

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)	
)	
G. HECKER and J. HECKER,)	OTA NO. 20096602
B. RICHARDS and G. CARISTE,)	20096603
)	
APPELLANT.)	
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, September 13, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
12900 Park Plaza Dr., Cerritos, California, 91401,
commencing at 11:35 a.m. and concluding
at 12:35 p.m. on Wednesday, September 13, 2023,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ OVSEP AKOPCHIKYAN

Panel Members: ALJ ASAF KLETTER
ALJ EDDY LAM

For the Appellant: ROBERT SEMONIAN
B. RICHARDS

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PAUL KIM
BRADLEY KRAGEL

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-5 were received at page 7.)
(Department's Exhibits A-WW were received at page 6.)

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By Mr. Kim	21

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By Mr. Semonian	34

1 Cerritos, California; Wednesday, September 13, 2023

2 11:35 a.m.

3
4 JUDGE AKOPCHIKYAN: We're going on the record in
5 the consolidated Appeals of Hecker and Hecker and Richard
6 Cariste. The OTA case numbers are 20096602 and 20096603.
7 Today is Wednesday, September 13th, 2023, and the time is
8 approximately 11:35 a.m. We're holding this hearing in
9 person at OTA's hearing room in Cerritos, California.

10 This appeal is being heard by a panel of three
11 Administrative Law Judges. My name is Ovsep Akopchikyan,
12 and I'm the lead judge for purposes of conducting this
13 hearing. Judges Asaf Kletter and Eddy Lam are the other
14 members of this panel.

15 The parties indicated before we went on the
16 record that they do not object to Judge Eddy Lam taking
17 the place of Judge Teresa Stanley on the panel. All three
18 judges are all equal decision makers and may ask questions
19 to make sure we have all the information we need to decide
20 this appeal.

21 Now, for introductions, will the parties please
22 identify themselves by stating their names for the record,
23 starting with Appellants.

24 MR. SEMONIAN: Robert Semonian, representative
25 for Mr. Hecker and Mr. Richards.

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JUDGE AKOPCHIKYAN: Thank you.

MR. RICHARDS: Bentley Richards.

JUDGE AKOPCHIKYAN: Thank you.

MR. KIM: Paul Kim for Respondent.

JUDGE AKOPCHIKYAN: Thank you.

MR. KRAGEL: Bradley Kragel for Respondent
Franchise Tax Board.

JUDGE AKOPCHIKYAN: Thank you.

As discussed and agreed upon by the parties at
the prehearing conference there are three issues on
appeal. First, whether Appellant Richards sale of a
membership interest in an LLC to Appellant Hecker should
be disregarded for tax purposes under the economic
substance doctrine; second, whether income from
cancellation of debt should be excluded under Internal
Revenue Code Section 108; third, whether a law should be
allowed under Internal Revenue Code Section 165.

With respect to the evidentiary record, FTB
submitted Exhibits A through WW during the briefing
process. Appellants have not objected to the
admissibility of any of those exhibits. Therefore, all of
FTB's exhibits are entered into the record.

(Department's Exhibits A-WW were received in
evidence by the Administrative Law Judge.)

JUDGE AKOPCHIKYAN: Turning to Appellants'

1 exhibits. Appellants submitted Exhibits 1 through 5 on
2 appeal. FTB did not object to the admissibility of those
3 exhibits. Therefore, all of Appellants' exhibits are
4 entered into the record.

5 (Appellant's Exhibits 1-5 were received
6 in evidence by the Administrative Law Judge.)

7 JUDGE AKOPCHIKYAN: As agreed, the hearing will
8 begin with Appellants' presentation for a total of
9 45 minutes.

10 Mr. Semonian, at the prehearing conference you
11 indicated that the only witness might be the former
12 attorney. Is Mr. Richards -- I was not anticipating his
13 presence here today. Is he going to be testifying?

14 MR. SEMONIAN: No, he won't.

15 JUDGE AKOPCHIKYAN: Okay.

16 MR. SEMONIAN: And the attorney decided not show
17 up, so we won't have a witness.

18 JUDGE AKOPCHIKYAN: There's no witness. Okay.
19 So you have a total of 45 minutes, then FTB will have a
20 total of 30 minutes for your presentation. And you'll
21 have five minutes for your rebuttal and final statement,
22 Mr. Semonian.

23 MR. SEMONIAN: Okay.

24 JUDGE AKOPCHIKYAN: You may proceed when you're
25 ready.

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1 clear that it has to be elected on the original return.

2 So we're not trying to make the assertion that
3 108 is applicable from the ability not tax the relief of
4 debt. I want that, you know, kind of noted for you guys.
5 So I don't want you to think I'm going off on tangent in
6 that regard in trying to assume a deduction that we're not
7 entitled to.

8 So to begin with, I'd like to start off by
9 talking about the Franchise Tax Board's assertion that the
10 transaction lacked economic purpose and, therefore, was a
11 sham transaction and entered into solely for tax purposes.
12 To begin with, I'd like to address simply -- I'm sorry.
13 Simply, it is not a true statement -- a true position for
14 the Franchise Tax Board, and their assertion lacks several
15 issues.

16 The Franchise Tax Board has gone through great
17 lengths to purport that the sale of the LLC had to be
18 completed by the end of 2010 or Mr. Richards would bear
19 the burden of the taxes imposed on the relief of debt.
20 And that all came from the Bank of America's reduction of
21 the debt against the property. Again, it's not really
22 true. Had the property not sold by the end of the year,
23 then we would have elected Section 108, and this is where
24 the applicability of 108 comes into to.

25 We had no proverbial financial gun to our head to

1 sell the property before the end of 2010. If it hadn't of
2 sold, we would have elected 108 on the original return,
3 and we would not have picked up the taxable income from
4 the relief of debt. We would have had a basis adjustment,
5 but there would have been no significant tax burden on the
6 Mr. Richards had we not sold by the end of year. So there
7 was no gun. There was no need to rush to make that sale,
8 and so we could have elected those but we did not.

9 The second issue is the -- the second aspect of
10 this transaction, I think we need to look at the
11 Affordable Care Act. The Affordable Care Act under
12 Section 7701, paragraph O, makes it very clear -- and this
13 was passed on September 10th. So it was applicable as of
14 2010. So it was applicable to our transaction in December
15 of 2010. And this occurred just prior to the sale. And
16 here the Franchise Tax Board is not making the proper
17 assertion. From our position the -- when we look at
18 Section 7701, paragraph O of the Affordable Care Act, it
19 set a new standard. And it said we have to look at the
20 after sale impact on the taxpayer. Did he incur some sort
21 of economic benefit, loss?

22 What was -- there should be a significant
23 economic benefit or impact to the taxpayer after the sale.
24 And so that's where 7701, paragraph O comes into play
25 here. Because what happened with this transaction is that

1 the property was losing dramatic sums of money. The loss
2 of the property ceased when it was sold to Mr. Hecker.
3 That in and of itself is a -- so we have two clear
4 independent economic acts. One, we have the loss of the
5 property because it sold. And we're speaking of a
6 multimillion-dollar apartment complex.

7 We also have the cessation of the losses that he
8 was occurring on a monthly basis. All of those things had
9 a dramatic financial impact on Mr. Richards and -- and
10 because they had the impact, Section 7701 applies. And
11 Section 7701 is basically -- because it's not readily
12 known -- it says the application of the doctrine in the
13 case of any transaction to which the economic substance
14 doctrine is relevant, such a transaction shall be treated
15 as having economic substance only if A, the transaction
16 changes in a meaningful way apart from the federal income
17 tax effects the taxpayer's economic position; and B, the
18 taxpayer has substantial purpose --

19 THE STENOGRAPHER: I'm sorry to interrupt.

20 MR. SEMONIAN: Yes.

21 THE STENOGRAPHER: Can you slow down just a
22 little bit?

23 MR. SEMONIAN: I can try.

24 THE STENOGRAPHER: Thank you.

25 MR. SEMONIAN: Okay. And B, the taxpayer has

1 substantial purpose apart from federal income taxes from
2 entering into such transaction. That's the specific
3 language in the code.

4 So Mr. Richards no longer owned the property. It
5 was no longer suffering financial losses on a monthly
6 basis. Therefore, it had a significant economic impact on
7 him. Therefore, under 7701(O), it qualifies. We should
8 be done there. That should be the end of it. He
9 qualifies because of the economic impact, and this was the
10 new standard. But I think we also have to look at
11 subsequent events that have occurred after the sale. In
12 particular, we have to look at the court case in Texas.
13 And I believe that's an equally important aspect of
14 everything that's going on here.

15 So -- so the transaction was fully litigated in
16 the District Court of Harris County, Texas, of the 165th
17 Judicial District, which is why I wanted the court ruling
18 part of our exhibit because it details -- it not only goes
19 through the process of detailing the events, it goes
20 through the process of detailing how they came about the
21 judges ruling on that case. So I believe that is an
22 extremely important aspect. And so -- and I think when we
23 review the actual order, the court declared -- ordered a
24 judge to create the following:

25 That the sale of the LLC from Mr. Richards to

1 Mr. Hecker was a valid business transaction. It resulted
2 in an arm's length transaction and support by adequate
3 consideration. It was consummated in an economically
4 reasonable terms, and it was valid for business purposes.
5 This ruling was not subject to being set aside, and it's
6 based on the facts and applicable law in Texas. Again, we
7 now have three issues that contradict the entire position
8 taken by the Franchise Tax Board.

9 Now, one of the things that has occurred
10 throughout the briefing process is that the Franchise Tax
11 Board has been trying to float the argument that Article 4
12 Section 1 of the United States Constitution, which clearly
13 states the recognition of sister-state court judgments
14 under its full faith and credit provisions. They are
15 trying to remove this case and its applicability. And
16 Mr. Kim would have you set it aside under the legal
17 principle that the body of law he is charged with
18 enforcing is immune from the statute. It is not.

19 This is not an -- we're not asking for the
20 Franchise Tax Board or this panel to interpret the U.S.
21 Constitution. It is the law. We're asking this Board to
22 apply the law, and that's a different standard. And so,
23 when we look at all of these chain of events, it's clear
24 that the Texas court ruling has valid evidence, and it
25 should be accepted by this panel.

1 I think we also have to look at the transaction
2 itself. The Franchise Tax Board implies that Mr. Hecker
3 was some sort of straw man in this deal, and he was
4 dealing clearly as a lackey for Mr. Richards. Well, I
5 think if we look at who Mr. Hecker is, I think that will
6 change your position on this.

7 He graduated from Cal Poly Magna Cum Laude with a
8 degree in finance. While working at Teradyne, he was in
9 charge of their international supply chain. He then later
10 moved to Amgen where he was in charge of -- he was the
11 executive director in charge of the company's operations
12 and manufacturing. He controlled over \$6 billion in
13 transactions annually. He was not a lackey. He knew what
14 he was doing, and he came into this transaction with
15 purpose. And so it would be a mistake to consider him to
16 be a lackey or just jumping on board. He was a competent
17 experienced executive.

18 Excuse me. Sorry. My voice is going dry.
19 Sorry.

20 So then I think as we continue to look at the
21 transaction, the purchase of the LLC by Mr. Hecker was
22 done so because that precluded him from having to go
23 through the refinancing of the property. He didn't have
24 to fire employees and rehire them under another entity.
25 He didn't have to go through all sorts of termination

1 costs. But primarily, he didn't go through the
2 refinancing of the property. That is a difficult thing to
3 do, and it's no easy task, especially with this property
4 that had been incurring so many losses.

5 It was drug infested. It had repeated fires.
6 The cops were always there. It was to be a very difficult
7 property to refinance by any buyer. So this was not only
8 the simplest way to acquire the apartment, it was also the
9 smartest way. And it was -- and so this was just simply a
10 smart transaction by a smart executive. And Mr. Hecker's
11 assessment turned out to be pretty good. He bought this
12 property. He managed it. He started cleaning it up, but
13 he ran into a couple of pitfalls that he was not
14 expecting.

15 There was an issue with respect to renewing the
16 fire insurance because they had had multiple fires on the
17 property, and the ability to renew the fire insurance was
18 becoming limited. Mr. Premji came in and made him an
19 offer. So three months after acquiring the property, he
20 sold to Mr. Premji. And in selling it, he recouped about
21 \$100,000, little less, and put that in his pocket. So for
22 owning the property for approximately three months, he put
23 \$100,000, or slightly less, into his pocket. That made it
24 a pretty good deal for him and made it a great deal for
25 Mr. Richards because he was done. He was no longer losing

1 money.

2 So this is why the court in Texas ruled that it
3 had economic benefit for both parties. They both came out
4 winning on this deal. So I think, again, the Franchise
5 Tax Board's assertion here falls pretty short because
6 we've been able to prove there was economic benefit, there
7 was a business purpose of this transaction, and all the
8 parties prevailed with -- with significant monies in their
9 pocket they wouldn't have otherwise had had the
10 transaction not occurred.

11 So I think we also look throughout the course of
12 this audit at the conduct of the Franchise Tax Board
13 because I think that's as critical in this matter as
14 anything else. The initial auditor, Mr. Ramirez, he
15 didn't understand the transaction and immediately from day
16 one attacked the transaction, tried to disallow the loss,
17 before even a document was presented. And he went through
18 multiple attempts to try to disallow the loss. And they
19 finally, after four or five different attempts and
20 arguments to try to disallow the loss, they settled on a
21 sham. That was the fall back for a lot of auditors when
22 they can't figure out any other way of disallowing a loss.
23 Let's just call it a sham to make the taxpayer prove that
24 it wasn't.

25 It puts a heavy burden on the taxpayer,

1 admittedly, but that's what we ended up with. So he
2 actually -- Mr. Ramirez actually had made a request for
3 documents. And if those documents weren't provided, he
4 was going to assess penalties, and he did assess penalties
5 before any documents were provided. Those penalties
6 waived by Mr. Kim who wisely realized that the support of
7 their assessment was based upon knowingly false
8 justifications.

9 The taxpayers were denied a meeting with
10 Mr. Ramirez or his supervisor. The subsequent protest
11 hearing was a farce under the impression that the protest
12 would be -- would provide a fair and impartial
13 reexamination of the case. That did not occur. Present
14 were two hearing officers. Both of them are here. One of
15 them was Mr. Kim, the prosecuting attorney. How fair is
16 the hearing going to be when the prosecutor is one of the
17 persons that's supposed to give us an un-bias review?

18 Excuse me. I'm so sorry.

19 To this date, we've never received a ruling on
20 the actual protest. We only received a ruling on the
21 penalty aspect of the protest, and that came through in a
22 corrupt email, and later that corrupt email had to be
23 fixed. I had to receive it. And it was re-characterized
24 by Mr. Kim in one of his briefs that it was a stalling
25 tactic on my part. We weren't informed in advance that

1 they were going to issue the ruling by email. We weren't
2 expecting, and we were -- but Mr. Kim was nice enough to
3 give us an extension to file the appeal with this agency.

4 So the Franchise Tax Board is also denying the
5 fraud loss. And it's denying the fraud loss under 165
6 because we've been unable to provide proof. Well, the
7 proof of that loss is in the hands of the Franchise Tax
8 Board. They received the file from Bank of America that
9 was subpoenaed by Mr. Ramirez, the auditor. And in that
10 file contains all of the documentation needed by Bank of
11 America to prove that Mr. Richards was defrauded in his
12 purchase of the property. And they have not -- and
13 Mr. Kim said in his brief that they are not obligated to
14 turn over those documents, and they have never turned them
15 over.

16 And assuming that the Franchise Tax Board is
17 interested in the fair administration of the tax laws, one
18 would expect that this denial of a major loss based upon a
19 technical adjustment for 2010 would require the loss then
20 to be reported on 2011, which is open. And as a matter of
21 equity, they have not done so. And there's further clear
22 evidence that the enforcement agency is failing. I'm
23 convinced that Mr. Kim will take the position that he's
24 not required to correct Mr. Richards' 2011 return, just as
25 he is allowed to refuse to turn over documents. This is

1 just the ongoing operation.

2 And in summary, the history of the property
3 provides proof that multiple efforts to sell and to stop
4 these financial dramatic losses that have been incurred by
5 Mr. Richards. There was no urgency for tax purposes. Had
6 it not occurred in 2010 we would have elected 108. So we
7 were fine. And there was a court ruling giving us a
8 factual ruling on the evidence. And I believe -- and I
9 don't want to pretend to be a lawyer here, but I believe
10 the equitable estoppel issue comes to play here because we
11 have a ruling in one court. And I believe the Franchise
12 Tax Board has to honor that court ruling.

13 So it's always been my impression that the
14 Franchise Tax Board and Internal Revenue Service, all of
15 these agencies, their role is to seek support for the
16 transactions that a taxpayer presents on a tax return.
17 The Franchise Tax Board is not doing that. They're doing
18 everything they can to remove any evidence that supports
19 the position for the taxpayer. They're trying to remove
20 the court ruling, and they have not turned over documents.
21 They have not proposed a change to Mr. Richards' 2011
22 return.

23 And I'm always confused. And isn't that really
24 purpose of them for the fair administration of tax law to
25 look for support for a position taken by a taxpayer, not

1 to take and make every attempt they can to remove that
2 support and deny the taxpayer any tax relief. It just
3 seems like this is contrary to the rule of law and to the
4 methodology that should be employed by the Franchise Tax
5 Board.

6 So there are the three issues. There's the issue
7 of the sham, which I believe we have, throughout the
8 briefing process and through the court orders, have taken
9 good steps to prove that there was economic basis for the
10 transaction. It was ruled upon a foreign court. And
11 there was no rush as purported by the Franchise Tax Board
12 to sell the property before the end of the year. That was
13 not a consideration.

14 But I'm left with the one final issue here. And
15 why is the Franchise Tax Board, throughout all of this
16 process, doing everything they can to keep Mr. Richards
17 from being able to take advantage of any tax relief
18 resulting from a multimillion-dollar loss? Mr. Richards
19 lost well in excess of \$3 million on this transaction. He
20 was defrauded, and he's not being allowed to receive in
21 issue with respect to tax relief. And when you look at
22 everything that's gone on, we only have to wonder why --
23 why are we not being allowed to take a tax relief for this
24 horrendous loss? And why is every attempt to prove that
25 tax relief being fought?

1 So we don't understand why we're really here to
2 be honest with you. It's something that we just haven't
3 been able to conjure up justifiable reason for going this.

4 So that is our position. And I hope I've said it
5 properly and haven't flubbed it up here too much being
6 nervous. But I want to thank you for listening to us, and
7 I appreciate it.

8 Thank you.

9 JUDGE AKOPCHIKYAN: Thank you, Mr. Semonian.

10 I'm going to go ahead and turn it over to my
11 panel members to see if they have any questions for
12 Appellants.

13 Judge Kletter, any questions?

14 JUDGE KLETTER: This is Judge Kletter. I do not
15 have any questions at this time. Thank you.

16 JUDGE AKOPCHIKYAN: Okay. Judge Lam?

17 JUDGE LAM: This is Judge Lam speaking. I'll
18 hold my question for after FTB's presentation.

19 JUDGE AKOPCHIKYAN: Thank you.

20 I also don't have any questions at this time.

21 Mr. Kim, please proceed when you're ready. Thank
22 you.

23

24 PRESENTATION

25 MR. KIM: At issue is whether Appellants' have

1 demonstrated error in Respondent's determination that the
2 sale of Nottingham Gate Lone Star W., LLC, or Nottingham
3 LLC, from Mr. Richards to Mr. Hecker or the transaction at
4 issue lacked economic substance.

5 As argued in Respondent's briefings, Appellants
6 have not met their burden of proof. The transaction at
7 issue lack both economic substance and business purpose.
8 Moreover, the step transaction doctrine is applicable to
9 the transaction at issue. Therefore, the tax consequences
10 thereof should be disregarded.

11 Regarding Appellants' Texas judgement,
12 Respondent's Exhibit SS, the Office of Tax Appeals does
13 not have jurisdiction to hear constitutional issues.
14 Moreover, even had the OTA had proper jurisdiction,
15 Appellants' Texas judgment is not entitled to full faith
16 and credit.

17 Lastly, Internal Revenue Code Sections 108 and
18 165 are inapplicable.

19 The economic substance doctrine requires that in
20 order for a transaction to be respected for tax purposes,
21 it must have economic substance. Whether a transaction
22 has economic substance is determined objectively by the
23 presence of economic substance, such that the transaction
24 could result in more than tax benefits, and whether
25 Appellants have had a valid business purpose other than

1 tax avoidance.

2 The question of whether a transaction has
3 economic substance requires analysis of the substance of
4 the transaction and whether the transaction was
5 objectively capable of producing benefits aside from tax
6 savings. Based on the evidence, the transaction at issue
7 lack economic substance. First, if the transaction at
8 issue had any substance beyond that of mere formalities,
9 Mr. Hecker, now owner of Nottingham LLC, was responsible
10 for the running of operations and more, importantly, the
11 closing of escrow by February 2011.

12 Whereas Mr. Hecker executed the necessary forms
13 on behalf of Nottingham LLC to facilitate the final
14 closing of escrow, there was a substantial lack of
15 communication in any form to or from Mr. Hecker,
16 Mr. Richards, Mr. Premji, or any other third party
17 involved in the sale of the subject property. Appellants
18 entered into contract with Mr. Premji for the sale of the
19 subject property for approximately \$5.5 million. By the
20 time escrow closed in February of 2011, the subject
21 property's sale price was reduced to approximately
22 \$4.5 million.

23 If Mr. Hecker was truly the owner of Nottingham
24 LLC negotiations and details of such conversations should
25 have involved Mr. Hecker. Appellants have only provided

1 one such communication from Mr. Hecker, and that is
2 Respondent's Exhibit X.

3 However, whereas Appellants have only provided a
4 single email regarding Mr. Hecker's involvement in the
5 sale of the subject property, there are several
6 communications to and from Mr. Richards, Respondent's
7 Exhibit W. The evidence shows that Mr. Richards was in
8 control of the sale of the subject property. For example,
9 as noted in Exhibit JJ in an email dated February 3rd,
10 2011, Mr. Richards wrote to the escrow officer and stated
11 and, quote, "Here's the proof of payment for property
12 taxes. Also, you need to credit me on the closing
13 statement for half of the prepayment penalty and debit
14 buyer. Abraham is sending you the correct commission to
15 housing income properties," end quote.

16 Correspondences such as these are evidence of
17 how, despite the alleged sale to Mr. Hecker, Mr. Richards
18 was still very much in control.

19 Second, Appellants did not adhere to the terms of
20 the transfer agreement. According to the transfer
21 agreement, Respondent's Exhibit H, Mr. Hecker allegedly
22 purchased the interest -- his interest subject to the
23 existing mortgage or approximately \$3.6 million and
24 payment of all fees and costs associated with the sale,
25 transfer, and assignment. However, there's no evidence

1 that Mr. Hecker made any such payments, or that Mr. Hecker
2 applied for the assumption of the loan. Thus, Mr. Hecker
3 could not have purchased Nottingham LLC subject to the
4 existing mortgage. Therefore, the transaction at issue
5 lacked economic substance.

6 In analyzing whether Appellants had a valid
7 business purpose, the question is one of motivation.
8 According to Appellants' letter dated December 2nd, 2013,
9 Respondent's Exhibit T, the representative informed
10 Mr. Richards that he would be facing an almost \$5 million
11 income from the cancellation of debt, and to avoid taxes
12 he had to sell the property before the end of the year.
13 The letter continues to state that as December approached
14 Mr. Richards became separate. At this stage, no sale of
15 the subject property could be consummated before year end
16 as the mortgage was unassumable.

17 Moreover, in a letter dated March 4th, 2015,
18 Respondent's Exhibit F, Appellants' representative stated
19 that he had several conversations with Mr. Richards
20 regarding the potential cancellation of debt income, and
21 that in order to avoid this tax liability, he could either
22 sell the subject property, or Nottingham LLC, itself.
23 The evidence shows that the transaction at issue lacked a
24 valid business purpose. Appellants' true business purpose
25 was the offsetting of cancellation of debt income before

1 the end of 2010.

2 The Appellants were issued cancellation of debt
3 income at the end of the July and by August listed the
4 subject property for sale. As Appellants could not find a
5 buyer until December, escrow could not close prior to the
6 end of the year. According to the Critical Dates
7 Memorandum, Respondent's Exhibit V, escrow on the subject
8 property was estimated to close in February 2011. Thus,
9 the losses that would have been generated by the sale of
10 the subject property would not be available in time to
11 offset the cancellation of debt income Appellants were to
12 recognize at the end of 2010.

13 Therefore, to avoid the impending additional tax,
14 Appellants entered into the transaction at issue solely to
15 create a recognition event whereby Appellants could
16 realize the loss to offset the cancellation of debt
17 income. Notably, the transfer agreement, Exhibit H, was
18 dated December 10th, 2010, only three days after
19 Appellants entered into contract with Mr. Premji for the
20 sale of the subject property.

21 Lastly, the Appellants alleged reasons for
22 engaging in the transaction at issue are found wanting.
23 Selling the entity holding title to the subject property
24 while the subject property is already in escrow serves no
25 purpose other than to accelerate the recognition of losses

1 necessary to offset cancellation of debt income.

2 Taxpayers' unsupported assertions are
3 insufficient to satisfy their burden of proof. As is the
4 case here, the evidence on record does not support
5 Appellants' characterization of events and allegations
6 regarding the issues at hand. And as noted throughout
7 Respondent's briefings, Appellants contradictory
8 statements are further evidence that the transaction at
9 issue lacked business purpose.

10 Regarding the Step Transaction Doctrine, separate
11 steps with independent significance are linked together or
12 disregarded to determine a taxpayer's liability resulting
13 from the entire transaction. Whether the Step Transaction
14 Doctrine is applicable depends on the end result test. In
15 applying the end result test, the court has to determine
16 whether a series of closely related steps are the means to
17 reach a specific result. To avoid this application of
18 this test, the taxpayer must demonstrate that at the time
19 it entered into the transaction, the result of that
20 transaction was the intended result in and of itself.

21 Here, the question is whether Appellants intended
22 to sell Nottingham LLC regardless of the sale of the
23 subject property to Mr. Premji. The evidence does not
24 support the conclusion that Appellants intended the sale
25 of Nottingham LLC as result in it of itself. Rather, as

1 Nottinghill LLC was already in contract with Mr. Premji
2 for the sale of the subject property, selling the entity
3 holding title to a subject property to a known partner
4 serves no purpose other than tax avoidance. Again, this
5 is further evidenced by the lack of substance and
6 inherence to the terms of the transfer agreement noted
7 above. Appellants intended result of the transaction at
8 issue was recognition of losses generated by the alleged
9 sale, not the transference of ownership. Therefore, the
10 tax consequences of the transaction at issue should be
11 disregarded.

12 Regarding Appellants' Texas judgment,
13 Respondent's Exhibit SS, on February 4th, 2021, Mr. Hecker
14 filed a declaratory judgement -- filed for declaratory
15 judgement. On February 11th, 2021, Mr. Richards filed a
16 general denial. In March 2021, Mr. Hecker filed a motion
17 for summary judgment of which Mr. Richards never filed a
18 response. Notably, Appellants waived any notice period,
19 and neither party conducted any discovery, written or
20 oral. In April 20, 2021, the Texas court issued a final
21 default judgement of which Appellants submitted a copy to
22 the OTA.

23 Again, the OTA lacks jurisdiction to hear the
24 issue of whether Appellants' Texas judgment is entitled to
25 full faith and credit. Per Section 3.5 of Article 3 of

1 the California Constitution, administrative agencies are
2 prohibited from determining that any part of the
3 California Revenue Tax Code is unconstitutional or
4 unenforceable pursuant to federal preemption or other
5 federal law, unless an Appellate Court has made such a
6 determination. Therefore, due to the lack of statutory
7 authority allowing Respondent to obtain judicial review of
8 any adverse decision on questions of constitutional
9 importance, the Board of Equalization has repeatedly
10 adopted a policy abstaining from constitutional issues.

11 Moreover, giving credence to Appellants' attempt
12 at circumventing this appeals process would invariably
13 lead to a flood of taxpayers simply obtaining declaratory
14 judgments in friendly out-of-state courts and presenting
15 the facts before the OTA. All the more so if Appellants
16 are successful in arguing that the Texas judgment be
17 deemed relevant and the questions of whether the Texas
18 judgment should be given res judicata effect be
19 considered. Therefore, Respondent urges the OTA to follow
20 precedent. Furthermore, even had the OTA had proper
21 jurisdiction, Appellants' Texas judgement would not be
22 entitled to res judicata effect.

23 To give full faith and credit means that a state
24 must respect a judgment obtained in the sister state and,
25 thereby, give the judgment the same res judicata effect as

1 determined by the laws of the rendering state. In Texas,
2 res judicata requires proof of three elements: A prior
3 final judgement on the merits by a court of competent
4 jurisdiction; identity of parties of those in privity with
5 them -- or identity of parties or those in privity with
6 them; and a second action based on the same claims as
7 raised or could have been raised in the first action.

8 Appellants have not met their burden to show that
9 the Texas judgement is entitled to res judicata effect for
10 three reasons. First, Respondent was not a party to the
11 Texas judgment. Pursuant to Texas Civil Code, when
12 declaratory relief is sought, all persons who have a claim
13 or a claimed interest that would be affected by the
14 declaration must be made parties. As neither Mr. Premji
15 nor Respondent were made parties to the Texas judgement,
16 there was no identity.

17 Second, there's no privity between Respondent and
18 Appellants. Under Texas law, when a person is in privity
19 with a party to a prior action can be determined by
20 establishing one of three things: First, the person
21 controlled the prior action, even though not a party to
22 it; two, the person's interest were represented by a party
23 to the prior action; or three, the person can be a
24 successor in interest deriving his claim through a party
25 to a prior action. Here, there was no privity because:

1 One, Respondent did not and could not control the Texas
2 action; two, Respondent's interests were not represented
3 in the Texas action; and three, Respondent cannot be a
4 successor in interest to either party in the Texas action.

5 Lastly, declaratory judgments require there it to
6 be a judiciable controversy. There was no such
7 controversy between Appellants. Appellants are business
8 partners and even used the same representative throughout
9 this entire process.

10 Regarding IRC Sections 108 and 165 as argued in
11 Respondent's briefings, Mr. Richards has not established
12 that he qualified under IRC Sections 108(b) and (d), or
13 that he suffered a loss under IRC Sections 165. Regarding
14 IRC Section 108(b), according to the Treasury Regulations,
15 an LLC with a single member is a disregarded entity for
16 tax purposes as treated as a sole, proprietorship, branch,
17 or division of the owner. For purposes of applying
18 Section 108(b) to discharge of indebtedness income of a
19 disregarded entity, the disregarded entity shall not be
20 considered to be the taxpayer. Rather, for purposes of
21 Section 108(b), the owner of the disregarded entity is the
22 taxpayer.

23 As of January 1st, 2010, Nottingham LLC was
24 converted to a single member LLC and, therefore, a
25 disregarded entity. As such, it is not Nottingham LLC

1 that must be insolvent, but Mr. Richards. Mr. Richards
2 has not shown that he, himself, was insolvent at the time
3 of the cancellation of indebtedness by the lender.
4 Therefore, IRC 108(b) is inapplicable.

5 Regarding IRC Section 108(d), Mr. Richards failed
6 to make a timely election. According to IRC, said
7 election shall be made on taxpayer's return for the
8 taxable year in which the discharge occurs. Bank of
9 America issued a 1099-C in 2010. Mr. Richards made this
10 election on an amended return on July 10th, 2014.
11 Therefore, said election is inapplicable. However,
12 assuming arguendo that Mr. Richards made a timely
13 election, the basis reduction must be limited to
14 approximately \$3.2 million and not the entire \$5.6 million
15 as claimed by Mr. Richards.

16 Regarding IRC 165, there shall be allowed as a
17 deduction any loss sustained during the taxable year and
18 not compensated for by insurance or otherwise. Moreover,
19 a loss shall be treated as sustained during the taxable
20 year in which the loss occurs as evidenced by a closed and
21 completed transactions and fixed by identifiable events
22 occurring in such taxable year. As argued in Respondent's
23 briefings, Appellants have not met their burden of proof
24 to show that Mr. Richards did, in fact, suffer such a
25 loss. For these reasons, Respondent requests that its

1 actions be sustained.

2 This concludes Respondent's arguments.

3 Thank you.

4 JUDGE AKOPCHIKYAN: Thank you, Mr. Kim.

5 I'm going to turn it over to my panel members for
6 any questions.

7 Judge Kletter, do you have any questions?

8 JUDGE KLETTER: Hi. This is Judge Kletter. I do
9 not have any questions. Thank you.

10 JUDGE AKOPCHIKYAN: Thank you.

11 Judge Lam, do you have any questions?

12 JUDGE LAM: This is Judge Lam speaking. I have a
13 question for Appellant. I wanted to ask you if you can
14 please clarify your points with regards to the practical
15 economic effects, other than tax benefits of this
16 transaction.

17 MR. SEMONIAN: Sure.

18 JUDGE LAM: Thank you.

19 MR. SEMONIAN: So -- sorry. So yes. So there
20 were two practical aspects to it. The first and primary
21 is the fact that Mr. Richards sold the property. It was
22 gone. He lacked ownership after the transaction. But
23 along with that, he stopped bleeding financial losses.
24 And these were substantial monthly cash flow losses that
25 he was incurring.

1 So upon the sale of the LLC, those losses
2 stopped. And it was just -- and that's a substantial
3 economical impact. He was no longer writing checks from
4 his personal account to cover the operating losses of an
5 apartment complex. As of December 10th, 2010, it came to
6 an end. His financial position significantly improved
7 from the sale of the LLC.

8 JUDGE LAM: This is Judge Lam. Is that all?

9 MR. SEMONIAN: With respect to answering your
10 question, yeah, I believe so. I think that's the basis
11 for the economic impact.

12 JUDGE LAM: Thank you.

13 JUDGE AKOPCHIKYAN: I don't have any questions
14 for Franchise Tax Board.

15 Mr. Semonian, it's time for your final statement
16 and rebuttal. You could proceed when you're ready.

17 MR. SEMONIAN: Sure.

18

19 CLOSING STATEMENT

20 MR. SEMONIAN: So a couple of things I'd like
21 respond to with respect to Mr. Kim's arguments.

22 First, the sale occurred in -- actually,
23 Mr. Premji was in escrow to purchase this building. There
24 was a fire. He canceled escrow. Mr. Richards was in a
25 panic over the sale. He felt that at that stage that he

1 was never going to be able to sell that property. That's
2 when Mr. Hecker offered to purchase the LLC. So that's a
3 critical point to keep in mind is that he was unable to
4 sell the property, and he was suffering these significant
5 monthly financial losses.

6 Mr. Premji's continued involvement and desire to
7 buy the property was -- we were unsure. I want to be very
8 clear that he was going in and out. We didn't expect any
9 of the sales to be concluded. We assumed that whatever
10 offer he was doing at that time was going to come back
11 with some sort of substantial reduction and probably not
12 enough of a selling price to cover the debt with Bank of
13 America. And, in fact, Mr. Richards, after the
14 cancellation of the escrow by Mr. Premji, he was actually
15 contemplating seriously turning the property over to Bank
16 of America and doing it in lieu of foreclosure. So that
17 opened up Mr. Hecker's offer to buy the property.

18 The aspect with respect to the court case in
19 Texas, I think we need to clarify. It wasn't a default
20 judgement. There was a hearing of the facts. Both
21 parties were present, and it was -- and the reason that
22 that court case occurred in Texas was because it was
23 predicated by the demands by the title insurance company
24 representing Mr. Premji, the eventual buyer of the
25 property. They were concerned that the -- following the

1 protest hearing, that the State of California's assertion
2 that this property sale was a sham would -- would somehow
3 impair Mr. Premji's title to the property, and they were
4 protecting their interest. They demanded clarification.
5 And that was the reason for the Texas court case.

6 It had absolutely nothing to do with this
7 hearing. It was all based upon massive threats by the
8 title insurance company. And they were threatening all
9 sorts of litigation and so forth if we didn't clarify
10 title. So that was the purpose of the hearing. And it
11 was -- all the documents were presented. There was a
12 hearing. Both parties were there. And as I mentioned
13 earlier, I believe the attorney for the title insurance
14 company was supposed to be there. I'm not sure if he was
15 actually was, but I was told that he was going to be
16 there.

17 So I think those two things counter with
18 Mr. Kim's presentation with respect to the effect of the
19 tax courts. It was a valid tax -- it was a valid court
20 case. It was properly heard. Both sides were properly
21 represented, and it was under duress that court case was
22 derived. And so its court ruling is valid. It's very
23 hard to say that you can't accept a court ruling from a --
24 just because you don't like it doesn't mean you shouldn't
25 acknowledge it.

1 And somehow Mr. Kim is making an argument that
2 had the court case occurred in California that there would
3 be a different ruling. Given the same set of
4 circumstances, that would not occur. And, of course, it
5 could not be heard in California because the property was
6 sold in Texas, and that's the jurisdiction. And it was
7 also determined by the court that Mr. Premji did not have
8 standing. He was not involved in the transaction between
9 Mr. Hecker and Mr. Richards, nor was the Franchise Tax
10 Board. Neither party had standing, and so they were not
11 party to this transaction.

12 And so Mr. Kim's argument that they -- that the
13 Respondent should have been party to this is improper.
14 They were not part of that original transaction. They're
15 a party to this audit, not to transaction that occurred in
16 2010. And so, again, I believe Mr. Kim's position on this
17 is invalid, and I think it's wrong. And to assert that
18 because Mr. Richards was somehow involved in the sale and
19 cooperating with the sale does not mean that he owned the
20 LLC. It's very common for buyers, prior owners of
21 properties to help with the sale if it's going to be their
22 benefit and not their detriment.

23 So I don't believe that Mr. Richards' continued
24 involvement in the sale, in any way, shows that he had
25 ownership in the LLC. It's corporation. And isn't that

1 what people expect? So again, I don't understand why
2 Mr. Kim is not accepting the court case, or why the
3 assertion because Richards was cooperating with the sale
4 should in any way affect a valid transaction. A valid
5 transaction that turned around Mr. Kim's -- Mr. Richards'
6 life and stopped the financial losses. And that is what
7 this is all about, substantial economic basis.

8 And 108, there was a tax return filed for this
9 partnership. It was not a disregarded entity. 108 would
10 have applied, and that's a different issue. My purpose
11 for bringing up 108 is to say that we would have elected
12 it had the sale not occurred by the end of the year. Not
13 that we're asserting the benefits of 108 now, but that we
14 would have asserted them had the sale not occurred.

15 And so the argument that 108 doesn't apply, it
16 does not apply from the standpoint that we are not
17 asserting the benefits of 108. We are asserting that we
18 could have taken advantage of the benefits of 108 had we
19 been put in the position of having the debt discharge on
20 the books and not had the loss before the end of the year.

21 And one other small point, I made it very clear
22 during the audit process that I did recommend Mr. Richards
23 that he sell the property before the end of the year. I
24 wanted to take advantage of the tax losses. It was not
25 just for this transaction, but there were other

1 transactions. Since Mr. Richards was losing so much
2 money, he was contemplating selling other assets, and we
3 were going to have other gains. And so my goal was to
4 protect his tax position.

5 And I'm an accountant. My job is to provide tax
6 advice when asked. And the proper tax advice is if you
7 have a gain, offset the gain. No different than if you go
8 to your accountant and say I just sold stock and made a
9 whole bunch of money. What should I do? Your accountant
10 is going to tell you to sell the losers before the end of
11 the year. That's no different here. We have a right to
12 minimize our tax positions. But the advice I gave
13 Mr. Richards was done during tax season when I'm working
14 110, 120 hours a week, and I had no time to do a tax
15 analysis.

16 When I became aware of 108 later on in that year,
17 it no longer became an event. But asked during the audit
18 did I advise Mr. Richards to do that? I said yes, but it
19 became of no effect by the end of the year. We knew about
20 108, and we were more than prepared to take advantage of
21 it. So, again, I believe that their assertion that 108
22 isn't invalid, it's not invalid if we were claiming the
23 benefits on this issue. We are not. We are claiming that
24 we could have taken advantage of them had that been the
25 issue at hand at the time. Had we had a taxable income

1 from relief of debt, I would have asserted 108. And it
2 was a partnership tax return. It was not a disregard
3 entity.

4 So hopefully I've answered and given you the
5 information that you needed on this stuff.

6 So thank you.

7 JUDGE AKOPCHIKYAN: Thank you, Mr. Semonian. The
8 last few points you made about what happened during 2010,
9 I just want to clarify that you -- that testimony, did you
10 want to go under oath and testify to that, or is that just
11 argument? It seems like you're personally involved with
12 the advice.

13 MR. SEMONIAN: I was personally involved, and it
14 is testimony. Sure absolutely.

15 JUDGE AKOPCHIKYAN: Okay. I'm going to have you
16 restate a few thing after I swear you in. Can you please
17 raise your right hand.

18
19 R. SEMONIAN,
20 produced as a witness, and having been first duly sworn by
21 the Administrative Law Judge, was examined and testified
22 as follows:

23

24 JUDGE AKOPCHIKYAN: Thank you. You may proceed.
25 Just restate anything you want to again.

1 MR. SEMONIAN: Again, my statement is one, that
2 the -- with respect to the benefits of 108, we were -- we
3 are not asserting that 108 --

4 JUDGE AKOPCHIKYAN: I think we can just
5 retroactively just what -- you could just reaffirm.

6 MR. SEMONIAN: I reaffirm what I previously said.
7 How's that?

8 JUDGE AKOPCHIKYAN: Under oath.

9 MR. SEMONIAN: Does that work? Yes.

10 JUDGE AKOPCHIKYAN: That should work.

11 MR. SEMONIAN: Yes. Under oath.

12 JUDGE AKOPCHIKYAN: Thank you so much. Okay. Is
13 there anything else you want to add before --

14 MR. SEMONIAN: I don't think so.

15 JUDGE AKOPCHIKYAN: Okay. Thank you.

16 MR. SEMONIAN: I'm hoping that you're going to
17 have questions.

18 JUDGE AKOPCHIKYAN: Let me turn over to my panel
19 members to see if they have any questions.

20 Judge Kletter, do you have any questions?

21 JUDGE KLETTER: This is Judge Kletter. I do not
22 have any questions. Thank you.

23 JUDGE AKOPCHIKYAN: Judge Lam, do you have any
24 questions?

25 JUDGE LAM: I do not have any questions. Thank

1 you.

2 JUDGE AKOPCHIKYAN: I have a quick question. The
3 sale between Mr. Richards and Mr. Hecker references an
4 amount for \$4.48 million. How did they come up with that
5 amount?

6 MR. SEMONIAN: It was basically the debt against
7 the property. But, again, that wasn't the final selling
8 price of the property. Because Mr. Hecker had offered to
9 buy the LLC from Mr. Richards, Mr. Richards was not going
10 to be duped. He had contingent aspects to the sale of
11 that LLC that if Mr. Richards was to sell it for over a
12 certain -- up to a certain price, that he would share in
13 the benefits of that sale after the fact, because the
14 initial sale was based upon the debt against the property.

15 But if Mr. Richards -- if Mr. Hecker had flipped
16 the property and sold it, then Mr. Richards would share in
17 some of the benefits of that sale later on. And so that's
18 one of the reasons why Mr. Richards was willing to
19 cooperate with the sale. He was going to receive certain
20 cash benefit from doing so.

21 JUDGE AKOPCHIKYAN: Thank you. And then you also
22 indicated that Mr. Premji, the ultimate buyer, canceled
23 escrow or pulled out and then went go back into escrow.
24 Is that your position?

25 MR. SEMONIAN: Yes. If -- one of the reasons

1 that the pictures were provided with a burning, is
2 Mr. Premji was in escrow to purchase the property from
3 Mr. Richards. In escrow, there was -- I believe it was a
4 meth lab fire or some sort of drug-related fire on the
5 property, and during the -- and because of the fire,
6 Mr. Premji canceled his escrow. He was no longer going to
7 buy the property. And that left the property -- you know,
8 at that stage, Mr. Richards thought it was never going to
9 sell. Mr. Premji came back and forth multiple times, but
10 those were negotiations.

11 JUDGE AKOPCHIKYAN: Are you aware of any document
12 that memorialized the cancellation of escrow?

13 MR. SEMONIAN: I thought it had been presented in
14 the documents provided by the Franchise Tax Board
15 during -- when they provided all the documents from the
16 audit. We provided in the audit the cancellation
17 documents by Mr. Premji, yes.

18 JUDGE AKOPCHIKYAN: Okay. Thank you,
19 Mr. Semonian. I don't have any other questions at this
20 time.

21 I also don't have any questions for the Franchise
22 Tax Board, but let me ask my panel members if they do.

23 Judge Kletter, do you have any final questions?

24 JUDGE KLETTER: This is Judge Kletter. No
25 questions. Thank you.

1 JUDGE AKOPCHIKYAN: And, Judge Lam, any final
2 questions?

3 JUDGE LAM: No questions. Thank you.

4 JUDGE AKOPCHIKYAN: Okay. Well, does either
5 party have any questions before we conclude?

6 MR. SEMONIAN: I do not.

7 JUDGE AKOPCHIKYAN: Thank you, Mr. Semonian.
8 Mr. Kim?

9 MR. KIM: Respondent does not have any questions.

10 JUDGE AKOPCHIKYAN: Thank you.

11 We are ready to conclude this hearing. This case
12 is submitted on September 13th, 2023, and the record is
13 now closed.

14 I want to thank the parties for their
15 presentation today.

16 The panel will meet and decide this appeal based
17 on the arguments and evidence presented to the Office of
18 Tax Appeals, and we will issue our written decision within
19 100 days of today.

20 Thank you. We'll take a brief recess, and the
21 next hearing will start around 1:00 o'clock.

22 Thank you.

23 (Proceedings adjourned at 12:35 p.m.)
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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for
the State of California, do hereby certify:

That the foregoing transcript of proceedings was
taken before me at the time and place set forth, that the
testimony and proceedings were reported stenographically
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transcription under my direction and supervision, that the
foregoing is a true record of the testimony and
proceedings taken at that time.

I further certify that I am in no way interested
in the outcome of said action.

I have hereunto subscribed my name this 10th day
of October, 2023.

ERNALYN M. ALONZO
HEARING REPORTER