

BEFORE THE STATE OF CALIFORNIA

OFFICE OF TAX APPEALS

COUNTY OF SACRAMENTO

IN THE MATTER OF THE APPEAL OF:)	
)	
SILVERADO LODGING CO., LLC, and)	CASE NO. 21047599
C.V. PATEL, K.C. PATEL,)	21047600
J.V. PATEL and J.A. PATEL,)	21047601
)	
APPELLANTS.)	
_____)	

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Tuesday, August 15, 2023

Reported by:

Maria Esquivel-Parkinson,
CSR No. 10621, RPR

Job No.:
43169 OTA(B)

1 APPEARANCES

2
3 PANEL MEMBERS:

4 Veronica Long, Lead ALJ

5 Mike Le

6 Tommy Leung

7
8 FOR THE APPELLANT:

9 Edward Kaplan, Attorney at Law

10 J.V. Patel, Taxpayer

11 C.V. Patel, Taxpayer

12
13 FOR THE CDTFA:

14 OFFICE OF TAX APPEALS

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16 Sacramento, California

By: Marguerite Mosnier, Tax Counsel

Carolyn Kuduk, Tax Counsel

I N D E X

EXHIBITS

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(FTB's Exhibits A through S were admitted at page 7)

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1 TUESDAY, AUGUST 15, 2023

2 SACRAMENTO, CALIFORNIA

3 1:40 P.M.

4
5 ALJ LONG: We are opening the record in the
6 consolidated appeals of Silverado, C.V. Patel, K.C.
7 Patel, J.V. and J.A. Patel, OTA Case Nos. 21047599,
8 21047600, and 21046001 [sic]. This matter is being held
9 before the Office of Tax Appeals. Today's date is
10 Tuesday, August 15th, 2023, and the time is
11 approximately 1:40 p.m.

12 My name is Veronica Long. And I am the lead
13 administrative law judge for this appeal. With me today
14 are Administrative Law Judges Mike Le and Tommy Leung.
15 As a reminder, the Office of Tax Appeals is not a court.
16 It's an independent appeals body. The office is staffed
17 by tax experts and is independent of the State's tax
18 agencies.

19 With that, please let me have the parties
20 introduce themselves for the record starting with
21 Appellants.

22 MR. KAPLAN: Edward Kaplan representing the
23 Appellants.

24 APPELLANT JAG PATEL: Jag Patel.

25 APPELLANT CHAN PATEL: Chan Patel.

1 ALJ LONG: All right. Thank you.

2 Franchise Tax Board?

3 MS. MOSNIER: Marguerite Mosnier.

4 MS. KUDUK: Carolyn Kuduk.

5 ALJ LONG: All right. Thank you. As confirmed
6 at our prehearing conference and in my minutes and
7 orders following that conference, the issue to be
8 decided in this appeal is whether Appellants have
9 demonstrated that they met the exchange requirements of
10 Internal Revenue Code Section 1031 to properly execute a
11 tax-deferred like-kind exchange.

12 Next, I'd like to move on to the evidence in
13 this appeal. Appellants submitted Exhibits 1 through
14 31. These exhibits were submitted by Appellant prior to
15 the prehearing conference, and FTB indicated they did
16 not have any objection to these exhibits. As such,
17 Appellants' Exhibits 1 through 31 are now admitted and
18 entered into the record.

19 (Appellants' Exhibits 1 through 31 admitted.)

20 ALJ LONG: FTB submitted Exhibits A through J
21 prior to the prehearing conference and Exhibits K
22 through S after the prehearing conference. Appellant
23 indicated they do not have any objection to Exhibits A
24 through J.

25 Appellants, do you have any objection to FTB's

1 Exhibits K through S?

2 MR. KAPLAN: No, we do not.

3 ALJ LONG: All right. Hearing no objection,
4 FTB's Exhibits A through S are now admitted and entered
5 into the record.

6 (FTB's Exhibits A through S admitted.)

7 ALJ LONG: Now, I'd like to go over the order
8 of the proceedings today. In my minutes and orders I
9 indicated that Appellants will have five minutes to make
10 an opening statement, and then Franchise Tax Board will
11 have five minutes to make an opening statement.

12 And then Appellants may begin their case
13 presentation in chief, including witness testimony. And
14 that will be for 50 minutes. At the conclusion of your
15 case presentation, the panel will have the opportunity
16 to ask questions. And at the conclusion of any witness
17 testimony, FTB will have opportunity to ask questions
18 regarding factual testimony. And then FTB will have 55
19 minutes for their presentation, and Appellant has
20 reserved five minutes for rebuttal. With that, I think
21 we're ready to begin.

22 Do you have any questions, either party?

23 MS. MOSNIER: None for Franchise Tax Board.

24 MR. KAPLAN: No, your Honor.

25 ALJ LONG: All right. And then I believe

1 Mr. -- is it Jag Patel?

2 APPELLANT JAG PATEL: Yes. Yes.

3 ALJ LONG: -- and, Mr. Chan Patel. My
4 understanding is that you both intend to testify today;
5 is that still correct?

6 MR. KAPLAN: It may very well be possible that
7 only Jag testifies. To the extent that Chan's testimony
8 is helpful or -- you know, he's certainly available to
9 testify. If anyone has questions, he's available to
10 respond to that. But essentially his testimony will be
11 identical to that of his brother.

12 ALJ LONG: All right. Well, the reason I ask
13 is because for the witness testimony to be weighed as
14 evidence, I will need to swear the witnesses in. So I'm
15 going to go ahead and swear in both Misterys Patel so
16 that they can both offer witness testimony.

17 So I will start with Mr. Jag Patel if you're
18 ready. I'm going to ask you to please raise your right
19 hand.

20 Do you swear or affirm to tell the truth, the
21 whole truth and nothing but the truth?

22 APPELLANT JAG PATEL: I do.

23 ALJ LONG: Thank you, Mr. Patel.

24 And then, Mr. Chan Patel, if you're ready, I'll
25 swear you in.

1 Mr. Patel, please raise your right hand.

2 Do you swear or affirm to tell the truth, the
3 whole truth and nothing but the truth?

4 APPELLANT CHAN PATEL: Yes.

5 ALJ LONG: All right. Thank you, Mr. Patel.
6 Appellants, you have five minutes to make your opening
7 statement and you may begin whenever you are ready.

8 MR. KAPLAN: Thank you, your Honor.

9 OPENING STATEMENT

10 By MR. KAPLAN, Counsel for Appellant:

11 For ease of reference and not to be
12 disrespectful to either of their wives or their full
13 names since both of these are Patel brothers, I think it
14 will be easiest if I refer to them as "Jag" and "Chan."
15 Their respective wives are parties to these appeals
16 insofar as they filed joint income tax returns with
17 their husbands and their investments are held jointly
18 amongst them. So when I refer to the two brothers, I am
19 including their respective spouses with that. I don't
20 think it will be confusing to anyone, but I just wanted
21 to make that clear at the outset.

22 What we have here today on these consolidated
23 cases involve the tale of investments made by two
24 brothers and their wives. The single issue is whether
25 the sale of their interests and acquisition of

1 replacement properties qualify for tax deferral under
2 Section 1031.

3 Respondent argues that the form of the
4 transactions do fully comply with their requirements for
5 qualified exchanges. It argues, however, as it
6 invariably does in a swap-and-drop context, that the
7 true seller of the property interests were not the
8 brothers but the LLC in which they owned membership
9 interests. The facts and the law clearly show that
10 Respondent's position is without merit and that
11 Appellants' appeal should be granted.

12 In a Section 1031 transaction, the substance
13 must be consistent with its form. There is no dispute
14 about that. That is the case here. It might be helpful
15 to review very briefly the historical chronology of the
16 brothers' investments in the properties so that it can
17 be understood how the property moved from one form into
18 another form into another form to its eventually sale --
19 to its eventual sale.

20 The brothers initially acquired the property --
21 it's a hotel property located in Calistoga, California,
22 which we'll continue to refer to simply as "the
23 property." They acquired the property as tenants in
24 common in the late 1980s. They operated the hotel as
25 tenancy in common through approximately the middle of

1 the year 2001 at which time they established an LLC by
2 the name of Silverado Lodging, LLC.

3 When Silverado was established, the brothers
4 transferred, contributed their TIC interests in the
5 property to Silverado in exchange for membership
6 interest in Silverado. Nothing about their investment
7 changed in any way, shape or form other than the formal
8 title in which their investments were held. They were
9 50/50 partners, 50/50 tenants in common ownership at the
10 outset. They remained 50/50 percent owners in the LLC.

11 The LLC operated the hotel as such from
12 approximately 2001 when it was acquired until 2014 at
13 which time the brothers decided to sell their -- sell
14 the property and go their separate investment ways.
15 Their families had been growing. Their children were
16 joining their own respective business operations, and
17 the notion of joint ownership amongst multiple families
18 with multiple generations appeared a little problematic,
19 and so they decided that it would be best if their
20 investments were held separately.

21 They engaged the services of an attorney to
22 assist them in the documentation of the sale. They knew
23 they were both familiar with the requirements of
24 Section 1031. They understood that if they wanted to
25 separate their interests and still be able to qualify

1 for tax deferral that they would need to own those
2 interests separately, and, therefore, they understood
3 that it would need to be transferred out of the name of
4 Silverado into their own respective ownership forms in
5 one fashion or another.

6 During the time that Silverado was operating,
7 each of the brothers had formed their own family limited
8 partnership: One, JagJudy, Limited Partnership; the
9 other one, ACT Enterprises, Limited Partnership.

10 In the middle of 2014 the brothers transferred
11 their membership interests in Silverado, which they had
12 held as -- initially as tenants in common. They
13 transferred their membership interests directly into
14 their respective partnerships so that now Silverado was
15 owned 50/50 by JagJudy Limited Partnership and ACT
16 Enterprises, Limited Partnership. The process of
17 marketing the property for sale, the negotiations for
18 its sale, all aspects related to its sale were performed
19 by the two brothers individually.

20 One of the difficulties, I think, that exists
21 here and that the Respondent has had a little difficulty
22 either comprehending or accepting is the fact that as
23 both members of Silverado and as partners in the members
24 that owned Silverado the brothers wear a number of
25 different hats during the course of all of this. It is

1 not necessarily readily apparent when they speak whether
2 they are speaking on behalf of Silverado, whether they
3 are speaking on behalf of themselves as individuals, or
4 whether they are speaking on behalf of their
5 partnerships. What is clear and what my brief questions
6 eliciting testimony from the brothers will focus on is
7 the fact that from the outset the intent to sell the
8 property was coupled with the intent to separate from
9 their brothers and their investment and that all actions
10 were taken consistent with that intent and goal. The
11 properties that -- the property was marketed. A
12 purchase and sale agreement was entered into. It was
13 entered into by Silverado Lodging signed by -- I don't
14 recall if it was one or both of the members, but that
15 will be reflected in the exhibit.

16 But at that time it had to be named -- the
17 purchase and sale agreement had to be in the name of
18 Silverado as Silverado was still the record owner of the
19 property. It was understood by the listing broker, it
20 was understood by the buyer, it was understood by the
21 title company, it was understood by the exchange
22 company, that was engaged to handle the exchange that
23 the ultimate sale was going to be by the two
24 partnerships representing themselves so that they could
25 go their separate ways and do their own exchanges.

1 ALJ LONG: Mr. Kaplan, I hate to interrupt you.
2 We've only allocated five minutes for opening
3 statements, and we're a little past the five-minute
4 mark. Would you like to wrap up your opening statement
5 and save the remainder for your opening presentation?

6 MR. KAPLAN: I will -- I will -- I do tend to
7 go on, as my children will tell you. No, I'm ready to
8 wrap that up. I think that is essentially the history.
9 I think that focuses on the key -- the key issue. And
10 the one thing I had not covered but which is overlaying
11 all of this is the overriding public policy behind
12 Section 1031, which is to mandate deferral of any gain
13 if, in fact, you have not cashed out of your investment.
14 All that has changed here is the form in which the
15 brothers held their investment. Their investment itself
16 economically never changed at all. All the entities
17 involved are flow-through entities. The only parties
18 that ever reflect actual tax liabilities or the
19 consequence of the income, expense, gain, or loss are
20 the two brothers and their respective wives, regardless
21 of whether it came through directly or came through via
22 a K-1. And with that I will stop.

23 ALJ LONG: All right. Thank you, Mr. Kaplan.

24 FTB, you have five minutes for your opening
25 statement. Whenever you're ready.

1 OPENING STATEMENT

2 By MARGUERITE MOSNIER, Tax Counsel:

3 Thank you. Good afternoon. Marguerite Mosnier
4 and Carolyn Kuduk for Franchise Tax Board.

5 FTB's proposed assessments result from its
6 determinations: First, that Silverado rather than the
7 limited partnerships JagJudy and ACT Enterprises were
8 the true sellers of the Silverado property; and second,
9 that no Section 1031 transaction was completed and the
10 Appellants were required to recognize gain from the
11 sale.

12 The evidence in the record shows that Silverado
13 owned the real property, that it negotiated the sale,
14 that the limited partnerships played no part in the sale
15 negotiations, that the sale was completed shortly after
16 its terms were set, that the sale was completed along
17 long terms negotiated by Silverado, and that the limited
18 partnerships bore no burdens nor enjoyed any benefits of
19 property ownership.

20 Applying well-settled law discussing the
21 substance-over-form doctrine, including two precedential
22 Office of Tax Appeals opinions to these facts, it's
23 clear that the limited partnerships were not for tax
24 purposes, the sellers of the property, and that they did
25 not meet Section 1031 requirements to qualify for gain

1 deferral. The proposed assessments are, therefore,
2 correct and should be sustained. Thank you.

3 ALJ LONG: All right. Thank you, FTB.

4 Appellants, you may begin your case
5 presentation whenever you're ready. You have
6 50 minutes.

7 MR. KAPLAN: Thank you, your Honor.

8 PRESENTATION

9 BY EDWARD KAPLAN, Counsel for Appellants:

10 MR. KAPLAN: I would like to call at this time
11 Jag Patel as a witness, and I'll direct my questions to
12 him.

13 EXAMINATION

14 BY EDWARD KAPLAN, Counsel for Appellants:

15 Q. As you just heard, it is the Appellants' view
16 that the negotiations and various documents related to
17 the sale of the property because it was done in the name
18 of Silverado was done by Silverado on its behalf. Is
19 this something that reflects in your mind what your role
20 was in the negotiations?

21 A. No. I think ever since we acquired the
22 property a little bit later on when my son got involved,
23 we decided that we were going to separate, and so we
24 always were looking at us being separated out. When I
25 say us, my family. And eventually when we decided to

1 sell, we were just looking at our families' interest
2 first in the sale of the property.

3 Q. Was any consideration ever given to the
4 continuation of Silverado at the time the sale was being
5 discussed and negotiated?

6 A. Absolutely not, no.

7 Q. Did, in fact, Silverado dissolve shortly after
8 the purchase and sale agreement was entered into?

9 A. Yes.

10 Q. At the time of the actual closing of the
11 transaction in January of 2015, was Silverado still in
12 existence?

13 A. No.

14 Q. Had it -- had it formally dissolved with the
15 State of California?

16 A. Yes.

17 Q. Effective December 31, 2014?

18 A. Yes. I believe it was October 14.

19 Q. Okay. And prior to the -- prior to the
20 dissolution of Silverado, had it transferred ownership
21 interest in the property from itself distributed out to
22 its two members, which at that time were JagJudy and ACT
23 Enterprises?

24 A. Yes.

25 Q. Is -- who would be the appropriate party, the

1 appropriate person to negotiate a transaction on behalf
2 of Silverado while it was in existence?

3 A. It was -- it was me.

4 Q. And who would have been the appropriate person
5 to negotiate a transaction on behalf of, in your case,
6 JagJudy Limited Partnership?

7 A. It was me.

8 Q. So it's not -- the fact that you were the one
9 negotiating the transaction at a time when you were both
10 a member of Silverado via your membership interest held
11 by JagJudy or whether you were representing JagJudy, it
12 would not necessarily be possible to determine that
13 from -- from above, I guess?

14 A. No.

15 Q. Okay. During the -- during the stages of
16 ownership, initially you and your brother as tenants in
17 common, as members of Silverado, and as owners via your
18 partnership interests in JagJudy and ACT, did the
19 economics of your investment change in any manner?

20 A. No, no.

21 Q. Was it a 50/50 ownership with your brother
22 every step of the way?

23 A. Yes.

24 Q. Is the only thing that changed the form that
25 your investment held and not the amounts or how the

1 hotel was operated or anything other than the name?

2 A. Yes. No, I mean its just stayed the, you know,
3 the same.

4 Q. So -- okay. Is -- what was the purpose of
5 liquidating Silverado following the entering of the
6 purchase and sale agreement?

7 A. The purpose was for us to go separate way.

8 Q. It served as Silverado was intended to go out
9 of business without assets, without activity. There was
10 no reason for it to continue to exist?

11 A. No.

12 Q. When Silverado was operating the property, did
13 it engage the services of a management company?

14 A. Yes.

15 Q. And who handled the day-to-day paperwork, the
16 payment of expenses and distributions of money and
17 whatnot? Was that you or your brother, or was that all
18 done by the management company?

19 A. Management company.

20 Q. At what point in time was the management
21 company informed of your intent to market and hopefully
22 sell the property?

23 A. Well, when we engaged a realtor to market the
24 property, then we had to tell the management company.

25 Q. Okay. So they were throughout the time that

1 the sale was being -- that the property was being
2 marketed and the sale was being negotiated and
3 documented, the management company was well-aware of the
4 impending sale?

5 A. Yes.

6 Q. Okay. And that it was about to essentially be
7 out of a job unless it could negotiate with a new buyer?

8 A. Yes.

9 Q. Okay. And, the -- again, to repeat myself or
10 repeated a question, the day-to-day expenses and bank
11 account for Silverado were handled by whom?

12 A. The management company.

13 Q. Okay. So if a -- if an electric bill or water
14 bill or maintenance bill of some type, who would -- who
15 would make payment on -- on -- for those expenses?

16 A. Management company.

17 Q. Okay. So the bills would go to them and they
18 would write -- they would write a check?

19 A. Yes.

20 Q. And from an account that was in the management
21 company's name or in Silverado's name?

22 A. I believe it was joint.

23 Q. Okay.

24 ALJ LE: Excuse me. When you're asking the
25 witness questions, please try to face the microphone.

1 Because when you face away from the microphone, your
2 voice cuts off.

3 MR. KAPLAN: I'm sorry, your Honor.

4 With -- who -- who negotiated -- once the sale
5 was completed, you engaged your exchange company to
6 handle the receipt of the sale proceeds from the
7 property as well as the acquisition of your replacement
8 property; is that correct?

9 A. Yes. We had an accomodator.

10 (Reporter interrupted)

11 MR. KAPLAN: Yeah, an exchange accomodator.

12 And they were obviously aware of who was
13 selling the property and who was buying the replacement
14 property?

15 A. Yes.

16 Q. Okay. And there were no issues related to
17 identification of the replacement properties or monies
18 distributed out by the accomodator during the time they
19 held the sale proceeds?

20 A. No.

21 Q. Okay. That -- so that would be consistent with
22 the fact that Respondent has no issue with the involved
23 transactions other than the determination of who should
24 be treated as the true seller of the property? Is
25 that --

1 A. Yes.

2 Q. Okay. Now, when -- actually, this is in the
3 documents.

4 I don't think I have any further questions at
5 this point. I would ask whether Respondent thinks it
6 would be helpful if I essentially asked the same
7 questions of Chan Patel or whether that can be foregone.
8 It does not matter to me. I would not be asking any
9 additional questions, and I certainly don't expect any
10 different answers so ...

11 ALJ LONG: All right. I don't think that would
12 be necessary.

13 Franchise Tax Board?

14 MS. MOSNIER: I think ultimately it's up to the
15 Appellant to determine whether and which witnesses to
16 call. We would note, though, if the Appellants would
17 like to make an offer of proof that if Chan Patel
18 testified, his testimony would be -- his responses to
19 those same questions would be the same, FTB would accept
20 that offer of proof no problem.

21 MR. KAPLAN: I will -- I will make such in the
22 hopes to bring this to a speedier conclusion.

23 MS. MOSNIER: And no objection by FTB.

24 MR. KAPLAN: Thank you.

25 ALJ LONG: All right. Thank you. In that case

1 I'm going to move on to the opportunity for Franchise
2 Tax Board and my co-panelists to ask questions of
3 Mr. Jag Patel.

4 Franchise Tax Board, do you have any questions
5 for the witness?

6 MS. MOSNIER: Thank you. No.

7 ALJ LONG: All right. Judge Leung, do you have
8 questions for Mr. Jag Patel?

9 ALJ LEUNG: Yes, I do. Thank you, Judge Long.

10 EXAMINATION

11 BY TOMMY LEUNG, Administrative Law Judge:

12 Q. Good afternoon, Mr. Patel. Thank you for --

13 A. Good afternoon.

14 Q. -- coming.

15 A. Thank you.

16 Q. I want to go back to the beginning when
17 Mr. Kaplan talked about the early days when Silverado
18 was formed and then you and your brother owned the
19 hotel. Now, when you created Silverado, you and your
20 brother created an LLC and you took a 50 percent
21 interest and your brother took a 50 percent interest; is
22 that correct?

23 A. Yes.

24 Q. You were the only two members of that LLC?

25 A. Correct, yeah.

1 Q. Okay. Now, when you formed your limited
2 partnership and your brother formed his limited
3 partnership, who was your other -- who were your other
4 partners in your limited partnership?

5 A. The limited partnership, it was a family
6 partnership.

7 Q. Okay. But besides yourself, who else was --

8 A. My wife. My wife.

9 Q. Okay. Who was the general partner? Who was
10 the limited partner?

11 A. I think we both were general partners, I
12 believe.

13 Q. Okay.

14 A. I don't know the exact -- but it -- a family
15 partnership. That's -- I think we have a document
16 there, I believe.

17 MR. KAPLAN: I don't have that in front of me,
18 but I believe it's in the documents, your Honor.

19 ALJ LEUNG: Okay.

20 MR. KAPLAN: The certificate of limited
21 partnership establishing that -- that entity is in the
22 documents, in the exhibits.

23 ALJ LEUNG: Thank you.

24 APPELLANT CHAN PATEL: Plus, our wives were
25 limited partners as well as general partners.

1 Q. (BY ALJ LEUNG): Okay. So --

2 A. And also -- also, myself and my wife were
3 limited and general.

4 Q. Okay. So basically, for both of those
5 partnerships, husband and wife, and at least for you,
6 Mr. Chan Patel, you and your wife were both limited and
7 general partners?

8 APPELLANT CHAN PATEL: Yes. Yes.

9 ALJ LEUNG: Okay.

10 APPELLANT CHAN PATEL: And I believe Jag's
11 would be the same, yeah.

12 Q. (BY ALJ LEUNG): Okay. At -- at the time when
13 you gentlemen each owned 50 percent of the hotel, was
14 that hotel owned by just you two gentlemen or were
15 other -- were there other owners?

16 A. Just two of us.

17 ALJ LE: I'm going to interject again. Please
18 make sure you're talking directly into the microphone as
19 you're speaking. Thank you.

20 APPELLANT JAG PATEL: There were just two of
21 us.

22 Q. (BY ALJ LEUNG): What about your wives? Were
23 they -- did they also have an ownership interest in the
24 hotel?

25 A. Well, the -- in the Silverado you mean?

1 (Reporter interrupted)

2 APPELLANT JAG PATEL: In the partnership, both
3 of us.

4 Q. (BY ALJ LEUNG): Yes. But when you and your
5 brother owned the hotel directly --

6 A. Correct. Yes.

7 Q. -- did your wife have any interest in the
8 hotel -- own any interest in the hotel?

9 A. Yes. You mean by managing it, you mean?

10 Q. No. Ownership.

11 MR. KAPLAN: I don't want to -- certainly, I do
12 not want to step on Jag's toes or try to answer for him,
13 but in the grant deed that transferred the property from
14 the two brothers into Silverado both of their respective
15 wives were also listed as grantees -- or grantors
16 rather. So it is husband/wife and husband/wife to
17 Silverado.

18 ALJ LEUNG: Okay. And I think that's all I
19 have for Mr. Patel. Thank you, sir.

20 Judge Long.

21 ALJ LONG: All right. Thank you.

22 Judge Le, do you have any questions for
23 Mr. Patel?

24 ALJ LE: This is Judge Le. No questions at
25 this time. Thank you.

1 ALJ LONG: All right. And with that, we will
2 move on to Franchise Tax Board. Actually, let me --
3 Mr. -- I'm sorry.

4 Appellant, does that conclude your case
5 presentation? Or do you have --

6 MR. KAPLAN: It does.

7 ALJ LONG: It does?

8 MR. KAPLAN: No, I have nothing further to add.

9 ALJ LONG: All right. Okay. I just wanted to
10 confirm. Thank you.

11 In that case, Franchise Tax Board, we're ready
12 for your case presentation. You have 55 minutes and may
13 begin whenever you are ready.

14 MS. MOSNIER: Thank you.

15 Mic check. Ms. Parkinson, can you hear me?

16 THE REPORTER: (Indicates with head)

17 MS. MOSNIER: Thanks.

18 PRESENTATION

19 BY MARGUERITE MOSNIER, Counsel for FTB:

20 Good afternoon. Marguerite Mosnier for
21 Franchise Tax Board. Silverado owned real property in
22 California that was improved with a hotel. In May of
23 2014, Silverado entered into a listing agreement to sell
24 that property and subsequently entered into a purchase
25 and sale agreement to sell the property. Those would be

1 Exhibits 11 and 14.

2 Ten days before escrow closed a deed conveying
3 Silverado's interest in the property was conveyed by
4 tenant in common, or TIC, interests to its members, the
5 two limited partnerships we've been discussing. That
6 deed was recorded. The sale closed. The limited
7 partnerships purchased other real property and reported
8 Section 1031 exchanges and deferred gain from the sale
9 of the Silverado property.

10 Following an audit, FTB determined that
11 Silverado and not the limited partnerships was the true
12 seller of the property, disallowed the 1031 exchange
13 because the exchange requirement was not met, and
14 proposed additional assessments, which should be
15 affirmed.

16 We'd start with a discussion of the burden of
17 proof. FTB's determination is presumed correct and it
18 must be upheld unless a taxpayer establishes error
19 through credible, competent, and relevant evidence.

20 I'd like to go over the nuts and bolts of
21 Section 1031 for just a moment. Internal Revenue Code
22 Section 1031 to which FTB generally conforms is an
23 exception to the requirement that income must be
24 recognized in the area it is received.

25 Generally speaking, a taxpayer must meet three

1 requirements to qualify for relief or gain deferral
2 under Section 1031, and they are known as -- commonly
3 known as the exchange requirement, the holding
4 requirement, and the like-kind requirement. Only the
5 exchange requirement is at issue. It is the Appellants'
6 burden to show that the same taxpayer sold the
7 relinquished property, which is the Silverado property,
8 and purchased the replacement property. And the
9 question of who was the true seller of the relinquished
10 property is a question of fact.

11 This all turns on a doctrine we know as the
12 substance-over-form doctrine. That doctrine was first
13 enunciated and established by the Supreme Court almost a
14 hundred years ago in Gregory vs. Helvering. It
15 instructs that "If the substance of the transaction
16 fails to satisfy the intent of the statute, then the
17 form of the transaction that gave rise to the tax effect
18 is disregarded for tax purposes."

19 And in the hallmark case of Court Holding, a
20 1945 Supreme Court opinion, the court there applied that
21 doctrine to disregard the form of a property sale. In
22 that case a closely held corporation negotiated the
23 terms for the sale of the property, and then before the
24 sale closed determined it would suffer adverse
25 consequence if it, rather than its shareholders, sold

1 the property. So it liquidated, transferred the
2 property to its shareholders, who then completed the
3 sale on the same terms as the corporation had
4 negotiated. The Supreme Court affirmed the IRS's
5 characterization of the corporation that should -- as
6 the true seller for tax purposes and noted that the
7 incidence of taxation depends on the substance of the
8 transaction.

9 A few years later the Supreme Court applied
10 that doctrine again and reached the opposite result in
11 the Cumberland decision. In that case another closely
12 held entity had approached a rival with an offer to sell
13 its stock. No deal was reached, and that closely held
14 entity then sold some property, dissolved and
15 transferred remaining assets to its own shareholders.

16 Those shareholders independently, after the
17 entity was truly dissolved, negotiated their own deal
18 with that same rival to sell assets. And a couple of
19 things the court focused on there to distinguish its
20 determination as different from its determination in
21 Court Holding were that in the first instance the entity
22 was looking to sell its stock, and when its shareholders
23 were negotiating with the same prospective purchaser, it
24 was negotiating to sell assets. So there was different
25 property that was the potential subject of a sale.

1 And secondly, the Court noted that the entity
2 had dissolved completely. It was no longer in
3 existence, nor did it own any property at the time the
4 sale closed.

5 The next case that is relevant in the
6 substance-over-form doctrine analysis is the tax court's
7 decision in Chase vs. Commissioner in 1989. And in that
8 case, the Court, again, determined that a partnership,
9 rather than its partner, was the true seller for tax
10 purposes even though it was the partnership whose name
11 was -- excuse me -- even though it was the partner who
12 had a TIC deed that was recorded shortly before escrow
13 closed and who had not borne any burden, nor enjoyed any
14 benefits of property ownership, nor had disclosed to the
15 purchaser between the time the sale was negotiated and
16 escrow closed the partner, rather than the partnership,
17 actually held title to the property. Our state tax
18 appeal agencies, previously the Board of Equalization
19 and now the Office of Tax Appeals, also have
20 precedential opinions that address this issue.

21 The Board of Equalization's opinion in Appeal
22 of Brookfield Manor addressed facts very similar to
23 those of Court Holding and reached a similar conclusion.

24 In Brookfield Manor, a corporation negotiated
25 the sale of property, opened escrow, and then dissolved

1 and transferred the property to its shareholders via a
2 TIC deed and the shareholders were substituted as the
3 sellers in escrow and they completed the sale per the
4 terms that the corporation had negotiated. The Board of
5 Equalization used Court Holding principles and held that
6 the corporation was the true seller for tax purposes.

7 And then we have two opinions from the Office
8 of Tax Appeals. In the first Appeal of Kwon, which was
9 issued in 2021 --

10 MS. MOSNIER: Yes.

11 ALJ LE: Excuse me. To the extent that case
12 names are difficult to spell, if you can just spell it
13 out for the stenographer, I think that would be helpful.
14 Thank you.

15 MS. MOSNIER: Thank you.

16 ALJ LE: Thank you.

17 MS. MOSNIER: I should have remembered.

18 Yes. Appeal of Kwon is K-w-o-n, a 2021
19 opinion. The Office of Tax Appeals applied
20 substance-over-form doctrine to determine who the true
21 purchaser of replacement property was. And the OTA
22 considered, among other things, the identification of
23 the person who negotiated the purchase of the
24 replacement property. And the corollary when we're
25 talking about who really sold the relinquished property

1 would be the identification of who negotiated the sale
2 of relinquished property. And OTA also considered the
3 timing between the close of escrow and the transfer of
4 the replacement property to the entity it ultimately
5 determined was the true purchaser for exchange
6 requirement purposes, and the corollary in the context
7 of true seller analysis would be to consider the timing
8 between the recording of the TIC deed and the close of
9 escrow. So that was Kwon.

10 And then just last year the OTA issued FAR
11 Investments, et al. -- I'll call it FAR Investments.
12 The facts in that appeal are very similar to the facts
13 in this appeal. The OTA applied the substance-over-form
14 doctrine, Court Holding, Cumberland, Chase, and
15 Brookfield Manor and concluded that the entity rather
16 than the TIC holders were the true seller of
17 relinquished property for tax purposes. And,
18 importantly, the OTA enumerated a nonexclusive list of
19 factors to consider in a substance-over-form analysis.
20 They set out five factors in that opinion, and I'm going
21 to go through them and analyze them based on the facts
22 in this appeal.

23 The first factor to consider is whether the
24 entity, here Silverado, took an active role in the sale
25 and negotiated the essence of the sale. All evidence in

1 the record establishes that only Silverado had an active
2 role in the sale and negotiated not only the essence but
3 the whole of the sale.

4 We see first looking at Exhibit 11, which is a
5 May 19, 2014 listing agreement to sell the property, it
6 was -- the sellers listed as Silverado, and it was
7 signed by Jag Patel, Mr. Patel, as a member of
8 Silverado.

9 Exhibit M is Silverado's September 9,
10 2024 [sic] counterproposal for the sale of the property,
11 and that was correspondence signed by Silverado's
12 counsel.

13 Exhibit 14 is the original purchase and sale
14 agreement. The seller is listed as Silverado. The
15 signatures are by Jag Patel and by Chan Patel. Both
16 designated -- designated as "authorized member" of the
17 seller, which is Silverado.

18 After that, we have the first amendment to the
19 purchase and sale agreement. It is in the record both
20 as Exhibit 19 and as Exhibit N. Exhibit N is a copy
21 that has signatures on behalf of Silverado. And
22 Silverado there is listed as the seller. All terms of
23 the original contract are confirmed, and it is signed by
24 Mr. J. Patel and Chan Patel as Silverado's authorized
25 members.

1 Exhibit 20, which is the assignment of the
2 first amended purchase agreement, was executed
3 November 30, 2014. It purports to sign -- to assign all
4 of Silverado's rights in the purchase and sale agreement
5 to the limited partnerships as of November 30, 2014.
6 And we note that it incorrectly recites -- incorrectly
7 recites that the relinquished property had already been
8 deeded to the limited partnerships.

9 Exhibit 21 is the second amendment to the
10 purchase and sale agreement. It is noted as being
11 effective as of December 2, 2014. And it's noteworthy
12 that pursuant to paragraph 2(f), the assignment of
13 Silverado's interests in the purchase and sale agreement
14 to the limited partnerships was not effective until the
15 TIC deed was recorded.

16 And we see in Exhibit 22, which is a copy of
17 the recorded TIC deed, it was not recorded until
18 December 30, 2014. We also see in Section -- I think it
19 is Section 5 of the second amendment -- Silverado
20 remains liable and obligated to perform all the seller's
21 terms, conditions, and covenants under the purchase and
22 sale agreement. And all provisions of the original
23 purchase and sale agreement are confirmed again in the
24 second amendment.

25 So all these documents with Silverado's name

1 all over them with signatures by Mr. J. Patel and Mr. C.
2 Patel individually as authorized members, not as general
3 partners of the respected limited partnerships that
4 purported to be the owners -- excuse me -- the members
5 of Silverado.

6 And I note in that context that FTB's response
7 or comment in its reply brief as to the capacity in
8 which both Misters Patel would have been signing
9 documents on behalf of Silverado June 30, 2014 the
10 putative date of the transfer of their individual
11 memberships to their respective limited partnerships, is
12 based simply on technical understanding that once there
13 has been that transfer, the signatures must have been on
14 behalf of the respective limited partnerships. But, in
15 fact, that is not what these documents I just discussed
16 tell us. They tell us that they were executed as
17 managing members. And we know that they could say that
18 they weren't signed as general partners of their
19 respective limited partnerships. In fact, they did so
20 in the assignment of the first amended purchase and sale
21 agreement, which is different from the first amendment
22 to the purchase and sale agreement. It is Exhibit 20.
23 The agreement was executed November 30, 2014. It was
24 between Silverado as the assignor and the respective
25 limited partnerships as the assignees, and as the

1 assignor Silverado, LLC, is listed and below that ACT
2 Enterprises Limited Partnership member, by C. Patel,
3 general partner, and by JagJudy Limited Partnership
4 member, by J. Patel, general partner. So we know that
5 they knew how to do it, but that is not the way they
6 signed any other document related to purchase, sale,
7 assumption, and assignment of rights and liabilities
8 related to this transaction that are in the record. And
9 all of this, even though Appellants say at one point
10 that Silverado dissolved effective
11 December 31st, 2014 -- and I believe Mr. Jag Patel might
12 have testified -- I think maybe I heard him say
13 October 14th, but maybe he was talking about "'14" as in
14 2014, I'm not sure. In reality, the facts and the
15 evidence in the record are not consistent with a
16 10/31/2014 dissolution date, but they are consistent
17 with two other statements the Appellants have made
18 during the appeal.

19 In the Appellants' reply brief at page 5, the
20 Appellants state that at no time did the brothers,
21 meaning Mr. J. Patel and Mr. C. Patel, intend that
22 Silverado would continue after the sale. So the
23 implication there was that Silverado, in fact, would
24 continue until the sale was concluded.

25 In the -- in Appellants' brief that was filed

1 September 26, 2022, a brief responding to OTA's request
2 for additional briefing on page 5., the Appellants
3 acknowledge -- or state that the dissolution did not
4 occur until Silverado filed its certificate of
5 cancellation on December 31, 2014.

6 So to answer the question whether the entity
7 Silverado took an active role in sale and negotiated its
8 essence, all documents in the file support the finding
9 that it did, that only Silverado did.

10 The second factor that the OTA considered in
11 its substance-over-form analysis in the FAR Investments
12 case was whether the purported sellers, here the limited
13 partnerships conducted any sale negotiations on their
14 own. The record shows no substantive negotiations by
15 limited partnerships although the second amendment to
16 the purchase and sale agreement has a couple non
17 substantive changes regarding extending the closing date
18 and providing -- putting the -- amending the conditions
19 under which -- the Silverado's obligations and rights
20 under the sale agreement would be assigned to the
21 limited partnerships. So neither of those affected the
22 actual terms of the sale. And that would have been the
23 limited partnerships' only involvement with any -- with
24 any sale negotiations, which, as we see, were
25 nonexistent.

1 And so not only were there no substantive
2 negotiations between the limited partnerships and the
3 purchasers the second amendment to the purchase and sale
4 agreement, first, it confirms the terms of the original
5 purchase and sale agreement, Section 5, and it confirms
6 that Silverado remains obligated to perform all the
7 sellers' responsibilities under the purchase and sale
8 agreement. These facts are similar to the facts in the
9 Chase case where there was no evidence of negotiations
10 solely by TIC holders.

11 The third factor the OTA considered in the FAR
12 Investments case was the amount of time that elapsed
13 between the entity's negotiations and the final
14 exchange. The latest document regarding -- that could
15 evidence any negotiations that is in the record is the
16 second amendment to the purchase and sale agreement,
17 which is Exhibit 21. The effective date is listed as
18 December 2nd, 2014, but we note that it was signed by
19 the purchaser with a December 7th, 2014, date.
20 Regardless which date you use though, there's no
21 evidence in the record of any action by the limited
22 partnerships between that date and the close of escrow
23 about a month later on January 9th, 2015 that would have
24 altered any terms of sale.

25 The fourth factor the OTA considered was

1 whether the sale was conducted under substantially the
2 same terms as negotiated by the entity, by Silverado
3 here. And we see that there were two amendments to the
4 purchase and sale agreement. There was the first
5 amendment, which is both Exhibit 19 and Exhibit N, but
6 the limited partnerships were not a party to that
7 agreement. And it had minor revisions, extended a
8 closing date, adding email as a form of correspondence
9 for notices.

10 The second amendment, Exhibit 21, as we
11 discussed, has -- and to which the limited partnerships
12 are a party has only non substantive changes. So what
13 we see here when we are looking for any evidence that
14 the limited partnerships participated meaningfully in
15 the negotiations and consummation of the sale is that,
16 in effect, their role was simply to step into the shoes
17 of Silverado and complete the sale that Silverado had
18 negotiated.

19 The final enumerated factor from the FAR
20 Investments case is whether the purported sellers, here
21 the limited partnerships, enjoyed the benefits and bore
22 the burdens of property ownership. The record is devoid
23 of evidence that the limited partnerships either enjoyed
24 the benefits and/or discharged any burden of property
25 ownership. The TIC deed was not fully executed until

1 December 8, 2014. It was not recorded until
2 December 30, 2014.

3 Exhibit O shows payment coupons dated
4 November 2014 and December 2014 from the lienholder.
5 Those are addressed to Silverado.

6 Exhibit P is a Silverado bank statement for the
7 month of January 2015. That could be the account that
8 the Appellants referred to on page 3 of their
9 September 26, '22 brief mentioning that the management
10 company had a signatory authority for. And I believe
11 Mr. Patel testified that he thought it might be a joint
12 account. There is no corroborating evidence in the
13 record on that point. The only documentary evidence is
14 a bank statement in the name of Silverado. That is
15 Exhibit P. And this document FTB argues would
16 contradict the testimony that there was no activity at
17 all by Silverado after it dissolved, and certainly we
18 would say none after the sale, although there are
19 transactions in that bank statement that postdate the
20 close of the sale.

21 So it's very odd to see that Silverado had an
22 active bank account in January of 2015 when it
23 theoretically dissolved either on October 31st, 2014
24 which is the effective date of the dissolution set out
25 in Exhibit 15, Section 1, or on December 31st, 2014,

1 which was the date the certificate of the cancellation
2 was filed with the Secretary of State.

3 This was an active account. During that month
4 it reflected 10 credit entries, a couple deposits, more
5 than a dozen withdrawals, and 82 checks negotiated. And
6 we note that there were electronic debit payments to pay
7 the utility PG&E. If you would look at Exhibit R,
8 page 5, there is a PG&E bill for \$570.66, and if you
9 look at Exhibit R, page 9, another PG&E bill for
10 \$436.67. You can match payments of those amounts that
11 were made by Silverado during January 2015 on their bank
12 statement, Exhibit P, page 2.

13 There is no evidence that the limited
14 partnerships notified the lienholder, the holder or the
15 issuer of property insurance. There is no documentary
16 evidence to corroborate Mr. Patel's testimony that from
17 the time -- I believe he testified the listing agreement
18 was entered into that the management company was aware
19 of the -- the transfer to the limited partnerships.

20 We note the TIC agreement, the tenant in common
21 agreement, between the two limited partnerships that is
22 dated October 31st, 2014 is in the record as Exhibit 16
23 is illusory because the limited partnerships had no
24 interest in that property until December 8th, 2014 at
25 the earliest, and as a public record until

1 December 30th, 2014.

2 And that would be the same with respect to the
3 agreement that is the assumption of Silverado's debts
4 and liabilities by the limited partnership. It is
5 Exhibit 17. Because while dated October 31st, it was
6 not effective until the property was distributed to the
7 limited partnerships, and we know that that didn't
8 happen until December.

9 And we note, too, that there is no evidence in
10 the record that the limited partnerships paid any costs
11 associated with their ownership of the property even
12 during the few days that they had public record title to
13 it. And that was similar to -- those facts were similar
14 to the facts in the FAR Investment case. And the
15 Appellants, apparently, in that case had argued that,
16 Well, they were paid in escrow because they were debits
17 to the -- in that case certain individual partners as
18 put here the limited partnerships. And although
19 it's really a very blurry copy of the escrow statement
20 that's in the record, you can make out -- and I can't
21 make out the amounts, but you can make out that there
22 were some debit entries that appeared to be debits for
23 property maintenance, maintenance costs, maybe pro rata
24 tax for example. And so to the extent that they paid
25 them, that's perhaps a little different from a voluntary

1 and proactive assumption to discharge those burdens of
2 ownership.

3 As the OTA stated and discussed in the FAR
4 Investments opinion, they didn't know. There was no
5 certainty that those -- that the -- in that case, the
6 underlying -- the purported sellers would have borne
7 those costs absent the completion of the sale. And FTB
8 submits that it would be -- it would be the same thing
9 here.

10 And Appellants' failure to establish that the
11 limited partnerships enjoyed the benefits and bore the
12 burdens of property ownership is consistent with their
13 statements during the appeal. In their opening brief on
14 page 11, they say that the limited partnerships waited
15 until they were reasonably assured the sale would occur
16 before liquidating Silverado and having their membership
17 interests converted to TIC interests. And in their
18 September 26, 2022, brief on page 4, they acknowledged
19 they had no right to the burdens or benefits of property
20 ownership until December 30th, 2014.

21 So in sum, there is no evidence they bore
22 burdens or enjoyed the benefits of their ownership of
23 the property. And that's the end of the discussion for
24 the five enumerated factors that were enumerated in the
25 FAR Investments opinion. As I said, the facts of this

1 case are very similar to those in FAR Investments, and
2 the FTB couldn't think of any other factors that would
3 be appropriate to consider in addition to the five that
4 were enumerated.

5 The Appellants' argument, that its economic
6 interests never changed, although their form of
7 ownership did and that that's sufficient to establish
8 that they met the exchange requirement and the reliance
9 on the decisions in Magneson, M-a-g-n-e-s-o-n vs.
10 Commissioner, and In Appeal of Rago, R-a-g-o,
11 Development, a Board of Equalization opinion, and in the
12 Ninth Circuit's decision of Bolker, B-o-l-k-e-r, vs.
13 Commissioner for that position, those arguments are
14 unpersuasive.

15 As the Office of Tax Appeals noted in Footnote
16 20 of the Kwon opinion, those decisions address the
17 holding requirement. They are not relevant to the
18 exchange requirement. And while the Appellants have
19 testified to their intent to go their separate ways
20 after they -- I believe they said they entered into the
21 listing agreement, intent itself is not determinative in
22 a true seller substance-over-form doctrine analysis.
23 The OTA -- longstanding cases indicate that, and the OTA
24 said so itself. In the FAR Investments case on page 13,
25 intent is not determinative. Furthermore, we give less

1 consideration to intent in this case where the purchase
2 agreement negotiated and executed by the parties fails
3 to implement such stated intent. FTB would submit that
4 that analysis is appropriate on the facts of this case
5 as well. The documents negotiated and set out in the
6 record do not evidence an intent that is consistent with
7 the way the membership and the signatures on behalf of
8 Silverado are set out.

9 Additionally, as we've stated, there's just
10 simply no evidence of any direct negotiations by the
11 limited partnership in the partnerships' capacities at
12 all. And so we get back to, you know, a well-worn legal
13 principle which is that taxpayers may organize their
14 affairs, their business affairs however they want, and
15 that comes with both the benefits of operating however
16 they want and it also comes with the burdens of
17 operating in a manner that is inconsistent with the way
18 they have structured their affairs. And for that, we
19 would direct OTA also to page 13 of its opinion in FAR
20 Investments at -- where it noted that while a taxpayer
21 is free to organize its affairs as it chooses,
22 nevertheless, once having done so, it must accept the
23 tax consequences of its choice, whether contemplated or
24 not, and may not enjoy the benefit of some other route
25 it might have chosen to follow but did not.

1 So considering all this evidence, Silverado
2 was, in substance, the seller of the property and the
3 Appellants have not met their burden to show that they
4 were the true seller, and, therefore, they have not met
5 the exchange requirement that the seller of the
6 relinquished property must also be the purchaser of the
7 replacement property. Consequently, OTA should sustain
8 the proposed assessments. Thank you. I'll be happy to
9 address any questions.

10 ALJ LONG: All right. Thank you, Franchise Tax
11 Board. Just to confirm, does that conclude your case
12 presentation?

13 MS. MOSNIER: Yes.

14 ALJ LONG: All right. Thank you. I'm going to
15 turn to my co-panelists to see if they have any
16 questions.

17 I'm going to begin with Judge Leung. Do you
18 have any questions for Franchise Tax Board?

19 ALJ LEUNG: Thank you, Judge Long. I think I'm
20 going to hold off until Mr. Kaplan gets a chance to
21 rebut, so thank you.

22 ALJ LONG: All right. Thank you.

23 Judge Le, do you have any questions for
24 Franchise Tax Board?

25 ALJ LE: No questions at this time. Thank you.

1 ALJ LONG: All right. Franchise Tax Board, I
2 also do not have any questions at this time.

3 Appellants, at this time I am going to let you
4 begin your rebuttal, but I want to mention that because
5 you had leftover time during your case presentation, I'm
6 going to add that to your rebuttal, so that will give
7 you 40 minutes to make your rebuttal.

8 At this time I want to check to --
9 Ms. Parkinson, would you like to take a 15-minute break?

10 THE REPORTER: No, I'm good.

11 ALJ LONG: All right. Does anybody need a
12 break or we can continue on? All right. I'm going to
13 go ahead and let us begin.

14 Appellants, you can begin 40 minutes when your
15 rebuttal -- for your rebuttal whenever you're ready.

16 MR. KAPLAN: Thank you, your Honor. Hopefully,
17 it won't take 40 minutes.

18 REBUTTAL ARGUMENT

19 BY EDWARD KAPLAN, Counsel for Appellants:

20 My first comment is "Wow." I note that the
21 Respondent's argument is based almost exclusively on the
22 forms of certain documents and not on the substance of
23 the transaction respondent has accepted that the form
24 followed by Appellants properly qualifies for
25 Section 1031. So I find it a bit odd that while they

1 followed the form correctly, there are significant
2 issues with the forms being used.

3 We need to look at the substance of the
4 transaction if the form is correct, it can only be the
5 substance of the transaction that could cause these
6 exchanges to fail. The substance of the transaction, to
7 quote from Court Holding, the substance over form
8 doctrine is designed, and I quote, "to permit the true
9 nature of a transaction to be disguised by mere
10 formalisms which exist solely to alter tax liabilities
11 would seriously impair the effective administration of
12 the tax policies of Congress."

13 At no point have I heard Respondent address the
14 question of what is the policy behind Section 1031.
15 Section 1031 is not something that can be accomplished
16 accidentally. Transactions have to be structured.
17 Steps have to be taken to ensure compliance with
18 Section 1031. Certain general tax principles are set
19 aside that would not otherwise allow for exchange
20 treatment.

21 The existence of an exchange accomodator, as
22 long as certain restrictions are placed upon the ability
23 to use the funds held by the accomodator, they will not
24 treat the accomodator as the agent of the seller. In no
25 other context in tax law would that be allowed except

1 within the structure of Section 1031. Why is it allowed
2 in Section 1031? Because use of an accomodator
3 restricting the funds from going to the seller is
4 completely consistent with the policy behind
5 Section 1031. The legislative history of Section 1031,
6 it's been in existence for over 100 years unchanged in
7 its policy.

8 Certain aspects of Section 1031 have changed.
9 Certain properties are now no longer eligible for this
10 treatment. Certain restrictions have been imposed,
11 which essentially came post Starker -- S-t-a-r-k-e-r is
12 the case name -- to allow for deferred exchanges. But
13 the one factor that has never altered, never changed in
14 the purpose of Section 1031 taken from the legislative
15 history, if a taxpayer's money is still tied up in the
16 same kind of property as that in which it was originally
17 invested, he is not allowed to compute and deduct his
18 theoretical loss on the exchange, nor is he charged with
19 a tax upon his theoretical profit. The calculation of
20 the profit or loss is deferred until it is realized in
21 cash, marketable securities, or other property not of
22 the same kind having a fair market value.

23 The policy is also reflected in the Treasury
24 Regulations at Section 1.1002-1(c). It discusses
25 Section 1031 and other statutory provisions that deviate

1 from the general rule of current taxation and make clear
2 that the underlying assumption of these exceptions is
3 that the new property is substantially a continuation of
4 the old investment still unliquidated.

5 The form in which the brothers' investment was
6 held did change. The investment did not change. At no
7 time was any other taxpayer charged with income,
8 expense, gain or loss whether it came via direct
9 investment or whether it came via a K-1 issued by the
10 LLC or via two K-1s. The first to the LLC, one of which
11 came to them directly in the first half of twenty --
12 2014. A second K-1 from the LLC was issued to cover the
13 second half of 2014, which was issued to the two family
14 partnerships. All of those numbers, the K-1s, the fact
15 that it's done via an LLC or in a partnership, in terms
16 of looking at the investment, these are essentially
17 accounting vehicles.

18 The tax and burden, economic burden, always
19 falls upon the two brothers. It flows to them, only to
20 them. Their investment in the property is not changed
21 at all. This is what 1031 says, not just deferral is
22 available, but deferral is mandated. A taxpayer is not
23 even allowed to choose to report a portion of the gain
24 on an exchange. If an exchange is accomplished, the
25 entire amount of the gain must be deferred.

1 There could be situations where you have a loss
2 from some other activity where it could be fully
3 absorbed by a portion of the gain. You cannot use that
4 in a 1031 transaction. The entire amount of the gain
5 must be deferred. The substance of the transaction is
6 not the form of the transaction. The substance in a
7 1031 transaction is on the economics.

8 What has happened here to defeat the policy of
9 Congress. What has been done that defies Congress's
10 policy of making sure that if your investment has not
11 been taken off the table, if it continues unchanged,
12 reinvested into like-kind property, where is that policy
13 being denied? It's denied in Respondent's position.
14 Respondent's position has turned substance over form
15 completely on its head. It makes no sense.

16 The substance of the transaction is the
17 economics. You'll see it in assignment of income cases.
18 Has this taxpayer earned money and somehow engaged in
19 various transactions that shift the burden of that
20 income earning to another taxpayer? Makes perfect
21 sense. Substance over form should apply there. You're
22 looking to who should bear the burden of tax on a
23 particular transaction.

24 If the party -- if the -- the brothers had
25 never put the property into an LLC and had simply sold

1 the property, any gain -- let's put 1031 aside -- any
2 gain from that sale would be reported on their
3 individual tax returns. If the LLC -- once the property
4 is in the LLC, if the LLC had sold the property again
5 with no Section 1031 transaction involved, a gain would
6 result from that sale. And who would pay the tax on the
7 gain from that sale? The brothers, not the LLC. The
8 LLC is the form from which the gain flows through to the
9 brothers, but in substance, how can you say this is the
10 LLC's gain? The LLC is not a taxpayer. It is an
11 entity. It's an entity that has a tax filing
12 requirement, but it itself does not have a tax
13 liability. That tax liability flows through to its
14 members via K-1s.

15 The exact same thing is true with the
16 partnerships. If the property had been distributed out
17 to the partnerships, they sold the property exactly as
18 was done but no reinvestment was made, who would bear
19 the burden of the tax consequence on that gain? It
20 wouldn't be the partnerships, per se. They are not
21 taxpayers in the sense of incurring the cost, the burden
22 of the tax liability. They're the vehicle through which
23 the gain flows to the brothers. There is no other
24 taxpayer in substance in any aspect of this transaction.

25 The form of ownership that the brothers held

1 this property in changed. Magneson and Bolker.

2 Respondent loves to think that these cases have no
3 relevance because their specific issue was in the intent
4 in holding property. I seriously differ with that view.

5 In the first place, I do not understand how it
6 is possible to determine that the form changes and yet
7 the owner in that new form is still treated as having
8 the intent in holding that property that they have held
9 momentarily, that they have held it, they are holding
10 it, for the exact same intent that it was held in prior
11 to that transfer. How is it possible to be treated as
12 holding a property for investment and yet not holding it
13 for the purpose of being able to sell it? It makes
14 absolutely no sense. The context of changing the form
15 of the investment, you can't change the intent in
16 holding an asset but somehow or another when it's sold,
17 Oh, you aren't treat -- you -- you held it with the
18 right intent, but you weren't the seller of it. I do
19 not understand that.

20 Bolker. Bolker is an interesting case. If you
21 read the Ninth Circuit opinion, the straight issue
22 addressed is the intent in holding. Similar to
23 Magneson. The factual underpinnings of those cases were
24 different, but the issue before the Ninth Circuit was
25 strictly the intent in holding. If you go back and read

1 the tax court opinion in Bolker from which the appeal
2 came, the issue of who was the true seller was addressed
3 in the tax court. If you read the tax court's opinion,
4 you will find that the tax court, consistent with the
5 intent in holding carrying over, held that the true
6 seller was the same. The Internal Revenue Service did
7 not appeal that issue. It appealed solely the intent in
8 holding issue. Why? I cannot guess. That's -- that's
9 their professional judgment. To my mind, they think the
10 issue was so obvious they're not even going to appeal
11 it. They dropped it.

12 This is similar to going back to Court Holding.
13 This is in the briefs, and I don't want to belabor and
14 repeat myself too terribly much. But the Court Holding
15 opinion lays out the substance-over-form doctrine and
16 why it's appropriate, certainly more appropriate in
17 cases where, like in Court Holding, and where, like in
18 Brookfield Manor, you have corporations and
19 shareholders. Who the appropriate seller is in that
20 context is very important. You have two separate
21 taxpayers. Corporation has its tax liability;
22 individual shareholders have their tax liabilities.
23 They do not dovetail. They do not flow one through to
24 the other as they do with LLCs and partnerships.

25 Court Holding, if you go back to the beginning,

1 go back to the original tax court opinion, the tax court
2 opinion looked at the various facts and made a factual
3 determination that on the facts in that case the
4 corporation was going to be treated as the true seller
5 and not the shareholder as the taxpayer in that case was
6 advocating. Taxpayer appeals to the Fifth Circuit. The
7 Fifth Circuit looks at exactly the same facts, makes its
8 own independent determination that, no, in its view, the
9 taxpayer, the shareholder, should be treated as the true
10 seller and not the corporation. It reverses the tax
11 court's holding.

12 Government appeals to the Supreme Court. The
13 Supreme Court takes a look at the issue, does not make a
14 determination on its own as to who the true seller is.
15 Rather, it simply says, when you read the opinion and
16 understand what it's talking about, it says the tax
17 court is the trier of fact. They determined as a fact
18 that the corporation should be the seller. The Fifth
19 Circuit is not the trier of fact and has no business
20 making its own independent determination. All it can --
21 is charged with -- all it has the authority to do is to
22 determine whether or not there is sufficient facts to
23 support the tax court's determination or whether it is
24 so wholly without factual support that it demands
25 reversal.

1 Supreme Court points out the facts that the tax
2 court pointed out, not because it felt those were
3 necessarily determinative but certainly with the -- with
4 the view that they do support, they do offer sufficient
5 support for the tax court's decision, and, therefore,
6 there is no basis for the Fifth Circuit reversal. It
7 acted well beyond its authority to make its own factual
8 determination, and it goes back and reinstates the tax
9 court opinion. It discusses the substance-over-form
10 doctrine. Very important doctrine. Again, very
11 important in a case as you have with Court Holding
12 corporations and shareholders.

13 The facts it points out aren't necessarily
14 determinative of how the Supreme Court would have held
15 as to whether it was the corporation or the shareholder.
16 It simply is an unknown. I don't think it makes any
17 difference. The fact of the matter is Court Holding
18 lays out the substance-over-form doctrine, which says
19 you need to look at what is the intent of Congress.
20 What is the policy behind congressional statutes and is
21 what the taxpayer attempting to do a mechanism to
22 circumvent those policies to achieve a result that is
23 different and contrary to what Congress wants to have
24 happen?

25 Congress with Section 1031 wants to defer gain

1 when your investment is not cashed out. When your
2 investment continues undiminished in like-kind property,
3 it wants you to defer gain. The brothers have made an
4 investment. They continued that investment irrespective
5 of the form in which the investment was held. They
6 never cashed it out. There were no other investors that
7 came in or out. It is the two of them with their
8 respective wives throughout the entire process. It's
9 the form of their investment that changed, not the
10 substance.

11 There are issues that -- that Respondent made.
12 You know, in particular I tried to jot down a few notes.
13 There are too many to go over here, but one in
14 particular, the second amendment to the -- to the
15 purchase and sale agreement, Exhibit 21. Respondent
16 points out that it specifically states the assignment is
17 not effective until the grant deed is filed from
18 Silverado to the -- to the family partnerships. Of
19 course, it's not effective until then. How can it be
20 effective before the partnerships actually are the
21 formal owners of the property? Similar to how can
22 anyone sign the purchase and sale agreement prior to the
23 time they are record owners?

24 Silverado owned the property at the time the
25 transaction was negotiated, at the time the sale was

1 worked out. It was worked out by the brothers on their
2 own behalf using the names of Silverado because
3 technically that was who held the property. You
4 couldn't have a purchase and sale agreement under any
5 other name. If Respondent is arguing that it is
6 essential that the taxpayers distribute the property out
7 before any negotiations are undertaken, that is an
8 incredible burden put on normal commerce that is simply
9 not required by Section 1031.

10 What happens if the sale isn't consummated?
11 Not every contract where there's a purchase and sale
12 agreement that's entered into is completed. Some of
13 them fall apart. Respondent seems to require bank
14 accounts need to be changed, leases need to be amended,
15 lender approval needs to be acquired. Try to get lender
16 approval of any -- of a change in ownership in less than
17 six months' time. It's simply not possible. All of
18 these things must be done. Change the bank account
19 name, change -- get new checks, tell PG&E, you know, the
20 account name needs to be changed. Do all of these
21 things and you find out three months later sale didn't
22 close. Now what do you do? You need to reverse
23 everything. You want the limited liability protection
24 of being in an LLC, you transfer everything back. You
25 reamend things. You go back for lender approval again

1 saying, "Forget what we wanted you to do the first time.
2 We want you to go back to the original loan." That's
3 insanity, and it's not what Section 1031 requires.

4 Section 1031 has specific requirements. Look
5 to the substance of it. Where is the investment? If
6 a -- if a bill comes in addressed to Silverado in
7 January of 2015, two weeks after it has formally
8 dissolved with the State of California, does that mean
9 Silverado shouldn't pay the bill or that the bill itself
10 shouldn't be paid? The bill has to be paid. Maybe it's
11 on a Silverado check. It's addressed to an account in
12 Silverado's name. But in substance who's paying that
13 bill? The brothers are paying it. The check is being
14 written by the management company. I don't care who's
15 writing the check. Who's paying the bill? The brothers
16 are paying the bill. I don't care what name it comes
17 in. That's not relevant to the substance of the
18 transaction.

19 If you fail to notify a lender that you have
20 transferred ownership of the property, perhaps you are
21 in breach of that loan. I don't know. I don't think we
22 have a copy of the loan in the record. But let's assume
23 for purposes of argument that you have breached a loan
24 covenant. Okay. So you're in breach of a contract.
25 Lender has a right to sue. Let them. They're fully

1 paid before they even know there's an issue. As long as
2 they're paid, they don't care. They don't care whether
3 the check is written on a Silverado account or whether I
4 write it on my own personal account. They want to be
5 paid. As long as they're paid, they're happy.

6 Management company, they're about to lose their
7 engagement. Their owner who has engaged them to operate
8 the hotel is about to disappear. There's going to be a
9 new owner. Sooner or later they're going to have to be
10 told. Even if they're not told, so what? That's their
11 problem. Maybe they find themselves going to work on a
12 Monday going, "Wait a second. Who's paying us? We have
13 a new" -- "there's no one there to pay us." That's a
14 contractual issue. Doesn't change the substance of who
15 made the investment. Doesn't change the question of
16 whether or not there might have been a breach in the
17 management agreement, which I don't believe there was in
18 both in reality or in possibility. It's not relevant to
19 the substance of the transaction when the substance
20 looks to the question of who is the party that has made
21 the investment that who bears the burden and reaps the
22 rewards of every dollar in or out of that investment.
23 That never changed.

24 That's what 1031 is about. That's what -- if
25 you read Magneson and Bolker and Maloney and all of the

1 other cases, that's what they are about. The focus is
2 on "Did the investment change?" If only the form
3 changed, okay, it doesn't change your intent in holding
4 it. Does that mean it changed everything else? I don't
5 see how. That's kind of a leap of faith. The Ninth
6 Circuit didn't say anything to the contrary. The Ninth
7 Circuit answered the question that it was faced with.
8 But if you ask yourself how is it possible for the Ninth
9 Circuit's opinion in both *Magneson* and *Bolker*, how do
10 you come up with that opinion and that view and its
11 analysis that nothing changes if the form itself is the
12 only thing that changes? How is that not relevant, even
13 relevant to the issue of substance over form?

14 Respondent insists on burying its head in the
15 sand. To put a little age on myself, it reminds me of
16 Sergeant Schultz in *Hogan's Heroes* covering your ears,
17 "I see nothing. I hear nothing." It's ludicrous. It's
18 absolutely ludicrous. There is a reason that those
19 cases have been out there for 40 years undiminished,
20 unchallenged, unchanged. They are the law of the land.

21 We're within the Ninth Circuit. California
22 does not have its own rules and laws for Section 1031.
23 It's statutorily bound to follow federal law. It likes
24 to make its own law. I'm a believer in negative
25 inferences. Why has the IRS not brought any of the

1 cases that the FTB pursues? In my mind, they don't
2 think there's an issue with it. I've been to
3 innumerable conferences where they say, "We don't have a
4 problem with it. If the FTB wants to go off on its own,
5 it's free to do so." My personal view, the FTB should
6 be talking to the State Legislature. It's not required
7 to follow federal law. It can always choose to do
8 something different.

9 The State Legislature, for whatever reason, I
10 make no -- I have no clue as to the hows or whys. It
11 has never even attempted to deviate from the federal
12 rules of 1031. It's got the Franchise Tax Board
13 constantly banging its head against the wall.
14 Legislature seems unconcerned. They could solve the
15 problem if they thought it was a problem. My sense is
16 they don't.

17 Federal government certainly doesn't seem to
18 have a problem with it. And I think it comes back to:
19 What is the purpose and policy of 1031? If you got a
20 change in the owners, you might have a different issue.
21 If you've taken certain monies off the table, you might
22 have a certain issue. If you've exchanged into property
23 that is not completely like-kind, you might have an
24 issue. Those aren't our facts. That's not this case.
25 We haven't changed anything with our investment other

1 than the form in which it's held. And to say that that
2 is in contradiction to what Congress intends, that that
3 is somehow impairing the effective administration of
4 congressional tax policies is completely backwards. It
5 is completely backwards.

6 Talked about -- Respondent talked about certain
7 case law. They, you know, the -- the responses to -- to
8 response's view of case analysis has been covered at
9 length in the briefs that have been submitted. I don't
10 have a great deal more to say about that, but it -- it,
11 you know, I will say one thing that I'm pretty certain
12 was addressed in the briefs, but I'm not a
13 hundred percent certain so I don't want to let this
14 opportunity pass.

15 Respondent is correct that the intent to do a
16 qualified 1031 exchange is not determinative of whether
17 you have done one or not. Obviously not. People intend
18 to do lots of things lots of times and they fail for one
19 reason or another. But the intent to do a 1031 exchange
20 is not irrelevant. It is -- it helps in this particular
21 case as a perfect example. It shows on whose behalf the
22 negotiations were done. The brothers intended to do a
23 1031 exchange. That intent in and of itself doesn't
24 mean they did one. But when Respondent says there's no
25 evidence that anyone other than Silverado negotiated the

1 deal, that is entirely inconsistent with what the
2 evidence has been, what the testimony was.

3 If you have the intent to do an exchange and
4 you understand both based on your personal knowledge and
5 awareness of 1031 as well as having the benefit of a
6 legal adviser helping you with the documentation
7 throughout the process and an exchange accomodator
8 involved throughout the process and a broker who
9 understands Section 1031 and a title company that
10 understands Section 1031, how is their intent not
11 evidence of who was -- who was doing this deal? It's
12 done in the name of Silverado because Silverado is the
13 technical owner at that time. It is not done on behalf
14 of Silverado. In substance, Silverado is not
15 negotiating the deal.

16 I alluded to it earlier. The brothers wear
17 multiple hats. You need to look at which hat they were
18 wearing. In my personal view, I'm not sure it makes any
19 difference because I think the only hat that's important
20 is who made the investment and what happened to the
21 investment. Wear any hat. Wear them both. Wear them
22 all at the same time. I don't think that matters. But
23 if you do think it matters, think about what hat they
24 were wearing at every step of the way. At no time were
25 they wearing Silverado's hat in the sense of doing this

1 transaction on Silverado's behalf.

2 Silverado was liquidated. Clearly it was never
3 intended or expected to exist beyond their ownership of
4 the property. Once it was clear that the property
5 would, in fact, be sold, it no longer served a purpose.
6 They liquidated it, they filed the appropriate papers
7 with the State of California, they transferred, they
8 assigned. They did all the things that a company -- a
9 dissolution of an entity. Everything is consistent with
10 that.

11 Again, going back to there's no evidence of who
12 bore, you know, the benefits and burdens of ownership.
13 Again, to repeat myself, the benefits and burdens of
14 ownership were always 100 percent held by these two
15 gentlemen sitting next to me and their respective wives.
16 The benefits and burdens -- if you own it via an LLC,
17 you may have some liability protection for your
18 investment, but your benefits and burdens of ownership
19 of the property, it's only your wallet that's affected,
20 nobody else's. There is no LLC wallet. It all flows
21 through.

22 I -- in my mind, I don't understand the
23 complexity of the issue. I honestly don't. I think
24 it's straightforward. I think it's very simple. When
25 you have a situation as we have here -- no other parties

1 going in and out, no monies going in and out, all that's
2 going -- property is being held this way, it goes into
3 this entity, it goes into that entity, it's exchanged --
4 you're in the world of Section 1031. You defer your
5 tax. And, again, it's deferral. It's not avoidance.
6 You carry over your tax basis. This isn't a freebie in
7 the sense of, "Oh, look," you know, "we never have" --
8 "we've done a tax-free deal." When you put the property
9 into the LLC, you've changed the ownership. There's no
10 tax owed on that contribution into the LLC. When you
11 distribute the property out to the partnerships, there's
12 no tax owed on that distribution, the liquidation of the
13 LLC. It requires a -- a -- you know, the property
14 itself to be disposed of. It's -- I -- I do not -- the
15 benefit of deferral clearly screams loud and clear in
16 the tax world that's what you want to do. You want to
17 defer your tax obligation as long as possible. If the
18 Code allows you a way to do it, you take advantage of
19 it. That's what was done here.

20 Again, it's not tax avoidance. They do not --
21 the replacement properties that they each acquired, they
22 do not get to depreciate those properties based on their
23 purchase price. No. They get a carryover basis from
24 the property they had held for twenty-plus years
25 already. I've had clients who looked at numbers and go,

1 "You know, I don't want to do an exchange. I've
2 depreciated my prior property down to zero already. I'd
3 rather pay the tax and get my accelerated depreciation
4 on my new property."

5 There is a cost to the deferral, and the cost
6 is you're foregoing that increased depreciation
7 deduction. It's a matter of economics. It's the way
8 you want to handle your investments. It's as
9 Respondent, you know, said, taxpayers are free to run
10 their economic lives the way they see fit, and they bear
11 the consequences of doing so. Everybody does their own
12 analysis. But what we have here is, in my mind, simple
13 and straightforward. And no investment was ever altered
14 from these taxpayers. They sold one investment. They
15 exchanged it entirely into new like-kind property.
16 Respondent accepts that the form that was followed, in
17 spite of all the problems with the various forms that
18 they mentioned, the form was followed. That's what 1031
19 requires. That's what was done. And with that, I will
20 put down my bully pulpit.

21 ALJ LONG: All right. Thank you, Appellants.

22 At this point I'm going to circle back to my
23 co-panelists see if they have any questions.

24 Judge Leung, do you have any questions for
25 either party?

1 ALJ LEUNG: Yes. Thank you, Judge Long.

2 EXAMINATION

3 BY TOMMY LEUNG, Administrative Law Judge:

4 Q. Mr. Kaplan, Franchise Tax Board seems to argue
5 as part of its case that the OTA's decision in FAR
6 Investments and the five factors should guide us in --
7 for the outcome of this appeal. Do you agree?
8 Disagree? Tell me why, why not.

9 A. I am a very strong believer that the decision
10 is incorrect both on factual basis as well as a legal
11 basis. If you review the facts of the case and look at
12 the exhibits, they do not support the opinion. The
13 opinion discusses substance over form and yet, as is
14 happening in this case, it exalts form over substance.
15 In that case, the facts are there was a seller. There
16 was a winery. There was real property affiliated with
17 the winery as well as inventory and operating assets of
18 the winery. The controlling owner of the winery, when
19 they were approached from the outside by a prospective
20 buyer, the -- the primary, the owner, insisted, I'm
21 happy to sell, but only if we can do a Section 1031
22 transaction with respect to the real property. Don't
23 really care about anything else, but I am not selling if
24 I have to pay tax on the sale of the property.

25 The negotiations other than that, that was

1 accepted. The buyers understood it. The other TIC
2 members understood it or LLC members understood it, and
3 all were in agreement. The assets, the operating assets
4 were different. They were not eligible for 1031
5 exchange treatment. And so no one was particularly
6 focused on how that would -- would transpire. The only
7 issue with respect to that was: How are you going to
8 value it and is there going to be a mechanism for what
9 happens if the buyer acquires your inventory and a month
10 later they realize that a hundred thousand gallons of
11 wine that is in barrels has gone bad and there needs to
12 be a purchase price adjustment?

13 The parties entered into a seller substitution
14 agreement prior to the time the purchase and sale
15 agreement was entered into, a seller substitution
16 agreement with respect to the property. Not with
17 respect to the wine -- the inventory and operating
18 assets, but the property was clearly carved out and was
19 going to be handled in a separate transaction. The
20 purchase and sale agreement is signed four days later.
21 The purchase and sale agreement was not a good document.
22 It was not particularly well-crafted. It did not carve
23 out the real property. It said this is the only -- you
24 know, this is the be-all and end-all of agreements, and
25 we are selling the real property and the inventory and,

1 seemingly, in contradiction to what had been signed four
2 days before from the parties.

3 Interestingly, if you go back and you look at
4 the exhibit, there is no purchase price contained in
5 that purchase and sale agreement that ultimately was
6 exalted above everything else to form the rationale for
7 the opinion. There was no purchase price in that
8 document. It does say property and inventory, you know,
9 is all being sold as one by the entity, but, again,
10 inconsistent with what was signed by all the parties
11 four days prior.

12 More importantly, completely inconsistent with
13 the escrow instructions that were signed by all of the
14 parties less than a week later, which clearly spelled
15 out how much was being paid for the property, how that
16 was being transferred and sold directly by the
17 individual TIC members and not by the entity, and the
18 remainder being covered by -- you know, the remainder
19 being covered separately in the escrow agreement.

20 The only way I can -- and also I want to add
21 there is nothing in the opinion that discusses the
22 policy of 1031. It said that -- that the only evidence
23 that the primary owner was involved in in the
24 negotiations was with respect to insisting that, you
25 know, it encompass a 1031 transaction, but he was not

1 involved in any of the other negotiations. I can't
2 begin to tell you how absurd that is. He dictated
3 everything. He did not care how you determined what
4 the -- the purchase price adjustment formula might be if
5 there were a problem with the winery, but clearly
6 nothing was done at any stage by anybody other than with
7 his approval.

8 There is absolutely no evidence that anybody
9 else was involved in negotiations. The only thing that
10 was ever specifically addressed in the testimony was his
11 insistence with respect to the real property transfer.
12 There was total silence with respect to every other
13 aspect and, yet, the opinion notes that there's no
14 evidence that he participated in anything other than.
15 Well, there's no evidence that anybody else participated
16 in it.

17 And then the opinion contains something that
18 will eat at me until I die, which is it pointed to the
19 number of versions of the purchase and sale agreement as
20 evidence of how deeply and significantly this agreement
21 was negotiated. And yet it still contains something
22 that was not what the parties had actually agreed to.
23 And so, therefore, because it was negotiated with 17
24 different versions of this document, that must be the
25 document that is the be-all and end-all irrespective of

1 the fact that it's inconsistent to what was signed three
2 days before and inconsistent with what was signed four
3 days later.

4 I don't know how often you create documents
5 yourself. The ones I am typing -- and I can't --
6 honest, I was not involved in those negotiations. I had
7 nothing to do with that particular purchase and sale
8 agreement. But I know that when I am typing up a
9 document, I take a look at it and I start to make my
10 edits, and if the only thing I change is I'm going to
11 add a comma or I'm going to capitalize one word or I'm
12 going to put a parenthetical, a defined term in, the
13 minute I make that change, I click new version.

14 There is nothing of substance that changed in
15 the document because there's a new version. It doesn't
16 necessarily -- it could, but it certainly doesn't
17 necessarily reflect this is a document going back and
18 forth multiple times and people are, you know, agonizing
19 over, you know, this provision or that provision. If
20 you look at the document, it's clear nobody agonized
21 over anything. It doesn't have a purchase price. It
22 doesn't have any instructions as to how the property
23 itself was going to be sold. It's -- it's not an
24 opinion I'm favorable of, as you can well imagine.

25 And then in terms of -- in terms of the legal

1 errors, again, you know, I take great issue with the
2 fact that it never asked the question: How is the
3 substance changed by whichever one of these documents
4 you choose to follow? The parties that had their
5 investments, the ones who want -- and there was one
6 party that was not interested in doing an exchange.
7 They took their -- their share of the proceeds, paid tax
8 on it, and moved on. Everybody else did an exchange.
9 But there was no -- no analysis or even inquiry into the
10 policy of 1031 and how is that policy violated by what
11 has transpired here.

12 The only way I can begin to understand that
13 opinion is by concluding that the problem was not in the
14 substance, it was in the form. The document that said
15 it was the be-all and end-all did not comport with
16 the -- with what the parties were trying to do. They
17 did not dot their i's correctly. They did not cross
18 their t's correctly, and as a consequence, it's not that
19 it was the substance that negated the form, it was the
20 form simply didn't meet the requirements. I personally
21 don't believe it, but it's the only way I can understand
22 that opinion.

23 The Chase opinion, which was referred to here,
24 also involves a situation unlike Court Holding and
25 Brookfield Manor, not two separate -- not a Corporation

1 shareholder. Chase was strictly partnership partners.
2 Chase is a fraud case. It has nothing to do with 1031.
3 It has nothing to do with form over substance. It's a
4 case where the deal had been done, fully negotiated. No
5 one ever thought of doing anything other than having the
6 partnership sell the property. Everybody was going to
7 go their separate ways, pay tax. The general partner,
8 the lightbulb goes off at the last minute after all the
9 documents have been signed, they're in escrow, he
10 changes the purchase and sale agreement unilaterally.
11 The buyer doesn't know this. The other partners don't
12 know this. It violates the very partnership agreement
13 that he's the general partner of to allow him to carve
14 his portion out as a TIC interest so that he can go off
15 and do an exchange. Hadn't been thought about by
16 anybody else, hadn't been discussed with anybody. He
17 violates his own partnership agreement. He unilaterally
18 changes a document. And the Court correctly determines:
19 We're not going to allow that. You can't play games.
20 You can structure things. You could have done it the
21 right way had the lightbulb gone off sooner. But it
22 didn't. But you can't come in, you know, under, you
23 know, the cloak of darkness, move things around and say,
24 "Oh, look. Here's what really happened," because it's
25 not what really happened. Again, it's not a form --

1 it's not a substance over form case. To my mind, it's a
2 fraud case. The Court was not going to allow this
3 fraudulent action to be recognized. Wholly agree with
4 the outcome.

5 The Kwon case also, you know, another case out
6 of the OTA also to my reading is not a substance over
7 form case. It's a failure of form case. In Kwon you
8 had -- you clearly had a different party making the
9 acquisition of the replacement property. It had paid --
10 they set up an entirely new entity with different owners
11 and that new entity is the entity that made the down
12 payment on the replacement property. And suddenly
13 someone went, "Holy smokes. I think we screwed things
14 up. We need to go back to square one and we need to
15 correct this."

16 And the way they went about it, they went to
17 the buyer and they said, "We'll give you a \$100,000 to
18 change the purchase and sale agreement," which was done.
19 They paid the buyer a hundred thousand dollars to change
20 the agreement. Unfortunately, it cost them an extra
21 hundred thousand because the OTA didn't allow the
22 exchange that they were trying to do. But, again, it
23 was -- it was a failure of the form. You had an action
24 by a third -- by another entity that was not the same,
25 that was entirely inconsistent with an exchange. Why is

1 this entity putting money into their exchange? You
2 can't do that. It's not an exchange. It's the form
3 that failed. It's not the substance was off. I mean,
4 the substance also was off, but it's because the form
5 was off. Not our case. Our form fits our substance.

6 ALJ LEUNG: Okay.

7 MR. KAPLAN: Very long-winded answer. I'm
8 sorry.

9 ALJ LEUNG: Thank you. Appreciate that.

10 Judge Long, I am done.

11 ALJ LONG: All right. Thank you, Judge Leung.

12 Judge Le, do you have questions for either
13 party?

14 ALJ LE: Yes, I do.

15 EXAMINATION

16 BY MIKE LE, Administrative Law Judge:

17 Q. Question for Respondent here. Can you address
18 Appellants' arguments that they -- I believe they're
19 arguing that they satisfied the policy intent behind
20 1031 because they continued their investment.

21 A. Thank you. Congress as a policy wants to
22 entitle taxpayers under particular circumstances to
23 delay recognition of gain when property is sold. That's
24 set out in 1031. That doesn't mean, though, that 1031
25 is an open-ended invitation for a taxpayer to sell

1 property and defer gain. There are specific
2 requirements in Section 1031, and if they are not met,
3 then ultimately the policy has not been realized or
4 fulfilled.

5 For example, I believe Appellants did note that
6 if you're going to exchange property for non like-kind
7 property that that would frustrate the policy behind
8 Section 1031. To the same extent -- because we know
9 that one of the three general requirements of 1031 is
10 the, quote, like-kind requirement. To the same extent,
11 if a taxpayer held and sold property that it had not
12 held for use in business or for investment, I think
13 Appellants would agree that disallowing a claimed 1031
14 transaction on those facts would not frustrate the
15 policy of Section 1031 because there is a holding
16 requirement that has to be met. Well, there's one other
17 requirement that has to be met and that is the exchange
18 requirement.

19 And so if a taxpayer cannot establish that the
20 taxpayer both sold the relinquished property and
21 purchased the replacement property, which we know is a
22 factual issue, then that taxpayer has not satisfied that
23 specific statutory requirement and disallowing a
24 Section 1031 transaction or a claimed transaction on
25 those facts, likewise, would not frustrate the

1 congressional policy to allow gain deferral in certain
2 fact patterns.

3 I think that the -- I don't think there is
4 necessarily a quarrel between FTB and Appellants with
5 respect to what a policy behind Section 1031 is. I
6 think what we have is simply a dispute as to whether the
7 facts establish that the requirements, the specific
8 statutory requirements of Section 1031 have been met.
9 Have I addressed your question?

10 Q. Yes. Thank you. Additional question. The
11 Appellants argue that a FAR Investment and Kwon it's --
12 it deals with form. There's a form issue in those
13 cases. Can you address that argument? So I believe
14 Appellants are arguing that FAR Investment should not
15 apply to this particular case because this particular
16 case does not have a form issue.

17 A. FTB's reading of FAR Investments is that the
18 OTA concluded that in substance the sales transaction
19 was made by the entity rather than by the TIC holders.
20 In this case, FTB is arguing that as a factual matter
21 the substance of the transaction, the evidence in the
22 record indicates that the substance of the transaction
23 is that the entity -- Silverado and not the TIC holders,
24 the limited partnerships -- sold the property.

25 So ultimately it is -- it is: What is the

1 substance of the transaction analysis? That is the
2 substance-over-form doctrine. And the only way to
3 determine what the real substance of the transaction,
4 is, is to drill down into the -- onto the facts. And we
5 have a precedential opinion here that tells us if we're
6 trying to figure out who the true seller is -- and the
7 parties here agree that the issue in this appeal is
8 whether the Appellants have established that from their
9 perspective it is the limited partnerships and not
10 Silverado that is the true seller.

11 So ultimately, if we went by -- if we went by
12 forms only, I think there would not -- there couldn't be
13 a true seller or a true purchaser analysis because the
14 substance-over-form doctrine is precisely a tax
15 exception to following the very form in question. The
16 grand deed that conveyed title to the property to this
17 third party purchaser was signed, executed and signed by
18 the limited partnerships. So the problem here is not
19 with the form. The problem here is that the substance
20 of the sale. The facts, the evidence in the record,
21 indicates that the substance of the sale was that it was
22 not made by the entities whose names appear on that
23 grant deed. So to that extent, I think the issue here
24 has simply been mischaracterized or misunderstood by
25 Appellants. The problem here is not failure of forms.

1 The problem here is that the facts establish that the
2 substance is different from what was reported on the
3 forms.

4 ALJ LE: Thank you.

5 No further questions.

6 ALJ LONG: All right. I also have no further
7 questions for either party. With that, I would like to
8 just check with both parties.

9 Is there anything else either party would like
10 to add before I end the hearing, any questions or
11 concerns?

12 I'll begin with Franchise Tax Board.

13 MS. MOSNIER: Thank you for asking. No.

14 ALJ LONG: All right.

15 Appellants?

16 MR. KAPLAN: I just had one quick gratuitous
17 comment --

18 ALJ LONG: All right. Go ahead.

19 MR. KAPLAN: -- to follow along after
20 Respondent's response to Judge Le, and that is it's --
21 it's a very strange thing to me to say the problem isn't
22 the form, it's the substance, but then you determine
23 what the substance is by looking at the form. I don't
24 understand it. If this panel can shed some light on
25 that, it might make things easier form me. And with

1 that, I'm done.

2 ALJ LONG: All right. Thank you, Mr. Kaplan.
3 With that, I think we're ready to conclude the hearing.
4 I want to thank the parties for their presentations
5 today. The panel of administrative law judges will meet
6 and decide the case based on argument, testimony, and
7 evidence in the record. We will issue our written
8 decision no later than 100 days from today. The case is
9 submitted and the record is now closed. This concludes
10 our hearing calendar for today. Thank you, everyone.

11 (Conclusion of the proceedings at 3:54 p.m.)

12 ---oOo---

REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)

COUNTY OF SACRAMENTO) ss.

I, MARIA ESQUIVEL-PARKINSON, do hereby certify that I am a Certified Shorthand Reporter, and that at the times and places shown I recorded verbatim in shorthand writing all the proceedings in the following described action completely and correctly to the best of my ability:

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DATE: Tuesday, August 15, 2023

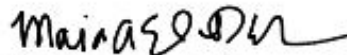
CASE: Silverado Lodging Co, LLC

Case Nos. 21047599, 21047600 and 21047601

I further certify that my said shorthand notes have been transcribed into typewriting, and that the foregoing pages 1 through 82 constitute an accurate and complete transcript of all my shorthand writing for the dates and matter specified.

I further certify that I have complied with CCP 237(a)(2) in that all personal juror identifying information has been redacted if applicable.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California on this 4th day of September, 2023.



Maria Esquivel-Parkinson
CSR No. 10621, RPR

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