OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **M. SAXON**	OTA Case No. 20036049

OPINION

Representing the Parties:

For Appellant: Thomas A. Nitti, Attorney

For Respondent: Carolyn Kuduk, Attorney

For Office of Tax Appeals: Oliver Pfost, Attorney

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Saxon (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $958,769, an accuracy-related penalty (ARP) of $191,753.80, and applicable interest, for the 2013 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Asaf Kletter, Eddy Y.H. Lam, and Richard Tay held an oral hearing for this matter in Cerritos, California, on September 12, 2023. At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

ISSUE

Whether appellant has demonstrated error in FTB's determination that appellant failed to complete any valid like-kind exchanges under Internal Revenue Code (IRC) section 1031.[1]

[1] On appeal, FTB agreed to abate the ARP.

FACTUAL FINDINGS

1. At the beginning of the 2013 tax year, appellant owned four residential real properties (each, a Relinquished Property, and collectively, the Relinquished Properties), as follows: one located in Sherman Oaks, California[2] (the Sepulveda property), one located in West Hollywood, California (the Gardner property), and two located in Los Angeles, California (together, the Cohasset properties).
2. On April 26, 2013, appellant entered into an Exchange Agreement with Investment Property Exchange Services, Inc. (IPX), a California corporation, as a Qualified Intermediary to facilitate a like-kind exchange of real properties (1031 Exchange) in compliance with IRC section 1031 and the Treasury Regulations thereunder. The Exchange Agreement governed all the Relinquished properties.[3] IPX assigned the anticipated 1031 Exchange a single exchange number ending in 8743.
3. IPX engaged three different escrow companies to facilitate the sale of the Relinquished properties.[4] On July 19, 2013, the Cohasset properties were sold for $5,650,000. On July 30, 2013, the Gardner property was sold for $1,850,000. On August 1, 2013, the Sepulveda property was sold for $2,800,000. Each respective Final Settlement Statement listed IPX as seller for appellant under the exchange number ending in 8743.
4. On August 15, 2013, IPX sent correspondence to appellant reminding her that based on the closing date for the sale of the first Relinquished Property, the 45-day identification deadline for the exchange number ending in 8743 was September 2, 2013.
5. On September 2, 2013, appellant completed and signed a Replacement Property Identification Notice (Identification Letter), pursuant to which she identified and designated five alternative real properties as replacement properties for the 1031 Exchange and stated her intention to acquire two total replacement properties in the 1031 Exchange. The Identification Letter includes IPX's acknowledgment of receipt.

[2] The City of Los Angeles includes Sherman Oaks, but the neighborhood is used for ease of reference.

[3] Exhibit A to the Exchange Agreement indicates that the agreement governs the Sepulveda property; however, subsequent exchange documents in the record indicate that the Exchange Agreement governed all Relinquished Properties, which the parties do not dispute. No document in the record shows the addition of the other Relinquished Properties to the Exchange Agreement.

[4] The escrow agreements, purchase and sale agreements for the respective Relinquished Properties, and any assignment agreements between appellant and IPX, are not in the record.

6. On October 22, 2013, through IPX, appellant acquired the first identified property from the Identification Letter in Winnetka, California through IPX for a purchase price of $4,460,000. On November 16, 2013, through IPX, appellant acquired the second identified replacement property from the Identification Letter in Van Nuys, California[5] for a total consideration of $8,750,000.
7. Appellant filed four IRS Forms 8824, Like-Kind Exchanges, with her 2013 federal income tax return. As relevant here, appellant reported the following 1031 Exchanges:
   a. Two transfers on July 19, 2013, for which replacement property was identified on July 19, 2013, and received on November 16, 2013. FTB identified these Relinquished Properties as the Cohasset properties.
   b. A July 30, 2013 transfer, for which replacement property was identified on July 30, 2013, and received on October 22, 2013. FTB identified this Relinquished Property as the Gardner property.
   c. An August 1, 2013 transfer, for which replacement property was identified on August 1, 2013, and received on October 22, 2013. FTB identified this Relinquished Property as the Sepulveda property.
8. FTB audited appellant and disallowed the claimed 1031 Exchange. Accordingly, FTB determined that appellant must recognize $7,404,801 in capital gains income from the sale of the Relinquished Properties. FTB subsequently issued appellant a Notice of Proposed Assessment (NPA) proposing additional tax of $958,769, an ARP of $191,753.80, plus interest.
9. Appellant protested the NPA. On February 27, 2020, FTB issued a Notice of Action affirming the NPA.
10. Appellant timely appealed. On appeal, appellant provides a declaration dated March 4, 2021, from a licensed physician who specializes in psychiatry and performed a comprehensive geriatric psychiatric examination of appellant on October 28, 2019. The physician states that in his medical opinion, appellant lacked the cognitive capacity on or

[5] Appellant identified the first replacement property as being in Canoga Park, although the Final Settlement Statement indicates it was actually located in Winnetka, a nearby neighborhood. The City of Los Angeles includes Canoga Park, Winnetka and Van Nuys; but the neighborhoods are used for ease of reference.

around September 1, 2013, to sufficiently understand and appreciate the information necessary to fill out tax forms correctly. FTB subsequently agreed to waive the ARP.

DISCUSSION

Burden of Proof

FTB's determinations are presumed correct, and a taxpayer has the burden of proving otherwise. (*Appeal of Rios*, 2021-OTA-341P.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) In the absence of credible, competent, and relevant evidence showing an error in FTB's determinations, its determinations must be upheld. (*Ibid*.) A taxpayer's failure to produce evidence that is within the taxpayer's control gives rise to a presumption that such evidence is unfavorable to his or her case. (*Appeal of Kwon, et al.*, 2021-OTA-296P.)

Except as otherwise specifically provided by law, the burden of proof is generally on the appellant as to all issues of fact. (Cal. Code Regs., tit. 18, § 30219(a).) The burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher*, 2021-OTA-284P.)

In briefing, appellant argues that we must apply the standard of review prescribed in California Code of Civil Procedure (CCP) section 1904.5, citing to *Topanga Assn. for a Scenic Community v. County of Los Angeles* (1974) 11 Cal.3d 506 (*Topanga*). CCP section 1094.5 describes a writ of mandate issued "for the purpose of inquiring into the validity of any final administrative order. . . ." Writs of mandate are issued under a court's discretion. (See CCP section 1085, *Topanga*, *supra* at 514.) However, OTA is not a court; rather, it is an administrative agency charged with determining the correct amount of tax. (*Appeal of Robinson*, 2018-OTA-059P; *Appeals of Dauberger, et. al.*(82-SBE-082) 1982 WL 11759.) OTA is subject to the Rules for Tax Appeals, Cal. Code Regs., tit. 18, § 30000, *et seq*. The Rules for Tax Appeals expressly provide that rules relating to evidence and witnesses contained in the California Evidence Code and CCP shall not apply to any OTA proceedings except as provided by the Rules for Tax Appeals. (Cal. Code Regs., tit. 18, §30214(f).) As described above, the Rules for Tax Appeals do not incorporate the CCP in its rules relating to the application of the

burden of proof. (Cal. Code Regs., tit. 18, § 30219.) Accordingly, the standard of review articulated in CCP section 1094.5 is inapplicable.[6]

IRC section 1031

California law generally conforms to IRC section 1031, which is an exception to the general rule requiring recognition of gain or loss upon the sale or exchange of property. (IRC, § 1001(c), Treas. Reg. § 1.1002-1(a); R&TC, § 18031.)[7] To qualify for nonrecognition treatment under IRC section 1031, three general requirements must be satisfied: (1) the transaction must be an exchange (exchange requirement), (2) the exchange must involve like-kind properties (like-kind requirement); and (3) both the property transferred (the relinquished property) and the property received (the replacement property) must be held for a qualified purpose (holding requirement). (IRC, § 1031(a)(1)-(3); *Appeal of Lovinck Investments N.V., et al.*, 2021-OTA-294P (*Lovinck*).) If IRC section 1031 is inapplicable, the general recognition rule under IRC section 1001(c) is triggered. (*Lovinck*, *supra*.)

The IRC permits deferred exchanges. (IRC, § 1031(a)(3); Treas. Reg. § 1.1031(k)-1.) However, IRC section 1031(a)(3) states that "for purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property" (emphasis added) if it fails to meet two requirements. The first requirement is that the replacement property must be identified "on or before the day which is 45 days after the date on which the taxpayer transfers the [relinquished property]" (identification period). (IRC, § 1031(a)(3)(A).) Second, the replacement property cannot be received "after the earlier of . . . the day which is 180 days after the date on which the taxpayer transfers the [relinquished property]," or the due date for the transferor's tax return for the tax year in which the transfer occurs (exchange period). (IRC, § 1031(a)(3)(B).) If, as part of the same deferred exchange, the taxpayer transfers more than one relinquished property on different dates, the identification period and the exchange period are

[6] At the hearing, appellant cited California Civil Code (CCC) section 3529, but failed to explain how that section applies to this appeal as OTA is not a court. (See *Palos Verdes Properties v. County Sanitation Dist. No. 5 of Los Angeles County* (1960) 177 Cal.App.2d 679, 691 [The court permissively applied the presumption of performance contained in CCC section 3529].)

[7] For the 2013 tax year, R&TC section 17024.5(a)(1)(O) provides that for Personal Income Tax Law purposes, California conforms to the January 1, 2009 version of the IRC. References to the IRC are therefore to the January 1, 2009 version. When applying the IRC, California also incorporates Treasury Regulations to the extent that they do not conflict with regulations promulgated by FTB. (R&TC, § 17024.5(d).)

determined by the reference to the earliest date on which any of the properties are transferred. (Treas. Reg. § 1.1031(k)-1(b)(2)(iii).)

The IRC also permits a taxpayer to identify multiple replacement properties in a deferred exchange; however, the maximum number of replacement properties that the taxpayer may identify is either (1) three properties without regard to their fair market values (FMVs), known as the 3-property rule, or (2) any number of properties so long as their aggregate FMVs at the end of the identification period does not exceed 200 percent of the aggregate FMV of all relinquished properties as of the date the relinquished properties were transferred by the taxpayer (200 percent rule). (Treas. Reg. § 1.1031(k)-1(c)(4)(i).)[8] But if a taxpayer identifies more properties as replacement properties than permitted at the end of the identification period, the taxpayer is treated as if no replacement property was identified. (Treas. Reg. § 1.1031(k)-1(c)(4)(ii).)

Analysis

In the Identification Letter, appellant identified five replacement properties. Here, OTA applies the 3-property rule and the 200 percent rule to determine whether appellant met the like-kind requirement. On appeal, appellant expressly concedes that the 200 percent rule is not met. Thus, the remaining question is whether the 3-property rule was met.

On appeal, appellant asserts she did not perform one 1031 Exchange, as determined by FTB, but rather three 1031 Exchanges with distinct identification and exchange periods. Appellant claims that she identified and designated five replacement properties for all three 1031 Exchanges, and accordingly, the 3-property rule was met. Appellant further asserts that the following evidence in the record supports three 1031 Exchanges: (1) IPX entered into three separate and independent contracts for the Relinquished Properties with different escrow companies, any of which could have failed to go forward with no impact on the remaining contracts for the other Relinquished Properties, and (2) appellant reported exchanging the Relinquished Properties on four IRS Forms 8824.[9] Concerning appellant's first assertion, no escrow agreements or purchase and sale agreements are in the record. Therefore, no evidence

[8] Treasury Regulation section 1.1031(k)-1(c)(4)(ii) describes two exceptions to the 200 percent rule; however, as discussed below, appellant concedes that the 200 percent rule is not met. Accordingly, the exceptions will not be discussed further.

[9] Although appellant relinquished four real properties, appellant contends she performed three independent 1031 Exchanges, first, exchanging the Cohasset properties, second, exchanging the Gardner property, and third, exchanging the Sepulveda property.

shows that if any Relinquished Property failed to close escrow or sell, there would be no impact on the disposition of the other Relinquished Properties. Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Rios, supra*.)

Concerning appellant's second assertion, appellant's IRS Forms 8824 are inconsistent with the facts she asserts to be correct. At the hearing, appellant concedes that there was only one Identification Letter. However, two Forms 8224 report that appellant identified replacement properties on July 19, 2013, one Form 8824 reports identification on July 30, 2013, and the fourth Form 8824 reports identification on August 1, 2013. None of the identification dates match the date of the Identification Letter, September 2, 2013. The September 2, 2013 date of the Identification Letter is also consistent with the deadline set forth in IPX's August 15, 2013 letter. Further, the Identification Letter references a single exchange number ending in 8743, and does not evidence three distinct exchanges. Appellant fails to explain how the Identification Letter assigns the properties according to three distinct 1031 Exchanges; at the hearing, appellant asserted that retroactive assignment was permissible. Appellant's interpretation conflicts with Treasury Regulation section 1.1031(k)-1(c)(4)(ii), which provides that if, as of the end of the identification period, the taxpayer has identified more replacement properties than permitted under the rules, the taxpayer is treated as if no identification of property was made.

Other evidence in the record identifies a single exchange number ending in 8743 which governed the Relinquished Properties. In response, appellant claims that she later added the Cohasset and Gardner properties to the Exchange Agreement for convenience only and used IPX as qualified intermediary for all Relinquished Properties for convenience only. FTB contends that appellant intended to perform one 1031 Exchange because a single exchange number ending in 8743 was referenced in the Identification Letter, no other exchange number is referenced in the record concerning the Relinquished Properties, and appellant's actions in exchanging the Relinquished Properties for two replacement properties were consistent with her designations in the Identification Letter. Appellant responds that IPX's internal assignment of a single exchange number is irrelevant and disputes that appellant's actions are consistent with a single exchange.

However, the burden of proof is on appellant as to all issues of fact, and appellant must provide credible, competent, and relevant evidence showing an error in FTB's determinations. (Cal. Code Regs., tit. 18, § 30219(a); *Appeal of Belcher, supra*.).) Here, the record contains conflicting indirect evidence. Appellant has not met her burden to show the facts she asserts,

show three distinct 1031 Exchanges, by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) Appellant disputes the evidence regarding a single exchange number ending in 8743 but provides no evidence to show that FTB's determinations that there was a single 1031 Exchange, and that appellant owes additional tax, were in error. Accordingly, FTB's determinations must be upheld. (*Appeal of Belcher*, *supra*; see Treas. Reg. § 1.1031(k)-1(c)(4)(ii) [excessive identification of properties treated as no identification of property]; *Lovinck*, *supra* [If IRC section 1031 is inapplicable, the general recognition rule triggers].)[10]

In the alternative, appellant asserts that she lacked the cognitive capacity to understand and appreciate the information necessary to fill out tax forms properly, which entitles her to relief from the additional tax. Appellant claims that she made an error out of her control despite the exercise of ordinary business care and prudence. However, appellant has not provided, and we are not aware of, any statutory or regulatory authority that excuses failure to comply with IRC section 1031 and the regulations thereunder for reasonable cause. Accordingly, OTA may not waive the requirement to designate replacement properties within the identification period.

[10] Alternatively, if there were three distinct 1031 Exchanges, FTB argued that appellant failed to properly identify replacement property. At the hearing, appellant asserted that the Identification Letter would satisfy the identification requirements of Treasury Regulation section 1.1031(k)-1(c). Because OTA finds that appellant failed to establish three distinct 1031 Exchanges, there is no need to decide this issue.

HOLDING

Appellant has not demonstrated error in FTB's determination that appellant failed to complete any valid like-kind exchanges under Internal Revenue Code (IRC) section 1031.

DISPOSITION

FTB's action is sustained, as modified by FTB's waiver of the ARP on appeal.

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Asaf Kletter
Administrative Law Judge

We concur:

DocuSigned by:
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Richard Tay
Administrative Law Judge

DocuSigned by:
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Eddy Y.H. Lam
Administrative Law Judge

Date Issued: 12/12/2023