacLeod. This matter is being held before the
6 Office of Tax Appeals, Case Number 18093762. Today is
7 September 21, 2022, and it's 2:15 p.m. We're here in
8 Sacramento, California.

9 I am the Lead Administrative Law Judge, Sara
10 Hosey. And with me today are Judge Vassigh and Judge Le.
11 All three Judges will meet after the hearing and produce a
12 written decision as equal participants.

13 Although the Lead Judge will conduct the hearing,
14 any Judge on this panel may ask questions or otherwise
15 participate to ensure that we have all the information
16 needed to decide this appeal.

17 Can I please have the parties state their names
18 for the record.

19 Mr. Hamersley?

20 MR. HAMERSLEY: Michael Hamersley for the
21 Appellant.

22 MR. IMMORDINO: Ciro Immordino for the Franchise
23 Tax Board.

24 MS. MOSNIER: Marguerite Mosnier for the
25 Franchise Tax Board.

1 JUDGE HOSEY: Thank you.

2 The issues we have in front of us today are
3 whether Appellants made an IRC Section 170 bargain sale of
4 the Palm Springs land; who has the burden of proof on this
5 issue; did Appellants have gain under IRC Section 731; if
6 so, was there a computational error; and who has the
7 burden of proof on this issue; whether under the doctrine
8 of res judicata and other concerns such as conformity and
9 disclosure, cause -- bar FTB's proposed California tax
10 deficiencies; whether Appellants have shown interest
11 should be abated pursuant to R&TC Section 1914; have
12 Appellants shown reasonable cause to abate the late filing
13 tax return penalty for the 2006 tax year.

14 These issues were set forth in the prehearing
15 conference minutes and orders issued on September 26,
16 2022.

17 Mr. Hamersley, do those sound accurate?

18 MR. HAMERSLEY: Yes. With -- with exception to
19 the res judicata complexity --

20 JUDGE HOSEY: Can you get a little closer to your
21 microphone?

22 MR. HAMERSLEY: Yes. With the -- with the
23 exception to the res judicata complexity that I made
24 earlier.

25 JUDGE HOSEY: Right. Regarding res judicata,

1 conformity, and disclosure issues.

2 MR. HAMERSLEY: Yes.

3 JUDGE HOSEY: Okay. Mr. Immordino, is that
4 accurate?

5 MR. IMMORDINO: Yes. Thank you.

6 JUDGE HOSEY: Thank you.

7 For exhibits, we admitted Exhibits 1 through 22,
8 for Appellant, and A through DD, for Franchise Tax Board,
9 into the record via the prehearing conference minutes and
10 orders issued on September 6, 2022.

11 (Appellants' Exhibit Nos. 1-22 were previously
12 received in evidence by the Administrative Law
13 Judge.)

14 (Department's Exhibit Nos. A-DD were previously
15 received in evidence by the Administrative Law
16 Judge.)

17 JUDGE HOSEY: Mr. Hamersley, you submitted 23
18 through 30 on behalf of Appellants.

19 Mr. Immordino, do you have any objection to these
20 documents?

21 MR. IMMORDINO: No. Thank you.

22 JUDGE HOSEY: Okay. Exhibits 23 through 30 are
23 now admitted as evidence into the record.

24 (Appellants' Exhibit Nos. 23-30 were received in
25 evidence by the Administrative Law Judge.)

1 JUDGE HOSEY: Mr. Immordino, you have submitted
2 Exhibits EE and FF on behalf of the Respondent, Franchise
3 Tax Board.

4 Mr. Hamersley, do you have any objections to
5 these two documents?

6 MR. HAMERSLEY: Just the ones I registered
7 previously.

8 JUDGE HOSEY: Yes. Mr. Hamersley was concerned
9 about new information this late in the hearing process.

10 However, both Exhibits EE, the FTB Returns
11 Received Display Printout for tax year 2006, and FF, IRS
12 Account Transcript for Appellants for tax year 2006, have
13 information in them that is in the record to date. So I'm
14 going to allow these documents -- overrule the objection.

15 But we will consider all objections when weighing
16 the evidence and making our decision pursuant to
17 Regulation 30124(f)(4).

18 So that being said, Exhibits EE and FF are now
19 admitted as evidence into the record.

20 (Department's Exhibit Nos. EE-FF were received in
21 evidence by the Administrative Law Judge.)

22 JUDGE HOSEY: All right. Mr. Hamersley, are you
23 ready for your opening statement?

24 MR. HAMERSLEY: Yes, I am, Judge.

25 JUDGE HOSEY: You have 20 minutes. Any time you

1 do not use, we will hold over. Go ahead and begin.

2
3 OPENING STATEMENT

4 MR. HAMERSLEY: So I -- before I get into the --
5 the substantive issues, on this issues of the weighing of
6 the evidence, I'd like to point out that in weighing the
7 evidence, even though the -- the OTA does not adopt the
8 Evidence Code, Section 412 of the Evidence Code discusses
9 the weighing of evidence with respect to weak -- weak
10 evidence.

11 So I'm speaking with respect to exhibits like
12 they're [sic] just submitted -- like the Exhibits AA and
13 DD that were past documents -- that were all, rather
14 than -- than provide all of them as requested in a
15 production request and the subpoena request -- that
16 they're -- they're -- they feel comfortable, you know, in
17 the protection of the order, they don't have to.

18 But what you do when you get that is the -- the
19 Cookston presumption -- I'm sure you're familiar with --
20 you cite it often -- but also this Evidence Code 412.

21 When you don't turn over -- and if you look in
22 Exhibits AA and DD in the IRS communications and on, you
23 know, the other past folders and things referenced in
24 there -- and Judge Hosey, I know you worked at FTB.
25 You're familiar with the past system. There's lots of

1 different folders and documents and stuff.

2 We asked for those. All we got were exhibits
3 attached to their briefs. We got no production on the
4 request.

5 So here's what Section 412 says with respect to
6 the weight of it -- to be given to evidence, quote, "If
7 weaker and less satisfactory evidence is offered, when it
8 was within the power of the party --"

9 (Reporter admonition)

10 MR. HAMERSLEY: Yes.

11 They have the sole possession of the past
12 documents and the IRS communications.

13 "If weaker and less satisfactory evidence is
14 offered, when it was within the power of a party to
15 produce stronger and more satisfactory evidence, the
16 evidence offered should be viewed with distrust."

17 Appeal of Don A. Cookston, cited often by the
18 OTA, it is well established -- quote, "It is well
19 established that the failure of a party to introduce
20 evidence, which is within his or her control, gives rise
21 to the presumption that, if provided, it would be
22 unfavorable."

23 So that's -- that's the rest of the bargain they
24 bought when they -- when they didn't turn over those
25 documents.

1 They're -- they're documents -- and I'll point
2 out with respect to the -- they're not authenticated, and
3 they're not complete in many cases.

4 ROB Exhibit X is a perfect example. ROB Exhibit
5 X was whited out, not redacted in black, as I'll point out
6 later. The line item that made their point in the brief
7 67 -- purportedly paid 67 percent of the deficiency was
8 disallowed to the IRS.

9 It was 8.3 percent. They made that point. They
10 cited Exhibit X, whited out the bottom and the top and the
11 line-item description of the 33 percent where they got
12 their 67.

13 I've never seen such a thing. That evidence is
14 completely unreliable.

15 Exhibit Y, attached to their RRB -- their --
16 their reply brief -- page 19 to 40 is that document. And
17 you can compare the two. They whited out the sections
18 that -- that contradicted the argument they were making in
19 their Respondent's Opening Brief citing Exhibit X.

20 So the weight given to their documentary evidence
21 should be zero. It's not reliable.

22 And as I said, the exhibits that should be looked
23 at -- their ROB's Exhibit X, which was our 7; ROB Exhibit
24 Y, which is our 8; ROB's Exhibit T, referred to as the
25 "smoking-gun letter" that was withheld from us for a

1 period of five years.

2 That was issued on February 15, 2013. It was
3 cited as Exhibit C in the IRS examinations report. The
4 IRS would not give it to us. When we asked for it, they
5 said the FTB Protest Hearing Officer requested
6 confidentiality. You'll have to get it from him.

7 When we asked for it, we were repeatedly denied.
8 It was finally attached to -- parts of it -- to the
9 Exhibit T to the Respondent's Opening Brief. That is not
10 reliable evidence.

11 Also Exhibits 25 and 26 show the subpoena
12 request, the two categories of documents, the past
13 documents, and the -- and the IRS documents, which are
14 referenced repeatedly, as I said, in Exhibits AA and DD of
15 Respondent's briefs.

16 All right. With that said, you know, here we are
17 11 years -- 11 years into this -- this protest -- this
18 appeal -- 7 of which was in the protest -- during the
19 protest -- just -- just under 7 years.

20 If you look at even the Exhibits AA and DD, what
21 on earth were you doing for 7 years? This -- that all
22 goes to the -- the interest-abatement issue.

23 But the transaction is actually quite simple.
24 And so I'd like to explain the transaction. The law is
25 quite simple. There are only Federal Income Tax Code

1 Provisions -- 170 and 731 -- as Judge -- Judge Hosey said.

2 So the ownership structure exhibit -- the
3 Respondent's Reply Brief Exhibit AA has a diagram of
4 the -- of the ownership structure.

5 Basically, the Appellants owned -- I think it was
6 58-point-something percent directly -- indirectly of MC
7 Properties. MC Property owned -- owned two part -- MC
8 Properties was a tax partnership. They -- LLC -- was a
9 tax partnership.

10 They owned two parcels of land that totaled
11 19.- -- I think it was -- -16 acres.

12 On or about 2003, they entered into negotiations
13 with the Palm Springs Unified School District to sell that
14 property to them. The Palm Springs Unified School
15 District is a 501 organization to the extent there's
16 excess value of the sale, there's a charitable
17 contribution deduction.

18 So the -- the negotiations went on from 2003 and
19 did not finally close until April 28th of 2006. There was
20 a -- a letter that threatened condemnation. And finally,
21 the taxpayer caved. And that's referenced in Section 1.2
22 of the Purchase and Sale Agreement.

23 Two things to reference there -- that it was
24 under threat of condemnation and it's a 1033 transaction.
25 No one disagrees about that. Well, 1033 is either

1 condemnation or threat of condemnation.

2 And the -- the -- the sale then took place and
3 closed on April 28th of 2006 for \$10.558 million, I think
4 it was.

5 The taxpayer wrote contemporaneously in Section
6 1.2 of the Purchase and Sale Agreement that the value of
7 the property well exceeds that \$10.5 million and -- and
8 documented that and the fact -- the fact that it was under
9 threat of eminent domain.

10 The problem here on the threat of eminent domain
11 is the appraisals and all the IRS stuff that -- that
12 Respondent relies upon -- Respondent's closing letter,
13 before we filed the protest -- treated that transaction as
14 a constructive condemnation.

15 They said, "You didn't give your property away.
16 There's no domain intent. They took it from you."

17 Well, when the IRS went and talked to the Palm
18 Springs Unified School District after getting all of the
19 FTB's arguments and Exhibit T and all the documents they
20 sent to them, the Palm Springs Unified School District
21 told them the exact opposite: It never went down that
22 road.

23 Well, how's it a 1033 transaction?

24 So the witness then, you know, on this was --
25 is -- switched their stories -- granted, it was a new

1 person and -- at the Palm Springs Unified School
2 District -- but they were very adamant that there was no
3 threat, despite the existence of this threat letter and
4 despite the fact that all the parties agree it was a 1033
5 transaction.

6 So the -- the witnesses supplying information to
7 the FTB and the IRS are questionable.

8 So the bargain sale transaction took place. As I
9 said, it was a 1033 transaction.

10 Procedural history of the case -- this case
11 started with the Franchise Tax Board. The protest got it
12 right about the beginning of -- we filed the protest at
13 the end of 2011; they got it beginning of 2012.

14 Not long after, there were some IDR requests.
15 And then the IRS opened an audit. And the original --
16 notice of proposed adjustment we got quoted a
17 typographical and grammatical error from the FTB's APE's.

18 So it was clear at that point. We knew they were
19 sharing information. We asked -- we asked the disclosure
20 office; they denied it.

21 They got into this -- this little debate about
22 what a "third-party contact" is. And we said
23 "third-party," under the statute, is anyone but the
24 taxpayer. The question is whether you have to disclose it
25 in 19504.7.

1 Just -- they wouldn't answer the question.
2 And -- and as we know in Exhibit T, which was cited in the
3 IRS Examinations Report, there were many communications.
4 It's in those Exhibits AA and DD. We now know.

5 Even though we didn't get the documents, it's
6 absolutely clear from the evidence and the record -- they
7 were -- they were talking regularly.

8 And -- and in Exhibit T, the -- the legal
9 analysis was written from the Franchise Tax Board to
10 the -- to the IRS, which adopted their arguments. And
11 then vice versa, when the Notice of -- of Assessment was
12 issued from the IRS, the FTB adopted their arguments.

13 So there was a lot of coordination. That'll --
14 that'll get to the privity issue.

15 So as I said, what -- what happened is, when the
16 IRS then issued their Notice of Deficiency, which is a
17 90-day letter, that's the end of the IRS controversy.
18 You're -- now, you're working with IRS Appeals and their
19 Litigation Section.

20 If you want to pursue an appeal, you have to file
21 a Tax Court petition. That's litigation. We -- as
22 exhibit -- we gave you Exhibit 3 and 4 that show the
23 docket and show the Tax Court decision.

24 I don't know why on earth we are still calling
25 this an "IRS Determination." An IRS Determination is an

1 IRS examinations -- an IRS audit report.

2 It is very clear that that is a decision of a
3 court of competent jurisdiction of the United States Tax
4 Court.

5 So I don't know why we're talking about an IRS
6 Determination. We don't agree with the IRS Determination.
7 They -- they completely -- the IRS Determination
8 completely disallowed the deduction, which was reversed by
9 the Tax Court.

10 So, as I said, there's only two -- two major code
11 sections here. Section 170 -- I think 12 percent of the
12 deficiencies attributable to that -- the bulk of it, I
13 think 88 percent is attributable to the 731 --
14 specifically, Revenue Ruling 81-242 theory.

15 We're being taxed on the theory based on an
16 article that the two attorneys -- the two attorneys from
17 Franchise Tax Board that have argued the two cases they've
18 had on this -- wrote -- and the -- the -- the article,
19 which is Exhibit 17, makes our case.

20 It says it's a horrible, horrible policy --
21 horrible rule. It should be done away with. But they
22 argue that, you know, because if you -- I'll get into
23 that -- when you look at the history of that Rev. Rule, it
24 was originally a taxpayer-favorable ruling that GCM 38389
25 reversed and said that Section 1033 and 752(b) operate

1 independently. The problem isn't 1033; it's 752.

2 Well in 1991, regulations were passed in
3 1.752-1(f) that allowed liability that it -- you got to
4 fix that problem.

5 The IRS has not litigated or even addressed in
6 any administrative controversy have they taken a position
7 in administrative guidance that 81-242 is still a good
8 law.

9 And yet here we are -- 88 percent of our
10 deficiency is attributable to this theory. That there's a
11 lot -- that there's a transitory liability relief -- that,
12 specifically, when the replacement property was purchased
13 on that Palm Springs Unified sale [sic] District to
14 qualify for 1033 treatment -- that when the -- when the
15 liabilities on the sale property were paid off -- that you
16 cannot view the replacement property transaction that are
17 bookends for nonrecognition, under 1033, as part of a
18 single transaction.

19 And so we stopped. And if you look in the middle
20 and you cut it off, you'll have a transitory relief of
21 liabilities that gives rise to a Section 731 gained --
22 deemed distribution.

23 The Franchise Tax Board freely acknowledges that
24 if an individual had done that transaction, there'd be no
25 problem. There's no -- this is purely a function of the

1 partnership.

2 This -- this -- this proposed issue -- if an
3 individual had -- had done that exact same transaction,
4 there would be no -- no -- no gain -- 731 gain.

5 Res judicata -- as I said, the Tax Court
6 determination letter is not -- the Tax Court April 30 of
7 2015 decision is not an IRS Determination. It's a -- it's
8 a -- it's a decision of a court of competent jurisdiction.

9 The I -- the FTB -- well let me back up a little
10 bit. There are three elements to res judicata. It
11 appears -- I'm not -- never clear what they've
12 acknowledged or not acknowledged -- but it seems like
13 we've limited it to this privity issue.

14 There's three elements to it that -- that --
15 the -- you have a final judgment on the merits. The U.S.
16 Tax Court opinion is that. It's not an IRS Determination.
17 You -- and that -- it's the same cause of action.

18 Well, the California Franchise Tax -- or the
19 Revenue and Taxation Code is derivative for Sections 1- --
20 it conforms to Sections 170 and 731. The tax for
21 California state tax purposes is derivative of the federal
22 income tax.

23 The United States Tax Court looked at the exact
24 issue of what are the federal -- federal income tax
25 consequences applying the Internal Revenue Code 170 and

1 731 to that exact same transaction for the exact same
2 taxpayer for the same tax year.

3 And the -- the FTB does not want to follow it.
4 If there's no federal conformity here, and they do not
5 have to follow this U.S. Tax Court decision, federal
6 conformity is a complete fiction. You'll never have a
7 better case than this for them being required to follow
8 fed.

9 So on the issue of privity, the last prong -- the
10 privity that the -- that the -- we -- the privity looks at
11 one of the things -- one of the things it looks at is
12 mutuality.

13 There is no question that, had the Tax Court gone
14 differently and gone against the taxpayer, that this
15 taxpayer would be barred and would have to pay the state
16 tax based on the federal tax liability -- the decision of
17 the U.S. Tax Court.

18 The FTB is playing this -- when they put it
19 "pending federal" and agreed to do that, they're playing
20 this "heads, FTB wins; tails, taxpayer loses" game. And
21 it's -- it's -- it's a ridiculously bad policy.

22 So looking at the -- the issue of privity. This
23 was recently addressed establishing the -- with respect to
24 the final judgment stipulated Tax Court -- stipulated
25 court decision being a final judgement on the merits for

1 res judicata purposes. There's a lot -- I mean, it's well
2 settled.

3 But it was recently addressed in an October 4th,
4 Ninth Circuit opinion Frank Lane Italiane. And it --
5 Frank Lane Jr. and Alicia -- BAP Number EC-20-1247-SGF --
6 and it confirms that, while subtle -- the law on it cites
7 California law -- California Automobile Association versus
8 Superior Court 50 Cal.3d 658, 664-665.

9 On the issue -- on the standard for res
10 judicata -- or privity, there was a June 3rd, 2022
11 California Supreme Court opinion, Lynn Grande versus
12 Eisenhower Fresh. And it, again, says here's the
13 established standard:

14 Identity or community of interest -- quote,
15 "Identity or community of interest" --

16 (Reporter admonition)

17 MR. HAMERSLEY: Sure.

18 "The standard for privity is an identity or
19 community of interest such that the interest represented
20 in the first action reasonably should have" -- they should
21 reasonably expected to be bound -- the -- the party in
22 privity in the first act -- in the second action should
23 have reasonably expected to be bound in the first suit.

24 They cited the long-standing California standard
25 in DKN Holdings 61 Cal.4th, 826.

1 So, you know, I had mentioned it's not just the
2 IRS communications that -- that caused the FTB to be in
3 privity. And there are lots of them. And they got --
4 they certainly had their chance to speak up and -- and
5 make their case.

6 They did it in Exhibit T to their opening brief,
7 argued their position. And then as the past documents,
8 their Exhibits AA and DD, show, they had early and
9 often -- they had lots of communications with the IRS.

10 So the -- the -- privity is established by the
11 fact that the Protest Hearing Officer, who happens to be
12 the tax counsel here, reviewed the tax documents provided
13 by the IRS and decided to put it "pending federal,"
14 deciding that it was the same transaction tax year and
15 federal income tax issues. That's an identity or
16 community of interest.

17 The conformity policy -- conforming to a federal
18 law is an identity or community of interest. It's, in
19 fact -- it's derivative.

20 The documents shared under the disclosure statute
21 and the MOA that's required to do that can only be
22 lawfully shared by the FTB and IRS and vice versa if there
23 was an identity and community of interest in the subject
24 matter.

25 There's a right to know and a need to know. FTB

1 had significant, as I said -- significant input and
2 meaningful voice in the IRS matters by sending its legal
3 analysis and regularly communicating.

4 So that's the part about, you know, how much
5 communication was there?

6 We'd like to see all of the documents. All of
7 the IRS -- and we don't have anywhere near those. We were
8 never given -- we have what they -- what they attached to
9 their exhibits. That's all we have.

10 JUDGE HOSEY: Mr. Hamersley, you have about a
11 minute left. Although, it seems that we're getting into
12 some argument. So you -- if FTB is comfortable with
13 waiving an opening and -- and just moving into arguments,
14 we are able -- you can use the 30 minutes of argument as
15 well.

16 MR. HAMERSLEY: Probably makes sense, yeah.

17 JUDGE HOSEY: Mr. Immordino?

18 MR. IMMORDINO: That's fine. Thank you.

19 JUDGE HOSEY: Okay. So you'd just be moving into
20 your arguments, as well, after Mr. Hamersley, if you --
21 or -- Mrs. Mosnier as well --

22 MS. MOSNIER: If -- if you wouldn't mind, we
23 might like just a short few minute's opening statements.

24 JUDGE HOSEY: Would you like to do that now? Or
25 would you like to -- hold on. Let me stop my clock.

1 Would you like to do that now? Or would you like
2 to wait until we finish with Mr. Hamersley? He's on issue
3 three right now.

4 MS. MOSNIER: We would defer to the -- to the
5 OTA. Although, our request would be to do it now.

6 MR. HAMERSLEY: That's fine.

7 JUDGE HOSEY: Mr. Hamersley, what are you
8 comfortable with?

9 MR. HAMERSLEY: That's fine.

10 JUDGE HOSEY: We'll do a short -- okay.

11 FTB, please proceed.

12 MR. IMMORDINO: Thank you. Yeah. I think it
13 would help to have an opening just to kind of lay some
14 foundation.

15 JUDGE HOSEY: I'm sorry. Can you get a little
16 closer --

17 MR. IMMORDINO: Oh, no. Thank you.

18 JUDGE HOSEY: Sorry. I turned my mic off.
19 Can you just get a little closer so we can hear
20 you?

21 MR. IMMORDINO: Is this better?

22 JUDGE HOSEY: Yes. Thank you.

23 MR. IMMORDINO: Sorry about that.

24 JUDGE HOSEY: It's okay. Thanks.

25 MR. IMMORDINO: I think that having an opening

1 would help lay a little bit of foundation, make it a
2 little bit better.

3
4 OPENING STATEMENT

5 MR. IMMORDINO: Okay. So thank you very much.

6 I am going to discuss the Palm Springs land and
7 the tax impact of Appellants' partnership distributions.
8 Then my colleague, Ms. Mosnier, will cover interest
9 abatement, res judicata, and the late-filing penalty.

10 The first issue in this appeal is whether
11 Appellants met their burden to show that they had a
12 bargain sale of land.

13 In a bargain sale, the taxpayer transfers
14 property in a transaction that is part sale and part
15 charitable contribution. Like most cases arising out of
16 real estate transactions, this appeal is document heavy,
17 and the documents show what happened.

18 The Palm Springs Unified School District was
19 interested in purchasing land which was owned by
20 Appellants and others through LLC's.

21 The School District was also interested in
22 purchasing the adjacent parcel of land which was owned by
23 an unrelated third party.

24 During a lengthy negotiation, the School District
25 and Appellants had multiple appraisals prepared. And as

1 real estate prices rose during this period, so did the
2 valuations in the appraisals.

3 Appellants had two separate appraisers prepare a
4 total of three appraisals, which had valuations starting
5 at \$8.2 million and ending at \$10.7 million.

6 Similarly, the School District's appraisers
7 prepared appraisals with valuations starting at
8 \$8.2 million and ending at \$10.5 million.

9 Ultimately, the parties agreed on a sales price
10 of \$10.5 million. The unrelated third party also sold the
11 adjacent parcel of land for the same per-acre sales price.

12 During negotiations, Appellants brought up the
13 option of a part sale, part charitable contribution. The
14 School District considered that approach but ultimately
15 made a fair market value offer and even had the purchase
16 agreement specifically state that the sale was made at
17 fair market value.

18 Appellants originally filed a 2006 tax return,
19 did not report the sale of the land as a bargain sale. It
20 was not until four and a half years after the sale and the
21 middle of the audit that Appellants filed an amended tax
22 return and claimed that the value of the land was worth
23 approximately \$20 million, which is almost twice the sales
24 price.

25 To support this inflated valuation, Appellants

1 did not use either of the two appraisers that they'd used
2 during the sales negotiations.

3 Instead, Appellants used a new appraiser who
4 prepared a valuation for tax purposes. During the IRS
5 examination, the IRS inspected the land and also prepared
6 an appraisal.

7 The IRS determined that the School District had
8 paid fair market value for the land. Further, the IRS
9 appraiser rejected the Appellants inflated \$20 million
10 appraisal, finding that it was inconsistent and biased.

11 To get bargain sale treatment, two separate
12 requirements must be met: First, the Appellants must show
13 the value of the land was clearly out of proportion to the
14 amount paid by the School District. Here, the evidence
15 will show that Appellants were paid fair market value for
16 the land.

17 Second, Appellants must show that the excess
18 value in the land was transferred with the intention of
19 making a gift. Here, the law does not allow there to be
20 intent to make a charitable contribution because the
21 Appellants accepted the School District's fair market
22 value offer.

23 Regarding Appellants' assertions to the contrary,
24 the IRS summarized its discussions with the School
25 District as follows, and I quote: "The attorney and

1 retired director stated that the taxpayer statements on
2 the Form 8283 attachment are not accurate and misrepresent
3 the School District's position at the time of the
4 transaction," end quote.

5 In addition, the courts have been especially
6 unwilling to allow taxpayers to unilaterally assert a gift
7 occurred when they receive a fair market value offer,
8 particularly in the background of eminent domain
9 proceedings such as in this appeal.

10 As courts state, if the Appellant did not feel
11 the offer was fair, they had recourse through the eminent
12 domain process -- an option the Appellant chose not to
13 pursue.

14 Next, I want to discuss -- let's see.

15 I'm going to discuss the -- the tax impact of
16 Appellants' partnership distributions.

17 Subchapter K of the Internal Revenue Code gives
18 partners in a partnership significant flexibility.
19 However, with that flexibility, Subchapter K also gives
20 limitations.

21 This appeal deals with one of those limitations.
22 Specifically, the limitations surrounding a partner's
23 basis in a partnership.

24 When a partner puts something into a partnership
25 or recognizes gain, their partnership basis increases.

1 Similarly, when a partner takes distributions out of the
2 partnership, their partnership basis decreases.

3 A partner can take distributions out of a
4 partnership without owing any tax as long as they have
5 basis to cover the distributions.

6 However, when a partner's distributions exceed
7 their basis, Subchapter K requires that they recognize
8 gain.

9 In this appeal, Appellants received cash
10 distributions and the relief of partnership liabilities,
11 which is also treated as a cash distribution. These
12 distributions exceeded the Appellants' basis in the
13 MacLeod Couch Properties, LLC. And so the Appellants are
14 required to recognize gain.

15 Regarding the portion of the distributions
16 related to the relief of partnership liabilities, there is
17 an IRS General Counsel Memorandum directly on point. The
18 General Counsel Memorandum, or GCM, analyzes the impact or
19 the relief of the partnership liabilities in IRC Section
20 1033 transactions such as we have in this appeal.

21 The GCM specifically considers the Appellant's
22 position, fully analyzes it, and then rejects it,
23 including the single transaction netting rule that
24 Mr. Hamersley mentioned was passed in '91.

25 Then one year later, a revenue ruling is issued

1 which memorializes the analysis and determination in the
2 GCM and which is consistent with the FTB's position in
3 this appeal.

4 Finally, there is discussion of a Tax Notes
5 article which proposes a law change. This article is
6 written by a tax practitioner in their personal capacity.

7 Further, while not authoritative, the article
8 reiterates that the law requires a result consistent with
9 the FTB's assessment and that a law change would be
10 necessary for a contrary result.

11 And with that, I'll pass it to my colleague,
12 Ms. Mosnier. Thank you very much.

13 JUDGE HOSEY: Ms. Mosnier, you have about 13
14 minutes.

15
16 FURTHER OPENING STATEMENT

17 MS. MOSNIER: Thank you. Good afternoon.
18 Marguerite Mosnier for Franchise Tax Board. And thank
19 you, Mr. Immordino.

20 I'd like to talk a bit about the concept of res
21 judicata, interest abatement, and the Section 19131
22 late-filing penalty.

23 Res judicata is an affirmative defense. It must
24 be proven -- it's offered up and proven by the Appellants.
25 They must establish four elements to avail themselves of

1 this defense.

2 The evidence will show that the Appellants have
3 not established three of the four elements necessary to
4 prove res judicata should govern the disposition of this
5 appeal. And there is no requirement that FTB follow a Tax
6 Court judgment with respect to tax year 2006.

7 And similarly, the statutory right to interest
8 abatement depends on the Appellant's having shown there
9 was an unreasonable delay by FTB in working the underlying
10 protest in this case. And here again, the evidence will
11 show that there was no unreasonable delay or delay at all
12 by the Franchise Tax Board.

13 Further, the -- the evidence will show that any
14 delay that the OTA may determine is attributable to the
15 Appellants.

16 And finally, with respect to the late-filing
17 penalty -- and this applies only to the 2006 tax year --
18 the record reflects a lack of evidence to establish
19 reasonable cause for filing a late 2006 California return.

20 So the evidence is clear that the Franchise Tax
21 Board properly proposed the adjustments denying the
22 charitable contribution deduction; proposing a Section 731
23 gain adjustment; and proposing a late-filing penalty; and
24 that the Appellants have not met their burdens of proof to
25 show otherwise.

1 And consequently, the OTA should sustain FTB in
2 this case.

3 JUDGE HOSEY: Okay. Thank you.

4 Mr. Hamersley, would you like to -- you're into
5 your closing argument time now. So you were able to
6 cover, again, any issues before, go in-depth, continue
7 forward --

8 MR. HAMERSLEY: Do I get rebuttal or -- after?

9 JUDGE HOSEY: No. This will be -- this will
10 be -- yeah. Rebuttal will be after FTB's argument.

11 So your 30 minutes will start now.

12
13 CLOSING ARGUMENT

14 MR. HAMERSLEY: Yeah. And well, you know, those
15 are wonderful narratives except they have nothing to do
16 with reality. And the evidence will not show what
17 evidence -- I've cited specific evidence that shows
18 exactly the opposite.

19 With respect to the appraisals, those appraisals
20 were two year -- he didn't mention dates -- two years
21 stale.

22 With respect to the GCM, that's a 1980 GCM which
23 reversed the private letter ruling -- '79 private letter
24 ruling that led to Revenue Ruling 81-242.

25 How on earth, in 1980, could Gerald Cohen, the

1 chief counsel who wrote GCM 38389 -- who I wanted to
2 testify as a witness, but was denied -- who thinks
3 81-242's was a dead letter -- How on earth could they
4 consider those partnership regs that were written in 1991
5 in 1980?

6 They -- what Gerald Cohen said was 752(b) is the
7 problem, not 1033. The authors of the article --
8 Mr. Immordino and -- and his colleague -- former colleague
9 suggested that to fix it -- to have a -- a single
10 transaction, you have -- you would have to modify 1033.

11 Well, the GCM says 1033 is not the problem; it's
12 752(b). And 752(b) was fixed in 1991 in 1.752-1(f). The
13 problem's fixed.

14 (Reporter admonition)

15 MR. HAMERSLEY: Yeah.

16 This is a theory that an -- articles were written
17 on. You can't tax taxpayers on theories. It's not right.

18 I've spoken to the author, Gerald Cohen, of GCM
19 38389. He doesn't agree with it. They reference Revenue
20 Ruling 2003-59, which was adopting the liability netting
21 and a 1031 to say, "See? It doesn't apply in 1033 because
22 you need a 1033 liability offset rule like you have in
23 1031."

24 You don't. They're just not getting it.

25 The single transaction -- and Gerald Cohen

1 concedes that. And -- and there was -- by the way, before
2 it was reversed, there was a lot of controversy at the
3 IRS.

4 The author of 2003-59 had told me that they were
5 trying to include 1033, but, as usual, the cases --
6 revenue rulings are limited to the facts of the questions
7 that were asked. It was a 1031 question. Had they been
8 allowed to extend it to 1033, they would have.

9 So this is a -- this is a problem that exists
10 only in the mind of two Franchise Tax Board attorneys. As
11 I said, you cannot tax a taxpayer based on that theory.
12 And that's 88 percent of the deficiency.

13 So the charitable contribution is 12 percent of
14 those two. So the bulk of it is this -- is this 81-242
15 theory based on their notions of what GCM 38939 was and
16 was not.

17 And they're wrong. They're flat wrong. And the
18 author -- the authors of both revenue rulings have said
19 that. And I'd like to have them here to testify to tell
20 you that.

21 And the IRS has not -- has not cited that revenue
22 ruling since it was issued -- 40-plus years. He -- he
23 just mentioned the rev. ruling. He didn't mention the
24 date. It's 81-242 -- it was over 40 years ago. No one's
25 been taxed on that except these two taxpayers that have

1 come before you.

2 All right. So with respect to these four
3 elements of res judicata. I have -- I've laid out the
4 elements of res judicata. And as I said, I was under the
5 understanding, from the prehearing conference, that the
6 privity was the only element that was in question.

7 Now, all of a sudden, we're reverting back
8 to "There's other elements that are in question."

9 Well, I wish I -- you know, I've spoken to
10 those -- that the U.S. Tax Court opinion's the final
11 judgment on the merits. And the -- it's clear that it's
12 the same cause of action. It has the same nucleus of --
13 of operative -- common operative facts.

14 So Respondent, if -- if somehow, we were to view
15 the -- the -- the April 30th 2015 U.S. Tax Court opinion
16 as somehow being an IRS Audit Report -- which is what an
17 IRS Determination is -- I mean, that would be more in this
18 fictional world.

19 But the -- the FTB's own pre- -- prehearing
20 conference statement said they would carry the burden of
21 proof, not the taxpayers. Well, to the extent that their
22 position is inconsistent with the U.S. Tax Court opinion
23 on Sections 170 and 731, then they have the burden, not
24 the taxpayer.

25 There's a presumption of correctness in the U.S.

1 Tax Court opinion. They just want to disregard the -- the
2 chief judge of the U.S. Tax Court. And they wanted to
3 say, "Oh. It's just a stipulated decision; therefore it's
4 a" -- you know, "it's really an IRS decision."

5 The law is well settled. That's not right.

6 Section 170 -- it -- basically, their position is
7 based on a couple of things: Those stale -- those stale
8 appraisals that -- you know, it was a rapidly rising
9 market in 2003 to 2006. And the taxpayer kept saying,
10 "I'm not closing. The price is going up. The price is
11 going up."

12 And the appraisals show it. And we've already
13 done this with the IRS. The -- the issue was resolved
14 based on a -- a meeting on the battle of appraisals.

15 Their appraiser was an IRS employee. Their
16 appraiser did a drive-by. He doesn't live in California.
17 He did not visit the Sandy -- the Palm Springs area.
18 There are a lot of things in the IRS Examinations Report
19 that are not quite accurate.

20 And as I said, the Palm Springs Unified School
21 District completely changed their story. They told the
22 FTB that, you know, it was taken; that's why it's a 1033.
23 They told the IRS that it never went down that road; it
24 was completely voluntary.

25 So -- the -- there's a lot of things in the

1 Examination Report that are not reliable. And based on
2 that and based on the strength of the taxpayer's
3 appraisals from a qualified appraiser, the FTB auditor has
4 acknowledged they don't have their own appraiser.

5 They are trying to rely on an IRS appraisal --
6 which was an IRS employee -- and -- and the FTB auditor
7 has acknowledged "We're not qualified. The FTB is not
8 qualified to challenge appraisals."

9 So let's leave that to the experts -- the -- the
10 people who do that for a living.

11 And we did that. And we did a battle of
12 appraisals with the IRS. And that's why -- why only
13 \$800,000 of \$9.577 million of disallowed deficiency,
14 charitable contribution deduction, was ultimately
15 disallowed. Because the appraisals prove it.

16 That's what the evidence will show specifically,
17 not generally.

18 Some of the exhibits -- point to on -- so where
19 they sprung with this theory -- they -- they state
20 throughout their briefs that we somehow paid 67 percent of
21 the deficiency. Well, \$800- out of \$9.577 million is
22 8.3 percent. It's not 67 percent.

23 That's the whited-out Exhibit X from their --
24 their -- Respondent's Opening Brief. That's a litigations
25 memo. What that is -- that was the Appeals Officer

1 arguing to her boss, the Chief Counsel -- who did not like
2 their views. He thought there was weakness in the
3 appraisals. He thought there was weakness in the witness
4 credibility. That's why it went from a complete
5 deficiency -- a complete disallowance to 8.3 percent.

6 The whitening out of in the arguments in the
7 Respondent's Opening Brief used that to springboard to say
8 that we paid 67 percent. What that is is they were
9 telling -- they were telling the Chief Counsel that they
10 had a 67 percent chance of victory.

11 Well, why do you concede and -- and -- and have
12 the taxpayer pay 8 percent?

13 So a lot changed. They're -- a lot of their
14 information is, really, nowhere near accurate.

15 And I was there firsthand, as I said. This was
16 the issue I was talking about testifying. They don't have
17 firsthand knowledge. They're reading documents and giving
18 a view from it.

19 And I'm telling you, I was there. I can testify
20 as to what happened and what did not happen. I'm a
21 material witness on that fact.

22 My clients would not have been very happy if we
23 paid 67 percent of the deficiency.

24 So as I said, that's the whole issue of res
25 judicata -- that we're not going to come here and

1 relitigate this battle of appraisals again. We've already
2 done that once on the exact same transaction.

3 We went through the appraisals. As I said, they
4 don't have their own appraiser. They -- they're relying
5 on the IRS; they weren't there. It wasn't their
6 appraiser; it was an IRS employee.

7 We have an appraisal. In fact, we have a second
8 appraisal from a woman named Rose Sweet. She wasn't
9 certified. We went out and got another one. And it
10 said -- it's close to the one that we have in the record.

11 So they're looking at the stale appraisals and
12 saying those are contemporaneous. It doesn't take a
13 genius to figure out that, in a "rising rapid" market like
14 we've had recently again -- that old sales aren't good
15 value -- aren't good information.

16 The -- the properties in our valuations were very
17 close in time. And there were properties to support the
18 \$20 million value.

19 They sold for way more, and it turns out the
20 taxpayer was right when he put that in -- in the Purchase
21 and Sales Agreement in Section 1.2.

22 The -- just -- on the 81-242 issue, just to give
23 you the -- the exhibits, it's our Exhibit 17, 15, and 16.
24 17 is the Tax Notes article. 15 is the Rev. Rule 81-242.
25 And Exhibit 16 is -- is GCM 38389.

1 On 81-242 and the GCM, it -- those exhibits tell
2 you all you need to know, especially the Tax Notes
3 article.

4 Excuse me one minute, please.

5 I guess airplane mode doesn't kill that. I
6 apologize for the disruption.

7 So yes, you mentioned the computational errors as
8 well. Exhibit 11 is EY 7 -- Section 737 computation.

9 On the interest abatement, look, you know, it
10 took seven years in the protest. Three years after the --
11 the April 2000 -- April 30th, 2015 Tax Court decision was
12 issued -- it took three years to issue the determination
13 letter.

14 We kept responding. That's in the correspondence
15 that we submitted. We had asked, again, during discovery
16 for FTB to say, "Is that all of the correspondence?"

17 They wouldn't say -- said, "Well, it's redundant
18 to give our correspondence. We were on -- on the other
19 end of it."

20 Well, then, just -- that's fine. Just say,
21 "That's it. That's true, accurate, and complete."

22 And they wouldn't do that. I can tell you;
23 that's it.

24 So if you look at -- at the lack of
25 communication; the lack of transparency; not giving us the

1 Exhibit C, the -- the Respondent's Opening Brief; Exhibit
2 T letter -- smoking-gun letter; not giving us any of the
3 documents in discovery; subsequent what was reflective of
4 what happened in the protest.

5 They were trying to prevail on this Section 170
6 and 81-242. And there just wasn't the facts of the law to
7 do it. So it took three years. There was communication
8 between that 2015 to 2018 period.

9 Take a look at the exhibits we submitted: the --
10 the Franchise Tax Board notice 2006-1, which was recently
11 updated -- or more recently updated in 2018-1. Those are
12 the Docketed Protest Procedures.

13 Well, none -- we kept asking for those to be
14 followed, including a case development plan. We were
15 ignored. There was no communication. There's a two-year
16 time frame for this kind of -- kind of issue.

17 As I said, it's a very simple fact pattern and
18 very simple law. What on earth could it take you seven
19 years -- albeit there was a brief hiatus for the -- the
20 federal tax matter -- but still, on the interest-abatement
21 issue, that's not reasonable in any world. So I would
22 take a look on those.

23 Exhibits 9 and 14 -- that's all the protest
24 corresponded [sic] in nearly seven years.

25 Respondent's Exhibits AA and DD -- those are the

1 past exhibits that they submitted, not all the past
2 documents that are relevant.

3 Exhibit 7-X -- 7 -- Exhibit 7, which is
4 Respondent's Opening Brief, X, which is the whited-out IRS
5 document.

6 Exhibit 25 and 26 and '7 are the -- showed that
7 they would not provide us with the requested IRS documents
8 or past documents.

9 Exhibit T is that -- that February 15, 2013
10 smoking-gun letter, which was Exhibit C to IRS's Audit
11 Report. That was withheld for five years until it was
12 attached as Exhibit T to the opening brief -- to
13 Respondent's Opening Brief.

14 Exhibit 23 is Notice 2006-6, the Docketed Protest
15 Procedures. And Exhibit 24 is Notice 2018-1.

16 On the delinquent penalty, I've explained those.
17 That's thorough -- been thoroughly discussed in our
18 briefs. They just assessed without asking any questions.
19 There's -- there are -- it's very well described in our
20 brief.

21 But the deficiency was created from the position
22 that the return -- the 565 was filed timely. The -- the
23 taxpayer's CPA, at the time -- a return preparer -- was
24 terminally ill. And I've attached a brief to show his
25 obituary. And he died. And then it took some time.

1 The -- the return with the extension was one
2 month late. So that's reasonable cause. And it's
3 explained, as I said -- explained thoroughly in the
4 briefs.

5 That's -- that's it.

6 JUDGE HOSEY: Sorry. That concludes your
7 arguments for now?

8 MR. HAMERSLEY: Yes.

9 JUDGE HOSEY: Okay. Thank you, Mr. Hamersley.

10 Mr. Immordino, would you like to begin your
11 closing arguments?

12 MR. IMMORDINO: Thank you very much.

13
14 CLOSING ARGUMENT

15 MR. IMMORDINO: I am going to discuss the sales
16 of Palm Springs land and the tax impact of the partnership
17 distributions. And then my colleague, Ms. Mosnier, will
18 cover interest abatement and res judicata and late-filing
19 penalty.

20 Initially, I want to address the burden of proof.
21 For the precedential OTA cases of Molosky and GEF
22 Operating Inc., FTB's determination is presumed correct,
23 and the taxpayer has the burden of proving it wrong.

24 Similarly, for refund claims, per the
25 precedential OTA appeals of Gillespie and Jolly, LLC, a

1 taxpayer bears the burden of proving entitlement to a
2 refund claim. See also the OTA Regulation Section 3219.

3 Further, Appellants have cited no law which would
4 cause the burden to shift from the Appellants to the FTB.
5 Accordingly, the Appellants bear the burden of proof in
6 this appeal.

7 Going to the bargain sale issue. First, I note
8 that in the relevant law, the term "condemnation" covers
9 eminent domain and is a term I will be using going
10 forward.

11 In a bargain sale, the taxpayer transfers
12 property in a transaction that is part sale and part
13 charitable contribution. For a bargain sale, two separate
14 requirements must be met:

15 First, Appellants must show that the value of the
16 land was clearly out of proportion to the amount paid by
17 the School District. Second, Appellants must show the
18 excess value in the land was transferred with the
19 intention of making a gift.

20 Going to the first prong of whether Appellants
21 have shown that the value of the land was clearly out of
22 proportion to the amount paid by the School District.
23 Notably, all contemporaneous appraisals, including
24 Appellants own appraisals by two different appraisers,
25 support that fair market value was paid for the land.

1 In addition, the IRS physically inspected the
2 land and also prepared an appraisal which determined that
3 fair market value was paid for the land.

4 Further, as discussed by the IRS in Exhibit B,
5 the IRS reviewed the Appellant's new appraisal, which
6 valued the land at \$20 million, and found that it was
7 biased, inconsistent, and did not support the valuation.

8 While this appeal deals with the threat of
9 condemnation, that threat came out just two weeks before
10 the purchase agreement was signed.

11 So let's look at the year and a half during which
12 there was no threat of condemnation and Appellants could
13 have sold the land to third parties. And, in fact, the
14 School District even encouraged the Appellants to accept
15 any third-party offers.

16 In Exhibit H, the Appellant's attorney summarizes
17 that the School District had informed Appellants to, and I
18 quote, "not hesitate to accept offers from third parties
19 because the School District may not ultimately proceed
20 with the acquisition," end quote.

21 The School District reiterated in Exhibit I that
22 Appellants are free to dispose of the property as they
23 believe is in their best interest.

24 Appellants had the opportunity to sell to any
25 third parties who offered a better deal than the School

1 District. But Appellants did not a sell to a third party
2 and chose instead to pursue negotiations with the School
3 District.

4 Let's look -- let's look at the negotiations
5 between the parties and the Appellant's own words during
6 the final round of negotiations that led to the purchase
7 price.

8 Exhibit H is a July 2005 letter from the
9 Appellant's attorney to the School District's attorney, in
10 which the Appellant's attorney summarizes that the
11 Appellant called the School District and told them that he
12 thought the value of the land to be \$550,000 per acre but
13 wanted at least \$600,000 per acre based on high interest
14 from third parties.

15 So \$600,000 per acre is the high point that the
16 Appellants asserted in their negotiation posturing. And
17 as we all know, the way negotiations work is that you ask
18 for the best, each side gives a little, and you meet
19 somewhere in the middle.

20 And that's exactly what happened here with the
21 School District making a fair market offer at \$550,000 per
22 acre -- an amount that even Appellants' own July 2005
23 letter -- dated -- reflected fair market value.

24 Appellants accepted this offer. And the sale
25 closed at \$550,000 per acre, which is a \$10.5 million

1 sales price.

2 The unrelated third party also sold the adjacent
3 parcel of land for the same per-acre price. This is a
4 sale that was fully negotiated and that closed at fair
5 market value.

6 The purchase price was equal to 98 percent of the
7 Appellant's highest appraisal and 100 percent of the
8 School District's highest appraisal.

9 Now, the Appellant mentions the timing of the
10 appraisals and that they were outdated. But the -- the
11 exhibits I just cited -- mentioned -- came from July,
12 which is where the Appellants mention of the property was
13 worth -- or July 2005, where the Appellants mentioned the
14 property's worth \$550,000 per acre. But he postured in
15 negotiations that he wanted \$600,000 per acre. That was
16 July of 2005.

17 Then, during August of 2005, the School District
18 got an update to its appraisal. And that update was then
19 modified in October of 2005.

20 So in October of 2005, the school district's
21 appraisal reflected a value of \$550,000 per acre. And the
22 Purchase Sale Agreement was signed just one month later in
23 November of 2005.

24 Now, the Appellants are using a date of April of
25 2006. That is the date that the sale closed. The

1 Purchase Sale Agreement was signed in November of 2005.
2 And that is the date when the parties agreed on a price.
3 And that's how, especially commercial, real estate
4 transactions work.

5 You sign a Purchase Sale Agreement. The deal is
6 set. And then there's a due diligence period for any
7 real, you know -- real property purchase. Once the due
8 diligence period is over, then the deal -- then the escrow
9 will close and the title transfers.

10 But the agreement on price was in that Purchase
11 Sale Agreement. That was a binding legal document. If
12 either party had not wanted to go forward with their --
13 with their obligations under that document, they would be
14 subject to breach.

15 And again, in November of 2005, the School
16 District had let the Appellants know about the
17 condemnation -- of the plan to begin condemnation process.

18 If the Appellants did not feel the School
19 District's offer was fair, they had the -- the option to
20 pursue remedies through the condemnation process. But
21 they chose not to.

22 In Meyer Brewing, the taxpayer values property at
23 \$1.2 million but accepted \$900,000. In not allowing a
24 bargain sale, the Tax Court stated, and I quote, "The
25 taxpayer who negotiates for the best terms he can obtain

1 in a commercial transaction cannot subsequently claim a
2 deduction based upon on any excess value of the
3 contributed property," end quote.

4 Also as the court in Hope stated, and I quote,
5 "Grover Hope, now, should not be allowed to claim that he
6 consented to the settlement only because he would later
7 claim a bargain sale and charitable gift to the state,"
8 end quote.

9 Similar to the taxpayers in Hope and Meyer
10 Brewing, Appellants engaged in lengthy negotiations which
11 resulted in a fair market value price and are now
12 precluded from asserting a bargain sale occurred.

13 The facts demonstrated that Appellants have not
14 met -- met their burden of showing that the value of the
15 land was clearly out of proportion to the amount paid by
16 the School District.

17 Now, moving to the second prong of a bargain
18 sale, which is whether Appellants have met their burden of
19 showing that the transfer of any excess value in the land
20 was made with the intention of making a gift.

21 Importantly, this appeal deals with properties
22 sold under the threat of condemnation. Appellants
23 deferred gain from the sale of the Palm Springs land under
24 Internal Revenue Code Section 1033 by asserting that the
25 land was sold under the threat of condemnation.

1 Appellants also assert, in Exhibit Q, that the
2 implications of the condemnation were so significant that
3 the School District would not sign the charitable
4 contribution form because the School District was
5 concerned about being legally required to pay more for the
6 land.

7 These statements were made by the Appellants
8 under penalty of perjury.

9 Now, under the case law, if Appellants feel that
10 they are not being offered enough for their property, then
11 they must go through the condemnation process.

12 Similar to Appellants, the taxpayers in Hope
13 inserted a clause in the purchase agreement that the
14 taxpayer believes the value of the property exceeds the
15 purchase price.

16 The Hope court rejected his clause and stated
17 that such a unilateral statement cannot change the
18 taxpayer's negotiated fair market value deal into a
19 bargain sale.

20 The Appellants argue that they should be
21 considered under the condemnation process for some items
22 that benefit their position in this appeal but not for
23 others that do not benefit them.

24 But Appellants cannot have it both ways. In
25 fact, the Hope court discusses exactly the

1 inappropriateness of the advantage Appellants, from the
2 taxpayers in Hope, were trying to obtain at the crossroads
3 of the condemnation process in tax law with the courts,
4 stating, and I quote, "The condemnation procedures should
5 not be forced to compete with the tax procedures for the
6 right to determine value in a condemnation case," end
7 quote.

8 Accordingly, if taxpayers felt the offer was too
9 low, they had recourse through the condemnation process,
10 which they chose not to pursue.

11 So in conclusion, it is the Appellants' burden to
12 show that they met each of the two separate requirements
13 necessary for bargain-sale treatment. In this appeal,
14 Appellants have satisfied neither.

15 This leads to the second issue in this appeal,
16 which is did the Appellants meet their burden of showing
17 error in FTB's assessment that partnership distributions
18 exceeded the Appellants' partnership basis.

19 Now, as we already discussed, partners must
20 recognize gain when distributions exceed their partnership
21 basis. This includes not only distributions of cash, but
22 the relief of partnership liabilities.

23 This appeal deals with Appellants' distributions
24 from the MacLeod Couch Properties, LLC, also referred to
25 as MC Properties, LLC, in various documents.

1 Appellants' total cash contributions received and
2 partnership liabilities relieved exceeded the Appellants'
3 basis; and therefore, Appellants have taxable gain under
4 IRC Section 731. It is a purely mechanical result.

5 Regarding the treatment of partnership
6 liabilities in an IRC Section 1033 transaction, such as we
7 have in this appeal, there are both a General Counsel
8 Memorandum, or GCM, and a revenue ruling directly on
9 point, which affirms the FTB's assessment in this appeal.

10 In GCM 38389, the IRS considered thoroughly --
11 and thoroughly reviewed the partnership liability netting
12 issue -- and specifically rejected the analysis set forth
13 by the Appellants.

14 Now, in their opening, the Appellants mentioned
15 Regulation 1.752.1(f) that was referred to as the
16 "single-transaction rule."

17 And so what this says is that, when there's a
18 single transaction, you net the impact to the partnership
19 change in liabilities in that transaction.

20 The examples given in that regulation are when
21 you contribute property, which is subject to a liability,
22 to a partnership. In this single transaction, there are
23 multiple impacts to a partner's liabilities, and you net
24 it.

25 It also gives the example of a merger. When you

1 have a -- a merger, which is a single transaction, you net
2 the impact on the partnership liabilities.

3 But even though these -- some changes to these
4 regs might happen after the GCM, the GCM still
5 specifically analyzed the single-transaction-netting
6 issue.

7 And it said there's no way that you could have a
8 sale of a property followed by a purchase of another
9 property, potentially years later, and you could say
10 that's one transaction.

11 And the OTA made a similar analysis in its
12 decision in the Appeal of Shaeffer.

13 And so one -- one year after the GCM was issued,
14 the IRS then memorialized the GCM's analysis and
15 conclusion in Revenue Ruling 81-242.

16 As the Ninth Circuit Court of Appeals held,
17 revenue rulings are entitled to substantial judicial
18 deference. With the Ninth Circuit stating The McKnight
19 Ranch, and I quote, "It is well stated that, where federal
20 law and California law are the same, federal rulings
21 dealing with the Internal Revenue Code are persuasive
22 authority in interpreting the California statute," end
23 quote.

24 Also, while not precedential, the OTA analyzed
25 this same issue in 2019 in the Appeal of Scott Schaeffer.

1 And consistent with the revenue ruling, made it -- a
2 determination consistent with the FTB's assessment in this
3 appeal, including analyzing the single-transaction rule.

4 In the briefing, the Appellants also discuss the
5 unitary basis rule, as discussed in Revenue Ruling 84-53.
6 And this revenue ruling also supports FTB's assessment.

7 This rule references the basis rules in IRC
8 section 705 and states that a taxpayer who has multiple
9 direct interests in a partnership will only have one basis
10 in that partnership.

11 So the scenarios in the revenue ruling are where
12 a taxpayer owns both a direct general interest and a
13 limited interest in the same partnership.

14 So while the taxpayer has two direct interests in
15 that partnership, the taxpayer still only has one single
16 basis in the partnership.

17 This same issue comes up -- or this same issue
18 comes up with disregarded entities. Say a taxpayer owns
19 an interest in a partnership directly and also owns an
20 interest in that same partnership via an entity that is
21 disregarded for tax purposes.

22 Since the disregarded entity does not exist for
23 tax purposes, the taxpayer is treated as owing -- as
24 owning the disregarded entity's interest directly.

25 So for tax purposes, the taxpayer's two direct

1 interests in the same partnership, i.e., the interest a
2 taxpayer owns directly and the interest the taxpayer owns
3 through the entity which is disregarded for tax purposes.

4 Now, in this appeal, Appellants have a
5 partnership interest in MacLeod Couch Properties, LLC, and
6 accordingly have a basis in MacLeod Couch Properties, LLC.

7 Other partnerships also have an interest in the
8 MacLeod Couch Properties. However, unlike the treatment
9 of disregarded entities I just mentioned, these
10 partnerships are not disregarded entities but are separate
11 taxpayers that have their own interests and their own
12 bases in MacLeod Couch Properties per IRC Section 705.

13 To the extent that Appellants have direct
14 interest in these other partnerships, Appellants would
15 have a separate basis in each partnership. However,
16 nothing in IRC Section 705 or the revenue ruling says that
17 these bases can be amalgamated.

18 For these reasons, the Appellants have not met
19 their burden of showing the error in FTB's assessment that
20 partnership distributions exceeded the Appellants'
21 partnership basis.

22 And the last item I wanted to cover has to do
23 with the IRS settlement.

24 So Exhibit 11 is the IRS Internal Settlement --
25 or Internal Settlement Document, where the IRS discusses

1 the pros and cons of going forward with the settlement.

2 I note that, as Exhibit X to Appellant -- or
3 Respondent's Opening Brief, we attached a -- a copy of the
4 schedule only. And the reason for this is that we had not
5 yet received permission from the IRS to release their
6 internal settlement analysis.

7 And so, working with FTB's general counsel, we
8 figured out what would be permissible to be released. And
9 a determination was made that that schedule alone could be
10 released without the entire document.

11 Subsequently, the IRS gave us permission to
12 release the full document. And it's included in Exhibit
13 Y. On page 19 of Exhibit Y, you can see the full analysis
14 of the settlement between the taxpayer and the IRS.

15 And if you go -- at the very top it says the 2010
16 appraisal value was \$20 million. The sales price was
17 \$10.5 million. The difference is amount claimed as a
18 charitable deduction is a -- \$9.5 million. That's on line
19 3.

20 And then the next line, line 4, "estimate of
21 government's litigating hazard," 33 percent. And so the
22 next line, "charitable deduction for settlement purposes,"
23 \$3.2 million.

24 For the IRS in their settlement of 33 percent
25 concession, they allowed \$3.2 million. And they

1 disallowed approximately \$6.2 million -- or \$6.3 million
2 of the claimed charitable deduction.

3 And then, as you can go through the line, you'll
4 see deducted in 2007, deducted in 2008, deducted in 2009 a
5 total of \$753,000.

6 And then it says, "carryover to 2010 based on
7 solvent range," \$2.4 million would carry over to 2010.
8 There's an AGI limitation that took away \$114,000.
9 \$2.3 million was used to offset the taxpayer's income.
10 They had claimed \$3.1 million. And so the resulting
11 assessment was \$800,000.

12 You can see that very bottom line, 2011
13 disallowance is \$800,000 on that particular tax return.

14 So they lost \$800,000 on their 2000 -- on their
15 2011 tax return. Plus the remainder -- because it -- it
16 was a total, you know -- they -- the IRS disallowed
17 \$6.2 million; they allowed \$3.2 million. And they used up
18 that \$3.2 million between 2007, '8, '9, '10, and '11 --
19 and it got all used up in 2011; so they had to pay
20 \$800,000 -- or they had \$800,000 disallowed.

21 And this \$800,000 figure comports with all the
22 documentation in the case. Mr. Hamersley has conceded
23 that's \$800,000 in 2011. But what hasn't been brought up
24 is they lost \$6.2 million of their claimed \$9.5 million --
25 or \$6.3 million of their claimed \$9.5 million charitable

1 deduction.

2 It's clearly a 67 percent taxpayer concession.

3 And with that, I'll pass it over to my colleague,
4 Ms. Mosnier.

5 JUDGE HOSEY: Ms. Mosnier, you have about
6 20 minutes.

7 MS. MOSNIER: Thank you. I was just going to ask
8 you for that number. Okay. Thank you.

9
10 FURTHER CLOSING ARGUMENT

11 MS. MOSNIER: Good afternoon. Marguerite Mosnier
12 for Franchise Tax Board. And I will be addressing the
13 issues of res judicata, interest abatement, and
14 late-filing penalty.

15 Turning first to the issue of res judicata. It
16 is Appellants' defense to the adjustments and the
17 attendant penalty -- which are issues, I believe, 1, 2,
18 and 4 set out in the prehearing conference minutes and
19 orders.

20 In other words, the Franchise Tax Board is bound
21 by res judicata to follow the Tax Court judgement for the
22 2006 tax year. That position is unsubstantiated by the
23 law.

24 And before I talk about what res judicata is, I'd
25 like to talk about what it isn't -- is not.

1 It is not, as Appellants assert, a conformity
2 issue. It's not entirely clear the context in which
3 Appellants are using that term today.

4 If they are using it in -- in the term that we
5 often understand it as Franchise Tax Board, which is that
6 we adopt as our own State tax laws specific Internal
7 Revenue Code sections, we say that we have "adopted them
8 by conformity."

9 So there is that conformity. And that is
10 unrelated to the concept of res judicata.

11 If the term "conformity" is used today to mean a
12 resulting action by the Franchise Tax Board that flows
13 from what's called a "final federal determination,"
14 pursuant to Revenue and Taxation Code 18622, that is also
15 not relevant to the concept of res judicata.

16 And I will speak a little bit more about 18622
17 later in my discussion about res judicata.

18 So what is res judicata?

19 It's an affirmative defense. And the burden of
20 proof to establish entitlement to that defense rests with
21 the party who is asserting it.

22 And in -- in OTA's February 4th, 2021 order
23 regarding requests for subpoenas for documents and witness
24 testimony, footnote 2, the OTA -- OTA noted the
25 Appellants' assertion that it was their burden of proof on

1 this area. And the OTA agreed with that.

2 And as the OTA recited in Appeal -- its
3 precedential opinion Appeal of Millennium Dental
4 Technologies, a 2019 opinion, a party wishing to assert
5 the affirmative defense of res judicata must establish the
6 following four elements:

7 First, that the parties in both actions are
8 identical or in privity. Second, that a court of
9 competent jurisdiction must have rendered the first
10 judgment. Third, the prior action must have resulted in a
11 judgment on the merits. And fourth, the same cause of
12 action or claim must be involved in both actions.

13 With respect to the first element, obviously
14 there's no identity. There's no identity of parties
15 because it was the Internal Revenue Service at the federal
16 level, and it is Franchise Tax Board at the state level.

17 There is also no privity between the IRS and the
18 Franchise Tax Board.

19 As FTB discussed in its opening brief, California
20 Supreme Court defines "privity," or a "privy," as one who,
21 after rendition of the judgment, has acquired an interest
22 in the subject matter affected by the judgment through or
23 under one of the parties as by inherent succession were
24 purchased.

25 So in other words, what we're talking about is

1 someone who, quote, "stands in the shoes of that first
2 party."

3 FTB does not have such an interest. There is
4 nothing in the record that indicates FTB had any influence
5 on or directed the Internal Revenue Service's actions,
6 either during its examination or subsequently during the
7 Tax Court litigation, when the matter was conducted or
8 overseen by the IRS Appeals Office.

9 What there was was information sharing, which is
10 authorized by agreement between the Internal Revenue
11 Service and the Franchise Tax Board.

12 And that is all it is. It is a sharing of
13 information. It is -- it -- it vests no interest in
14 either party -- in the outcome reached by the other party.
15 And so there is no identity of parties, and there is no
16 privity.

17 With respect to the second element, Franchise Tax
18 Board acknowledges that the U.S. Tax Court is a court of
19 competent jurisdiction. That element is not in dispute.

20 And moving on to the third element, which is that
21 there must have been, in the first action, a judgment on
22 the merits.

23 Here, it's instructive to look at the Appellants'
24 Exhibit 10 to its opening brief -- to their opening brief
25 and note the first, I think it's seven words of the

1 judgment, "pursuant to the agreement of the parties."

2 This was not a matter in which the Tax Court
3 considered the merits of either party's decision and
4 applied relevant law to reach a judgment. It was an
5 acceptance of an agreement negotiated between the Internal
6 Revenue Service and the Appellants.

7 And as we have just heard Mr. Immordino explain,
8 the Appeals Division of the IRS determined that it would
9 settle for 33 percent -- allow 33 percent of the claimed
10 deduction based strictly on hazards of litigation.

11 That is not a judgment on the merits. You can
12 see that also if you look at the Tax Court docket -- it is
13 one of the Plaintiff's additional exhibits -- one that we
14 discussed at the beginning of the hearing today.

15 There are very few entries on that docket.
16 There's nothing on it -- nothing substantive between the
17 filing of the action in Tax Court and the entry of the
18 judgment.

19 And that -- that confirms the fact that the Tax
20 Court itself took no active role in the review of or
21 disposition of the issues on appeal there. So they have
22 not established the third element either.

23 They are equally -- they have failed equally to
24 establish the fourth element -- that the same cause of
25 action or claim must be involved in both actions.

1 Now, here, we have to take a step back and look
2 at the procedural -- or not the procedural -- the factual
3 difference between the taxpayer's position and their
4 amended return filed with FTB in October of 2010 and the
5 same amended return filed at the federal level at that
6 time.

7 The Franchise Tax Board processed and accepted
8 the 540X -- the amended return that the Appellants
9 filed -- the one in which they claimed the charitable
10 contribution deduction, which was subsequently disallowed
11 as shown on the Notice of Proposed Assessment.

12 If, however, you look at the federal account
13 transcript, that's Exhibit FF on page 2, you will see that
14 in October of 2010, the Appellants did file an amended
15 return and that the IRS disallowed that claim.

16 In other words, there was never a charitable
17 contribution deduction allowed at the federal level for
18 the 2006 tax year.

19 And a third way to -- to cross check that is look
20 on the first page of the account transcript. And you see
21 that the federal AGI is the -- its around \$4,200 -- it's
22 the same amount listed on the 540X as the amount that was
23 reported on the original 1040 -- on the original federal
24 return.

25 So there could not have been an adjudication or

1 an -- an issue of the -- the charitable contribution
2 deduction between the IRS and the Appellants for the 2006
3 tax year. It was never allowed. It was never -- it was
4 not a part of the negotiated settlement.

5 Likewise, with respect to the Section 731 gain
6 issue, the record in this case is devoid of discussion or
7 evidence that indicates the IRS considered the Section 31
8 [sic] gain issue for this tax year.

9 So there has not been symmetry or identity
10 between the causes -- or causes of actions or claims that
11 were resolved at the federal level and what is in dispute
12 before you all today.

13 Appellants have failed to establish elements --
14 as I have them numbered here, one, three, and four -- for
15 res judicata. And it is not applicable in this case.

16 And a finding that there was no res judicata is
17 consistent with Board of Equalization precedential
18 opinions starting with the Appeal of Der Wienerschnitzel
19 in 1975 and followed by Appeal of Bertrand in 1985. And
20 the OTA adopts this view as well.

21 In Millennium Dental Technologies, in footnote
22 13, the OTA noted a plaintiff's objection -- a comment
23 regarding an objection to a proposed penalty -- and noted
24 that the IRS had not assessed a -- excuse me -- had not
25 assessed a penalty.

1 The OTA went on to note that the FTB's assessment
2 was proper in that case and that the Franchise Tax Board
3 does not have to follow IRS actions and cited to Der
4 Wienerschnitzel.

5 Further, if you would look at the January 22,
6 2020 orders re discovery that the OTA issued in this
7 appeal and look at footnote 3, it is instructive:

8 "Appellants have cited no authority for their
9 claim that Franchise Tax Board is bound to accept the
10 Internal Revenue Service's one-third concession (much less
11 to treat it as a total concession as Appellants demand)
12 and the law is clear to the contrary," with cites to
13 Revenue and Taxation Code 18622(a) and to Appeal, I think
14 it's Giselle 80-sbe-035.

15 And then, finally, if we look at uncertainty as
16 to how this IRS judgment would translate to the Franchise
17 Tax Board.

18 It is -- the uncertainty there is reason enough
19 to disregard the idea that it could be a document that
20 would govern the outcome of this appeal.

21 Because there's no 731 issue or 2006 issue at the
22 federal level -- there was no charitable contribution
23 allowed -- how could you allow one-third of a proposed
24 deduction that wasn't even part of that?

25 And since there was no -- there could not be an

1 effect on the proposed adjustments or additional tax. So
2 the -- the Appellants have failed to establish that res
3 judicata should be applied in this appeal with respect to
4 the 2006 tax year.

5 And when I said I would double back to 18622 on
6 this topic, the conformity that FTB has -- and under
7 18622(a), when FTB issues a proposed assessment that
8 results from a federal action, it's presumed correct. And
9 the burden is on the taxpayer to prove that it's wrong.

10 However, we know under Der Wienerschnitzel that
11 neither the OTA nor the Franchise Tax Board is bound to
12 follow the Internal Revenue Service.

13 And this is not a federal action assessment. It
14 does not result from the work and the determination of the
15 Internal Revenue Service.

16 And I would just make a side note there that a
17 final federal determination -- and when we talk about an
18 IRS Determination -- it -- it does include a Tax Court
19 judgment.

20 1862(d) [sic] defines "final federal
21 determination" as defined in 6203 of the Internal Revenue
22 Code. And then, if you go to the attendant regulation --
23 and I believe it's Revenue Ruling 1-2007- -- I'm sorry. I
24 can't remember the last numbers -- the -- well,
25 actually -- actually, that part probably isn't relevant

1 there.

2 What it says is what's on the account transcript
3 is evidence of the final federal determination. And it's
4 a point where there this is no longer any appeal or action
5 that could be taken by the Appellants. And so, of course,
6 that would -- that would encompass the terms of the
7 settlement.

8 So to turn now to interest abatement, here,
9 again, the Appellants have the burden of proof.

10 And we know from the Office of Tax Appeals
11 precedential opinion in Appeal of GEF Operating, Inc.,
12 that to establish an abuse of discretion, the Appellants
13 must show that in refusing to abate interest, that the
14 Franchise Tax Board exercised its discretion arbitrarily,
15 capriciously, or without sound basis in law and fact.

16 And this, the Appellants have not done. Although
17 interest abatement is authorized in limited circumstances,
18 Appellants haven't showed entitlement to it in this case.

19 FTB diligently prosecuted the protest since it
20 was filed. It was filed towards the end of -- the protest
21 filed towards the end of 2011. And FTB wrote promptly in
22 January of 2012 to say, "we have the appeal" -- or excuse
23 me "the protest. It's being assigned to the Protest
24 Unit," and received a request then in response from
25 Appellants asking to have the protest docketed.

1 So dual time got it docketed. And then the first
2 Protest Hearing Officer promptly issued a set of info --
3 information and document request -- an IDR letter.

4 And that was followed later in 2012 by a
5 request -- a response from Appellants, asking to have that
6 Protest Hearing Officer switched out for a -- a conflict
7 of interest.

8 And there's no -- there's no record in the file
9 that indicates whether FTB made any decision on the
10 merits, whether there was any actual conflict of interest.
11 But -- or whether -- but to avoid the appearance of any,
12 there was a second Protest Hearing Officer assigned to
13 this case.

14 And he, in early 2013, sent out IDRs and
15 responded to the Appellants' request since the first
16 January 2012 letter saying, "you know, we may need to put
17 this on hold because the IRS is looking at these same --
18 is looking at these same issues."

19 And so while FTB then said, "Well, you know,
20 there are some things, issues, perhaps we can go ahead on.
21 Maybe there are others that will have to wait." And the
22 bottom line is that the Franchise Tax Board accommodated
23 the Appellants' request to wait until there was a, quote,
24 "final federal determination" before it finished its work
25 on this protest.

1 And it didn't happen until July of 20-- 2015.
2 FTB was advised there had been a judgment. And it took
3 almost two years after that, waiting for IRS documents, to
4 determine the extent to which that federal judgment would
5 affect the outcome at the state level.

6 And, specifically, in the July 16, 2015 letter
7 from -- from the Appellants' Counsel -- or from their
8 representative, they represented that both the charitable
9 contribution deduction issue and the 731 issue were
10 covered by that judgment.

11 As it turned out, and as I said, it took FTB
12 almost two years -- until 2017, to determine that it had
13 all the federal documents and that there wasn't the
14 overlap and, further, that, in any event, it was not
15 required to follow what the IRS did.

16 After that, the appeal -- the -- the protest
17 hearing was held in May of 2018. The notices of -- the
18 notices of action were issued -- oh, I don't know -- a
19 couple weeks after that.

20 So throughout this -- throughout the entire time
21 period of the protest, FTB worked with the Appellants to
22 accommodate them and to keep working on the protest as --
23 as possible.

24 Finally, with respect to the Section 139
25 late-filing penalty. If you see on -- as you see it on

1 Exhibit EE, the Appellants 2006 California return was
2 filed November 29, 2007.

3 It was due April 15th. So it was more than seven
4 months late. And the penalty was applied -- it's applied
5 automatically under the law.

6 Since the -- no return had been filed during the
7 extension period -- there was no extension with respect to
8 Appellant -- so the penalty was properly computed at the
9 maximum 25 percent rate.

10 The Appellants' assertion in their reply brief --
11 the reason it was late is that the -- their tax -- the
12 representative preparing the return had died is
13 unsupported by any documentary evidence in record.

14 There is nothing to show whether he was their
15 representative; whether he was preparing the return for
16 that year; when they learned that he would be unable to
17 complete that return so that they could file it; and, if
18 so, what steps they took to ensure that if he couldn't,
19 that someone else could prepare it so that they could meet
20 their filing obligation.

21 And so for a failure of proof, they have not
22 established that they -- that reasonable cause exists to
23 abate that penalty.

24 Thank you.

25 Mr. Immordino and I -- this concludes our

1 argument. And we're happy to address your questions.
2 Thank you.

3 JUDGE HOSEY: Okay. Thank you.

4 I am going to check with the panel and see if
5 they have any questions before we move forward with
6 rebuttal.

7 Judge Vassigh, do you have any questions?

8 JUDGE VASSIGH: I do not. Thank you.

9 JUDGE HOSEY: Judge Le, do you have any
10 questions?

11 JUDGE LE: No questions. Thank you.

12 JUDGE HOSEY: Okay. I'm going to go ahead and
13 deny the request for testimony since we have the
14 documents. And, well, it was a late request. And we
15 didn't have any questions regarding the factual
16 circumstances.

17 MR. HAMERSLEY: I'm sorry. What testimony would
18 that be?

19 JUDGE HOSEY: Oh. You just requested you
20 would -- could be sworn in and testify yourself as to
21 personal knowledge. But I just don't think we need that
22 at this time.

23 MR. HAMERSLEY: There's been factual -- material
24 fact statements back and forth.

25 JUDGE HOSEY: Yeah.

1 MR. HAMERSLEY: -- by both sides this entire
2 time.

3 JUDGE HOSEY: I think we have --

4 MR. HAMERSLEY: But I -- but I am first -- I'm
5 willing to go under oath. And I have firsthand knowledge.

6 JUDGE HOSEY: Yeah. We're not going to need that
7 today. But thank you. I appreciate it.

8 We will go ahead, though, with some rebuttal
9 time, if you'd like some.

10 Let me make sure I just have everything here.

11 Yes. You have time for some final statements, if
12 you'd like to, Mr. Hamersley.

13 MR. HAMERSLEY: How long do I have?

14 JUDGE HOSEY: Go ahead.

15 MR. HAMERSLEY: How long do I have, Judge?

16 JUDGE HOSEY: Oh, yes. You have 20 minutes.

17
18 REBUTTAL

19 MR. HAMERSLEY: Okay. Well, that -- that's
20 why this -- this protest took seven years.

21 No matter what we say, no matter what evidence we
22 put into the record, they keep -- they read a script. And
23 they just say no evidence -- we didn't prove -- they say
24 the burden of proof is on us.

25 Well, I've explained thoroughly why the burden of

1 proof shifts from the U.S. Tax Court decision. 18622, if
2 you look at Wiener Schnitzel, Giselle, McAfee -- those
3 cases all deal with an IRS Audit Report.

4 They're -- the -- the case law I gave you on the
5 recent Ninth Circuit decision and the -- and the
6 California Supreme decision cite well-settled law a
7 stipulated court decision, and -- from a settlement
8 agreement in litigation -- once you file a U.S. Tax Court
9 petition, it's litigation.

10 You're done with the IRS when the 90-day letter
11 is issued. They're -- now, you're -- they're -- now,
12 they're their opposing party in litigation.

13 So I can't even begin to say how wrong that was
14 on the law on several points and how wrong on the facts.

15 Adopt the law and those facts at your own peril.
16 It's just flat wrong. The documents show it. I have
17 testimony -- I have firsthand observed the -- the true
18 facts.

19 So 18622 is not accurate here. There's never
20 been a case where -- where -- I'm aware of where -- where
21 the FTB refused to follow a U.S. Tax Court decision that
22 was pending federal on the same taxpayer for the same year
23 for the same transaction.

24 On the issue of the zero dollars in the 2006. It
25 carried over to the subsequent years. The -- those --

1 they -- they have no idea what they're reading in those
2 documents.

3 I negotiated that settlement. All but \$800,000
4 of \$9.577 million was allowed. They took the benefit of
5 that charitable contribution benefit deduction.

6 Those are the facts. They don't have any
7 firsthand knowledge to the contrary. They're reading
8 stuff they don't understand.

9 On res judicata, that law is not correct.
10 There's no identity required. Because -- I -- I read you
11 the quote. It's an identity or community of interest.

12 That's the law. And it's very broad. And if you
13 look at the case law of all of the facts that have been
14 viewed to be -- have an identity or community of
15 interest -- I told you, they said we didn't establish that
16 there was an identity or -- identity of interest.

17 Well, they follow the same law. They could only
18 have exchanged documents, which they did, if they had an
19 identity or community interest in the -- in the MOA and
20 the disclosure statutes.

21 The -- they didn't just send documents and
22 exchange it. If you look at the -- if you look at the
23 Exhibits AA and DD, they -- they talked often. And
24 Exhibit T, the smoking-gun letter that they wouldn't give
25 us for five years, was the legal arguments on 731 and 170.

1 I was there. The IRS laughed at the 81-242.
2 Just like the chief -- former Chief Counsel who wrote the
3 GCM, they don't think that's good law.

4 And they say -- and the IRS, by the way, wasn't
5 sharing anything with us. We had to get that, ultimately,
6 from the FTB -- from what they would disclose in their
7 exhibits. So we were in -- just as in the dark with the
8 IRS.

9 So why would there be anything -- the -- the
10 analysis they're pointing to -- they keep saying that --
11 that -- that Exhibit X, which was whited out -- so you
12 compare the other redactions -- they're all blacked out in
13 normal redaction mode -- look at the arguments made in the
14 Responding's [sic] Opening Brief that refers to that
15 Exhibit X.

16 He's making the 67 percent argument there. We
17 didn't pay 67 percent. It's flat wrong. And if he had
18 left those -- if he had left those paragraphs above and
19 below in the line-item description, that argument would
20 not hold. It's contradicted by the information that was
21 removed -- was whited out.

22 Why would you white out information? You said
23 you were waiting on IRS approval -- that -- they had that
24 those -- those letters for a long time. Why did you put
25 it in there at all?

1 And if you did, when you put it in, why didn't
2 you redact it in normal fashion to let people know that
3 there was something removed?

4 So -- on -- on -- on the rest of the law, the
5 81-242, I've already testified or argued how that works
6 and -- and doesn't work.

7 They just categorically do not understand the law
8 or the facts. And no matter what we say or what we
9 write -- and that's why we've had to write volumes in this
10 case, and we've had to spend inordinate amounts of time to
11 try to get the rest of the documents, the rest of the past
12 documents, the rest of the IRS documents that they just
13 selectively chose to put little pieces in.

14 If you look at Exhibits AA and DD, their own
15 documents, you will also see that there's a reference in
16 there that says the IRS -- the Tax Court decision --
17 what -- after speaking with the IRS, was decided on the
18 merits.

19 It wasn't litigation hazards. They had
20 67 percent chance of winning -- is what it says in their
21 memo.

22 The reason they settled at 8.3 percent is because
23 their appraisal was horrible. It was from an IRS agent.
24 And our appraisals were -- showed -- showed the value and
25 supported it, and because their witness, as I said, in the

1 Palm Springs Unified School District switched their story
2 and was completely unreliable.

3 Their case, on the merits, was terrible. And
4 that's why it was settled at 8.3 percent. 67 percent is a
5 fiction. And it's the carryover, I guess -- that they
6 don't understand how that works.

7 Bottom line, \$800,000 of \$9.577 million was all
8 that was disallowed. That's 8.3 percent; it's not
9 67 percent.

10 So I don't know what to tell you. Read the
11 documents. I'd love to give firsthand testimony under
12 oath. I'm not able to do that.

13 I'd love to have other witnesses testify about
14 81-242 -- what it means and what it doesn't. You can read
15 their own article. It makes all the arguments that it's
16 not good law.

17 So they'll say that's not authority. It sure as
18 heck is a statement of the intent, interest, or -- or an
19 admission that our position is well supported.

20 So when you're looking at the weight of evidence,
21 consider all those things.

22 They said that we didn't submit any evidence that
23 the CPA had died. I submitted his obituary that
24 referenced that he had a long-term illness.

25 There was no dialogue. When you don't have

1 communication with a taxpayer for seven years -- and you
2 can see from the -- the -- the -- all of the emails that I
3 put in -- that's it over seven years.

4 When you don't have communications and you hide
5 your actions in -- in -- in violating 2006-6 and
6 transparency policies that this -- this OTA is under as
7 well -- when you hire -- it's going to take a long time,
8 and you're not going to get it right.

9 If you would talk to the taxpayer and -- and you
10 would listen and you wouldn't keep repeating the same
11 script no matter what they say or what they give you, then
12 we wouldn't -- it wouldn't have taken seven years.

13 It took two years with the IRS because, finally,
14 we got to a point where they realized the appraisals were
15 bad. That the IRS appraisers -- appraisal was bad from
16 Mr. Power, the IRS employee -- and that their witness on
17 all those statements that were reiterated here, were not
18 reliable or accurate.

19 So -- the credibility and the weight of evidence
20 matters. Narratives are just that. They're useless
21 statements unless they're supported by documents.

22 And they're -- they're citing documents to say
23 they're supported. I'm trying to tell you that's not what
24 those documents say. And my -- my -- my testimony can
25 enlighten that because I was there. And I'm the one who

1 negotiated several of those documents.

2 That's all we have to say.

3 JUDGE HOSEY: Okay. Thank you.

4 I'm just going to check with my panel again to
5 see if there's any questions before we submit the case.

6 Judge Vassigh, do you have any questions?

7 JUDGE VASSIGH: I do not.

8 JUDGE HOSEY: Judge Le, any other questions?

9 JUDGE LE: No questions. Thank you.

10 JUDGE HOSEY: Okay. Then we are ready to submit
11 the case today. The record is now closed.

12 This concludes our hearing. And the panel will
13 meet and decide the case based on the exhibits and
14 arguments presented. We will aim to send both parties our
15 written decision no later than 100 days from today.

16 Thank you all for your participation. The
17 hearing is now adjourned. Thank you.

18 (Proceedings concluded at 3:58 p.m.)
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1 REPORTER'S CERTIFICATION

2
3 I, Sarah M. Tuman, RPR, CSR No. 14463, a
4 Certified Shorthand Reporter in and for the State of
5 California, do hereby certify:

6 That the foregoing proceedings were taken before
7 me at the time and place herein set forth; that any
8 witnesses in the foregoing proceedings, prior to
9 testifying, were duly sworn; that a record of the
10 proceedings was made by me using machine shorthand, which
11 was thereafter transcribed under my direction; that the
12 foregoing transcript is a true record of the testimony
13 given.

14 Further, that if the foregoing pertains to the
15 original transcript of a deposition in a federal case,
16 before completion of the proceedings, review of the
17 transcript [] was [x] was not requested.

18 I further certify I am neither financially
19 interested in the action nor a relative or employee of any
20 attorney or party to this action.

21 IN WITNESS WHEREOF, I have this date subscribed
22 my name.

23 Dated: November 4, 2022

Sarah M. Tuman, CSR, RPR, CSR No. 14463

Certified Shorthand Reporter

For The State of California

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