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APPEARANCES:

Panel Lead: ALJ SHERIENE RIDENOUR

Panel Members: ALJ JOHN JOHNSON
ALJ ANDREW WONG

For the Appellant: A. LAVAR TAYLOR
SALLY FARAH

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PETER KWOK
NATHAN HALL

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-12 were received into evidence during the Prehearing Conference.)

(Appellant's Exhibits 13-19 were received into evidence at page 7.)

(Department's Exhibits A-B were received into evidence at page 7.)

(Department's Exhibit C was received into evidence post hearing.)

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Cerritos, California; Wednesday, September 11, 2024

9:42 a.m.

JUDGE RIDENOUR: We are on the record.

We're opening the record in the Office of Tax Appeals oral hearing for the Appeal of Sarah [sic] Farah, OTA Case No. 220810976. Today's date is Wednesday, September 11th, 2024, and the time is 9:42. The hearing is being held at Cerritos, California.

Today's hearing is being heard by a panel of three Administrative Law Judges. My name is Sheriene Ridenour, and I'm the lead judge. And Judges John Johnson and Andrew Wong are the members of the panel. All three judges will meet after the hearing and produce a written decision as -- sorry. Sally, my apologies.

All three judges will meet after the hearing and produce a written decision as equal participants. Although the lead judge conducts the hearing, any judge on this panel may ask questions or otherwise participate to ensure that we all have the information needed to decide the appeal.

I do apologize on the record, Ms. Farah.

For the record, will the parties please state their names and who they represent, starting with representatives for Appellant.

1 MR. TAYLOR: Good morning. My name is Lavar
2 Taylor. I'm appearing on behalf of Sally Farah.

3 MS. FARAH: Good morning. My name is Sally
4 Farah.

5 JUDGE RIDENOUR: Thank you.

6 FTB.

7 MR. KWOK: Peter Kwok, appearing for Respondent
8 Franchise Tax Board.

9 MR. HALL: Nathan Hall on behalf of Respondent
10 Franchise Tax Board.

11 JUDGE RIDENOUR: Thank you.

12 As stated in my Minutes and Orders, dated
13 August 8th, 2024, there is one issue in this appeal;
14 whether Appellant's receipt of her community property
15 interest in an arbitration award qualifies for
16 nonrecognition treatment under IRC section 1041; and if
17 not, whether it is taxable income in the 2015 tax year.

18 However, since the prehearing conference, I
19 realize I may want to two separate that into two separate
20 issues, along the lines of: Issue One, whether
21 Appellant's receipt of her community property interest in
22 an arbitration award qualifies for nonrecognition
23 treatment under IRC section 1041; and Issue Two, if the
24 award does not qualify, whether it is taxable in the 2015
25 tax year.

1 Does either party have any objection?

2 Mr. Taylor?

3 MR. TAYLOR: No.

4 JUDGE RIDENOUR: Mr. Kwok?

5 MR. KWOK: No, Judge.

6 JUDGE RIDENOUR: Great. Okay. And as for
7 exhibits, they are listed in the exhibit log as provided
8 in the Exhibit Binder, which has been distributed to the
9 parties. During the prehearing conference, FTB raised no
10 objections to Appellant's Exhibits 1 through 12, and they
11 were admitted into evidence. Since the prehearing
12 conference, Appellant has submitted Exhibits 13
13 through 19.

14 Mr. Kwok, do you have any objections to
15 Appellant's Exhibits 13 through 19?

16 MR. KWOK: No, Judge.

17 JUDGE RIDENOUR: Appellant's Exhibits 13
18 through 19 are hereby admitted into evidence.

19 (Appellant's Exhibits 13-19 were received
20 in evidence by the Administrative Law Judge.)

21 JUDGE RIDENOUR: During the prehearing
22 conference, Appellant raised no objections to exhibits for
23 FTB A through B, and they are admitted into evidence.

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

1 JUDGE RIDENOUR: Since the prehearing conference,
2 FTB has admitted Exhibit C.

3 Appellant, do you have any objections to FTB's
4 Exhibit C?

5 MR. TAYLOR: No.

6 JUDGE RIDENOUR: Okay.

7 FTB indicated it will not call any witnesses.
8 Appellant indicated that both she and Mr. Taylor will be
9 testifying today, and FTB raised no objections. As such,
10 Mr. Taylor and Ms. Farah will both be sworn in before
11 Appellant's presentation. There are no other witnesses
12 today.

13 All right. As a reminder to the parties, during
14 our prehearing conference we decided that Appellant will
15 have 60 minutes to make her presentation, followed by FTB
16 who will have 30 minutes. Then Appellant will have 5
17 minutes to provide closing remarks should you choose.
18 Each party are encouraged to monitor their own time.

19 Before we move on to presentations, does anyone
20 have any questions.

21 MR. TAYLOR: No.

22 MR. KWOK: Nope.

23 JUDGE RIDENOUR: Okay. All right. Ms. Farah and
24 Mr. Taylor, I need to each place you under oath so that we
25 can consider your statements as testimony, and you will

1 remain under oath until the close of the hearing. Will
2 each of you please raise your right hand.

3

4 S. FARAH,

5 produced as a witness, and having been first duly sworn by
6 the Administrative Law Judge, was examined, and testified
7 as follows:

8

9 L. TAYLOR,

10 produced as a witness, and having been first duly sworn by
11 the Administrative Law Judge, was examined, and testified
12 as follows:

13

14 JUDGE RIDENOUR: All right. Thank you very much.

15 The time is 9:46, and when you're ready,

16 Mr. Taylor, please begin your presentation.

17 MR. TAYLOR: Thank you. I will start by having
18 Ms. Farah read her prepared statement, which were provided
19 to the tribunal Monday, as well as FTB's counsel.

20 JUDGE RIDENOUR: Okay. Thank you.

21

22 WITNESS TESTIMONY

23 MS. FARAH: Okay. My name is Sally Farah. I'm
24 the Appellant in this appeal. I'm providing testimony in
25 support of my appeal challenging the efforts of the

1 California Franchise Tax Board to tax me on the payment
2 that I received from my former husband, Michael Farah, in
3 2015 in the amount of \$1,468,739.

4 I married Michael Farah on September 21st, 2002.
5 At that time, he worked for Wedbush Securities,
6 Incorporated, Wedbush. Although, I did not learn this
7 fact until the fall of 2013, in 2025 [sic], Mr. Farah
8 filed a claim against Wedbush seeking a seven-figure
9 recovery based on the misconduct of Wedbush. Mr. Farah
10 and I separated in October of 2009, and he filed for
11 divorce shortly after. We entered into a settlement
12 agreement dividing our property that I was aware of. At
13 the time we entered into our settlement agreement, I was
14 unaware of Mr. Farah's claim against Wedbush. Our
15 property settlement agreement did not mention the action
16 against Wedbush.

17 On February of 2012, our marriage was dissolved.
18 The judgment did not mention the action against Wedbush.
19 Mr. Farah's arbitration against Wedbush occurred in August
20 and September of 2013. On September 25th, 2013, the FINRA
21 arbitration panel ruled in favor of Mr. Farah, awarding
22 him millions of dollars in damages. He was awarded over
23 \$1.3 million in lost income, \$1.4 million in punitive
24 damages, \$260,000 in attorney fees incurred fighting
25 Wedbush, \$1.2 million in attorney fees incurred in

1 defending other claims, plus other amounts for a total
2 award of almost \$4.3 million.

3 Mr. Farah failed to disclose this award to me. I
4 learned about the award from two independent sources.
5 After I learned that my former husband had recovered
6 millions of dollars from Wedbush, I consulted with my
7 divorce attorney regarding my rights to a portion of the
8 Wedbush award, and then asked him to sue my former husband
9 in Family Law Court to recovery what I believed to be my
10 community property share of that award. I filed a request
11 for adjudication of an omitted asset with the Family Law
12 Court in October of 2013.

13 After several hearings over an extended period of
14 time, the Family Law Court held that Mr. Farah breached
15 his fiduciary duty to me, and ordered him to pay me
16 one-half of the portion of the Wedbush recovery that was
17 community property. The Court order directing him to pay
18 me the funds that he paid to me in 2015 was entered by the
19 Family Law Court in 2015. I did not report any portion of
20 the Wedbush award on my 2000 income tax return because I
21 never received any portion of that award in 2013. My
22 former husband never offered to share a portion of that
23 award with me in 2013.

24 To the best of my belief, my former husband
25 reported the entire amount of the Wedbush award as income

1 on his own federal and California income tax returns.
2 Neither the Franchise Tax Board nor the IRS audited my
3 2013 income tax returns, and I'm certain that audits of my
4 2013 returns would have occurred if Mr. Farah had failed
5 to report the entire amount of the Wedbush recovery on his
6 own personal income tax returns for 2013. Although my
7 former husband paid me in full in 2015 as required by the
8 Family Law Court, Mr. Farah appealed the Family Law Court
9 order. Mr. Farah lost the appeal.

10 Litigation against Mr. Farah to recover a portion
11 of the Wedbush award was lengthy, very difficult, and
12 emotionally draining. He used bullying tactics in the
13 litigation, such as filing motions to change judges and
14 other tactics. I prevailed because I persevered, but it
15 was not easy for me to persevere. I did not include any
16 portion of the payment I received from Mr. Farah in 2015
17 in my income -- on my 2015 income tax returns. My
18 understanding was that I was not required to include that
19 amount in my income. After I filed my California and
20 federal tax income -- tax returns for 2015, I was
21 contacted by an IRS Revenue agent.

22 The IRS Revenue agent demanded that I file an
23 amended 2015 income tax return that included in my income
24 the amount of the payment I received from my former
25 husband in 2015 pursuant to the Family Law Court order.

1 At that point, I contacted Mr. Lavar Taylor's office firm
2 and asked him to help me deal with the IRS agent. I gave
3 Mr. Taylor an IRS power of attorney so that he could
4 represent me before the IRS. Mr. Taylor wrote a letter to
5 the IRS agent explaining why I was not required to include
6 the amount paid to me by Mr. Farah in 2015 as income on my
7 2015 federal income tax returns.

8 After Mr. Taylor sent his letter to the IRS
9 agent, the IRS agent contacted me again regarding my --
10 never contacted me again regarding my 2015 return. The
11 IRS agent never taken the position I was required to
12 report the payment I received from Mr. Farah in 2015 on my
13 2015 federal income tax return. It's been extremely
14 frustrating for me having to fight the Franchise Tax Board
15 on the question of whether I was required to report the
16 2015 payment to me by Mr. Farah as income on my 2015
17 California income tax return. I do not understand why the
18 Franchise Tax Board is taking the position that is
19 completely contrary to the position taken by the IRS agent
20 who contacted me and ultimately agreed with Mr. Taylor's
21 analysis that I was not required to report Mr. Farah's
22 2015 payment to me as income on my 2015 return.

23 My fight against the Franchise Tax Board has been
24 mentally exhausting. I feel like I'm fighting my former
25 husband again. And I was shocked to learn that the

1 Franchise Tax Board had settled his case and had agreed
2 that he could deduct the payment he made to me. I feel
3 like the Franchise Tax Board is not turning square
4 corners, particularly since the Family Law Court
5 determined that my former husband should have to bear the
6 tax burden associated with the receipt of the entire
7 amount of the Wedbush recovery.

8 I thank the members of this panel for their
9 consideration of my appeal and ask that you determine that
10 I'm not required to include the payment made to me by my
11 former husband in 2015 in my 2015 income.

12 Thank you.

13 JUDGE RIDENOUR: Thank you, Ms. Farah.

14 Mr. Taylor, would you like to proceed?

15 MR. TAYLOR: Yes. Well, does anybody -- well, I
16 guess --

17 JUDGE RIDENOUR: I was going to wait until after.

18 MR. TAYLOR: Oh, wait until after?

19 JUDGE RIDENOUR: Yes.

20 MR. TAYLOR: Fair enough.

21 JUDGE RIDENOUR: Thank you.

22 MR. TAYLOR: Thank you.

23

24 WITNESS TESTIMONY

25 MR. TAYLOR: I want to testify just to relate --

1 give some more flavor to what happened with the Revenue
2 agent and discuss the letter I sent to the agent a little
3 bit, which I believe is Exhibit 10. So after my firm was
4 retained by Ms. Farah, I contacted the agent. The agent
5 was fairly insistent. He says now I need -- I need to
6 have this amended return filed. I asked for some time to
7 do some research, and he granted me a little bit of time
8 and did the research. And the result of my research led
9 me to believe that the payment was nontaxable under
10 section 1041. So I drafted the letter that's Exhibit 10,
11 and I sent it to him.

12 Now, at the end of that letter, there is a
13 discussion of one of the issues that was raised in the --
14 I don't want to get the terminology wrong. Basically,
15 what the essence of it is, I call it pretrial order that
16 was issued by Chief Judge Ridenour.

17 JUDGE RIDENOUR: I'm sorry to interrupt. Can you
18 please put the microphone closer to you.

19 MR. TAYLOR: Yes. Okay. I'm sorry.

20 JUDGE RIDENOUR: And move it closer just to --

21 MR. TAYLOR: Okay.

22 JUDGE RIDENOUR: Much better. Thank you very
23 much.

24 MR. TAYLOR: Okay. So I'm going to talk about
25 the letter. At the end of that letter I made a statement

1 regarding the taxability of the interest. There is
2 \$43,000 in the -- in the, what I call the pretrial order.
3 The panel asked -- Judge Ridenour says, "We want to know
4 what your position is on the taxability of this \$43,000 in
5 interest."

6 I said in the letter that I thought the interest
7 was taxable. That was a tactical move. I was concerned
8 for Ms. Farah that we would end up in a potentially long
9 drawn out battle with the IRS. And I felt that if I said
10 conceded up front, that this interest is taxable, the
11 chances are that we wouldn't have to deal with the IRS
12 thereafter. I fully expected a response from the agent.
13 My reading of the 1041 is that, literally, if you apply
14 the literal application, the payment of the interest was
15 paid pursuant to the court order. It was transfer
16 incident to divorce and, although, it would be taxable
17 under literally any other context.

18 And the context of 1041 there's this broad policy
19 judgement by Congress that payments between spouses that
20 are incident to divorce -- or ex-spouses that are incident
21 to divorce are simply not taxable, even where the
22 income -- where the payment would be income outside of
23 that context. So I -- I looked at the issue, and I said
24 literally I think the interest is not taxable. But I just
25 put it in the letter as a way of hoping --- as s tactical

1 move, hoping that the Revenue agent would look at it and
2 go, oh, okay. He's going to give me something. I can
3 close my case. And I offered to -- to file an amended
4 return reporting that it is interest income.

5 Now, the strange thing from my standpoint, I
6 heard nothing at all from the Revenue agent after that;
7 not a phone call, not a letter. And I thought about it,
8 and I said well, he -- he must think the whole thing is
9 not taxable 'cause I never -- literally never heard
10 anything. And we provided the transcript of the 2015
11 return, the IRS transcript. So -- so you could see that
12 the IRS never audited the return. But not only did they
13 never audit the return, they never contacted me in any way
14 after I sent the letter.

15 Now, I -- when the agent spoke to me first, he
16 didn't tell me he was auditing the ex-husband's return.
17 But that's the -- I drew the -- and because of disclosure
18 rules, the IRS agents won't say, oh, I'm auditing the
19 ex-husband's return. I -- I -- and while I was doing
20 that, your client's -- yeah, I saw this payment was made
21 to your client. They won't tell you because of disclosure
22 rules that they are auditing the ex-husband's return, but
23 I knew they weren't auditing my client's return.

24 There was no -- made that clear. I drew the
25 conclusion without the agent telling me that they were

1 auditing his return. And so, you know, that was -- that
2 was my conclusion. So you can understand my thinking
3 about that. And that's what I have to say about -- about
4 that.

5 JUDGE RIDENOUR: Thank you.

6 So before we proceed, is that the end of your
7 presentation?

8 MR. TAYLOR: That's the end of the testimony.

9 JUDGE RIDENOUR: Okay. Thank you. I'm just
10 going to go ahead and let you do your presentation as
11 well, and then at that point I will allow FTB and the
12 Panel to ask you both questions as witnesses.

13 MR. TAYLOR: Okay. Thank you.

14 JUDGE RIDENOUR: Thank you.

15

16 PRESENTATION

17 MR. TAYLOR: I want to make clear that there are
18 two different things, and this is in response to the
19 question posed in, again, what I call the pretrial order.
20 2013 was the year in which the community got the income.
21 There's no doubt about that. And the cases we cited in
22 our brief, like, C -- you know, Poe v. Seaborn and one
23 other new case that I -- that is on my list, Hardy v.
24 Commissioner makes that crystal clear as a Ninth Circuit
25 case. It deals with section 66(c), which is the innocent

1 spouse -- spouse provisions in community property states
2 where there is no joint-return filed.

3 So there's really no doubt in the law that when
4 you look at the community and when the community is
5 supposed to report the income, they report the income in
6 the year the -- the income is received. And the rule is,
7 even if one spouse doesn't physically receive the income,
8 they're required to report 50 percent of the community
9 income on their return. That's the year in which the
10 income should have been reported on somebody's return.

11 Now, in this case, it's unusual because the
12 ex-husband treated it and acted as if it was his own
13 separate property, and later the Family Law Court said,
14 no, you're wrong. Not only are you wrong, but, you know,
15 you breached your fiduciary duty. And as one sanction,
16 we're not going to give you credit against the payment
17 that's due -- now due to your ex-spouse, which is half of
18 the portion of the award that the court determined was
19 community property. The total portion that was community
20 is \$2.9. So she gets half. The Court said we're not
21 going to give you, Mr. Ex-Husband, credit for taxes you
22 paid.

23 That was a sanction rendered against him under
24 Family Law Court 1101. And under that section, the Family
25 Law Court had the authority, actually, to award the entire

1 omitted asset if there was, you know, fraud and oppression
2 and -- and -- but it's discretionary. It's not mandatory
3 even if there was fraud and oppression and the judge can
4 do what they want. In this case, the judge said, I'm not
5 going to give you, Mr. Ex-husband, credit for the taxes
6 you paid on that. I want you to transfer to Ms. Farah
7 half of the gross of the community property that you got
8 in 2013. Okay.

9 Now, the Family Law Court doesn't deal with the
10 taxability of that. But, clearly, the Family Law Court in
11 awarding that sanction was proceeding on the premise that
12 Mr. Farah had included the entire amount of that award in
13 his income, acting as if it were his separate --
14 everything was his separate property. In fact, it wasn't.
15 Okay. And Ms. Farah came in and -- and, you know, almost
16 immediately after learning about this, the award, she came
17 in and went to Family Court and said, wait, I'm entitled
18 to my share of community property. Okay. 2013 is the
19 year in which the income was reportable by the community.

20 And, again, under cases like Poe v. Seaborn and
21 Malcolm, which is on -- both on my list, both in the
22 briefs. There's really no dispute about that. It's
23 reportable by the community and, in theory, reportable by
24 my client, half of it, if to the extent it's community
25 property. Now, one of the things the FTB could have done

1 here, at -- you know, after they looked at this and they
2 found out what was going on, in theory, they could have
3 said, oh, we're going to open up 2013 for audit, and we're
4 going to try to tax Ms. Farah on half.

5 They could have tried that since Mr. Farah
6 reported the entire amount. You know, I probably would
7 have screamed that's not fair. But, in theory, the FTB
8 could have said, you know what, we're going to -- we -- we
9 see that you're in litigation against your ex-husband
10 because you're claiming half of this community -- you
11 know, this community income was paid in 2013 -- you're
12 entitled to half of it. And so we'll put the audit on
13 hold until your litigation is over. And if you get that,
14 we'll tax you in 2013.

15 They could have done that. They had the
16 opportunity to do that; because there's a six-year statute
17 of limitations in this case; because the omitted -- you
18 know, if you view this amount that was paid to Ms. Farah
19 in 2015 as omitted income for 2013 purposes, they had a
20 six-year statute of limitations. They had until 2020 to
21 do this, if they wanted. They didn't. That was their
22 remedy. Okay. It's taxable in 2013, not in 2015.

23 2015 is the year of the division of assets or
24 this asset. There were assets divided earlier, not
25 omitted assets. But 2015 is the division of assets. It's

1 not the reporting of income. And Section 1041 has this
2 very, very broad policy of -- we're not saying we're not
3 going to treat as a taxable transfer for gain or loss any
4 transfers between either spouses or former spouses to the
5 extent it's incident to the divorce. There's a reason for
6 this policy.

7 If this Panel were to say, oh, we think this is
8 taxable to Ms. Farah, you're gonna -- I hate to use this
9 technical term. You're going to freak out every single
10 Family Law attorney in California, because every one of
11 them is under the impression that transfers between
12 spouses, omitted asset, not omitted asset, whatever, it's
13 nontaxable. And if you think about it, now, these
14 distinctions that the Franchise Tax Board draws between
15 possession and ownership, they're meaningless. There's
16 nothing in the statute that says that.

17 But, for example, you can have the ex-husband has
18 a piece of property and there's a fight over what to
19 extend it's community property because it was bought
20 before the marriage but there were improvements made after
21 the marriage. You've got this big -- big really thicket
22 of -- thorny thicket over how much of that house is
23 community property. Maybe some of it is, but we don't
24 know how much. Who made the mortgage payments? You know,
25 maybe some of it was made with a gift to separate

1 property. It's a mess.

2 And so what the parties can do is say, okay,
3 look, they can agree. Or the judge can say you know what,
4 since you two are squabbling forever and a day, and I'm
5 tired of the squabbling, I'm going to award the house, the
6 property -- the party to what -- this party, the husband,
7 and I'm going to value the -- the wife's community -- the
8 community property interest at X, whatever it is,
9 half-a-million dollars. And, therefore, I'm going to
10 order the husband to pay half of that to the ex-wife as an
11 equalization payment. Okay.

12 Now, if you change that to a commercial property,
13 clearly that's a taxable sale outside of a divorce. Okay.
14 One party selling a piece of property, the commercial
15 property -- I'll shift from commercial -- to commercial
16 from homes because I don't want to have to deal with
17 half-a-million dollar exclusion. So for community
18 property purposes, this -- this property is sold outside
19 of 1041. This property is being sold that -- it's partial
20 interest is being sold to one spouse in return for money.
21 That's gain or loss. Or if -- if the money is equal to
22 the basis, it's a wash. But it's a reportable taxable
23 sale, which reports tax gained or tax loss.

24 But in the context of a divorce, Congress said
25 none of this should be reportable as gain or loss. And

1 that's a policy decision made by Congress. Literally no
2 transfer of property that's incident to the divorce
3 between a former spouse -- former spouses is taxed with
4 gain or loss. There's no gain. There's no loss. There's
5 no exceptions. This is not something where you file an
6 election on a return. It says I elect nonrecognition.
7 It's mandatory.

8 So, again, just think of -- of the -- of the
9 difficulties if we now have to, in the context of
10 transfers of property, not reporting income, which
11 happened in an earlier year, which, you know, should have
12 happened or happened in an earlier year. But that income
13 is now an asset that has to be divided, and 2015 is all
14 about division of assets, not about reporting of income.
15 And so because of this broad policy, okay, you don't get
16 into, okay, was this income in an earlier year that's --
17 what's -- what's the source of the property? What's being
18 transferred as property?

19 They're equalizing the division of community
20 property. That's what happened here. It was equalization
21 of community property. And if you think about the fact
22 that under the 1101 of the Family Law Code, the Court has
23 the authority to award the entire asset to the other party
24 if there's fraud and oppression. Are you going to call
25 that entire amount now taxable is fair if that had

1 happened? How do you deal with that? Conceptionally it's
2 a mess. And Congress has said we don't want to go there.

3 We just don't want to go there because this is a
4 transfer of property incident to a divorce. The key case,
5 of course, at the federal level is Balding. Okay. And
6 then there's another case, Witcher. And I'd like to talk
7 little bit about what happened in Balding and Witcher.
8 Both of those cases involve, you know, pension plans.
9 Okay. And the difference between Balding and Witcher, is
10 that in Balding, the wife -- ex-wife gave up rights in a
11 pension plan in return for payment of money outside the
12 tax -- outside 1041. Boy is that taxable income. It's
13 income.

14 Okay. It's a pension plan. She sold her rights
15 to the pension plan for money. Okay. That's clearly
16 taxable outside 1041. And the Court said nope. This is a
17 transfer. This is -- this is, basically, an equalization
18 of splitting of the assets in the divorce. And the cash
19 that Ms. Balding got in that in the -- that was awarded to
20 her in the family -- as part of the Family Law Court's
21 division of assets was not taxable at all.

22 Witcher was different. Witcher, there was a
23 pension plan -- interest in a pension plan awarded to the
24 wife -- ex-wife. And then later -- years later, she
25 starts getting money. And she said, whoa, wait a second.

1 I shouldn't have to pay tax on that, in a later year. And
2 the Court said, look, the transfer to you in the year of
3 the transfer was nontaxable. That just deals with
4 transfer. Once it's yours, okay, once it's been
5 transferred to you, you have to pay the income -- you
6 know, you have to report the income generated by the
7 asset.

8 Now, there's a corollary when you divide assets
9 without gain or loss, and that is the basis in the assets.
10 So in my property hypothetical involving commercial
11 property where it's not clear how much is -- you know, the
12 parties are fighting over how much of the property is
13 community property. Then there's a transfer of the
14 building -- of interest in the building, okay. And then
15 there's cash paid by the husband to the wife as an
16 equalization payment. The corollary under 1041 is that
17 cash payment doesn't increase the husband's basis in the
18 property. Okay. He doesn't get that.

19 You inherit the basis. That's an important part
20 when you're not dealing when you're -- you know, when
21 you're dealing with property. Here, we're dealing with
22 cash. Okay. And the husband's basis is cash is cash. He
23 got the cash. Okay. He reported the income. Okay. So
24 we don't have a basis issue here. Okay. She gets the
25 cash. She gets transferred the cash. It's tax free

1 because it involves a division of asset incident to a
2 divorce.

3 Now, I -- and -- and so that's the basic
4 difference between Balding and Witcher. Witcher, you
5 know, Franchise Tax Board says, oh, Witcher supports this.
6 No it doesn't. Witcher says in the year you get -- of the
7 transfer, it's nontaxable. But down the road income
8 produced by the asset is taxable, of course, subject to
9 the basis rules. And so for Ms. Farah this is, you know,
10 why I -- you know, when I looked at the issue of the
11 interest, which is, you know, the question posed in the
12 pretrial order. You look at that and, literally, it is a
13 transfer incident to the divorce.

14 It's a transfer ordered by the judge, you know,
15 unless it's an equalization payment that was -- that was
16 increased by, quote, "interest due to the passage of
17 time." But it was transferred in 2015, and it was part of
18 the transfer. And because it was part of the transfer,
19 it's nontaxable even though clearly outside of 1041
20 context, it's taxable. No question. But in the content
21 1041 context, it's not taxable.

22 Now, Ms. Farah is not here to argue that the
23 interest in 2016 and '17 and '18 and '19, it was generated
24 by the proceeds she received is not taxable. We're not
25 here to argue that. We agree all the income generated by

1 those proceeds in later years is taxable. So we agree
2 with the holding of Witcher because Witcher deals with
3 what happens later on. And the spouse was trying to use
4 the 1041 as a way to avoid paying tax on the -- on the --
5 the income generated by the asset forever. And the Court
6 rightfully said, you're wrong. We're not here to argue
7 that.

8 On the question of whether or not this is
9 incident to a divorce, I can't come up with a -- with a
10 stronger set of facts to qualify as incident to divorce
11 than the facts of this case. It's literally impossible
12 for me to come up with a stronger set of facts. You look
13 at the regulations. I mean, you look at the -- the code.
14 The codes says no gain or loss recognized to the extent
15 there's transfers between spouses or former spouses if
16 it's incident to divorce. And if it's incident to
17 divorce, it's related to the cessation of the marriage.
18 Boy, was this related to the cessation of the marriage.
19 The marriage stopped. Ceased.

20 The marriage stopped, and there was an omitted
21 asset that should have been disclosed and should have been
22 divided. And Ms. Farah went back to the Family Law Court
23 and said, this is -- we just -- we got divorced. I'm
24 entitled to half of the community property. And if you
25 look at the regulations, you don't even need a -- you

1 know, if this presumption exists, if it doesn't relate to
2 the division of assets, it doesn't -- there's no
3 presumption that it's -- that it's not related to the
4 cessation of the marriage when you're dealing with
5 division of marital assets.

6 So, again, I can't come up with this -- Franchise
7 Tax Board raised all these theories. I don't under --
8 frankly, I do not understand it. To me they're gibberish.
9 How do you -- what's the difference between ownership and
10 possession? It doesn't matter. You can transfer -- like,
11 one client takes their own separate property and transfers
12 it to the one -- you know, one ex-spouse and transfer it
13 to other as part of a marital settlement in return for
14 surrendering community party. They can mix. They can
15 match. They can trade.

16 If one spouse says I want -- you own 50 McDonalds
17 and you own 50 -- you know, together we have 50 McDonalds
18 and 50 Burger Kings. And some of the stores are community
19 property and some of them are separate property on both
20 sides, both McDonalds and Burger Kings, they can sit down
21 and say, you know what? I want all the Burger Kings, even
22 the ones at your separate property, and you want all the
23 McDonalds, even the ones that are my separate property,
24 and we'll trade and we'll split them up, and there's no
25 gain at all. No loss. They keep the same basis.

1 So I don't understand the distinctions they made
2 at all in their briefs. I literally don't. To me, the
3 only issue here that's arguable is the question raised
4 by -- in the pretrial order, what about this, what you
5 didn't know at this time, was interest income? You said,
6 "What is it? Well, you now have -- you -- so it's
7 interest. That's what it was. That, I think, is
8 ultimately covered by Balding. Why? Because it was
9 transferred as part of the -- the transfer in 2015; part
10 of the whole thing. It's not something that was paid in a
11 later year not part of the transfer. It wasn't something
12 earned by the proceeds in a later year. It's something
13 that was included in the transfer.

14 And Congress, for policy reasons, did not want to
15 get into the taxability of interspousal transfers in
16 connection with a divorce. And so the rule is broad.
17 Maybe broader than I would draw if I were a legislature,
18 but it's broad. There's no exceptions. Its mandatory.
19 And so that's why we think the interest income is
20 nontaxable. I've already explained, I think, why we
21 believe and content that there's -- you know, the proper
22 year of reporting is 2013. All the cases support that.
23 Every single one.

24 Now, again, I'd like to talk a little bit when I
25 said -- earlier when I said that the Franchise Tax Board

1 could have said -- could have opened up an audit of my
2 client's 2013 return after they found out she was trying
3 to get a portion of the community -- you know, community
4 property income in 2013. You could have done that. What
5 would have happened?

6 I think, Judge Ridenour, you -- you would have
7 said, what about section 66? Well, I went back and looked
8 at section 66, and I -- I was surprised. There's two
9 provisions that are relevant. One is 66(b). 66(b) allows
10 the taxing authorities to absolve somebody of reporting of
11 income. It's a one-way street. Taxpayers cannot take
12 advantage of it. Okay. But the taxing authority can say,
13 you know what, we can absolve you. And -- and all the
14 requirements for 66(b) are met because all that's required
15 is that the ex-spouse not tell my client about the award.

16 It doesn't say they -- you know, she learned
17 about it independently. But 66(b), if she's not told
18 about the income by her former spouse or -- then she
19 qualifies for absolution under 66(b). Strangely, she
20 doesn't qualify, wouldn't have qualified for innocent
21 spouse under 66(c). And there's a reason for that because
22 the test is different. Okay. 66(c), it's like the old --
23 it's like the old 6013 innocent spouse provisions, which
24 are now incorporated in 6015(a) of the Internal Revenue
25 Code.

1 Those old provisions said, you didn't know about
2 the income. You had no reason to know about the income.
3 Well, the income was in 2013, and she did learn about it
4 before the end of the year, and then she sued. And two
5 years later she won, and two years after that she won the
6 appeal. So, ironically, I -- you know, while the FTB
7 would have had the ability to absolve Ms. Farah of
8 reporting the tax -- you know, of reporting any portion of
9 that income on her 2013 return. I don't think she would
10 have qualified for relief under 66(c) because she knew
11 about the income before the end of the year. Very
12 strange, but all of that never happened. Okay.

13 The FTB, however, did have the opportunity to go
14 and try and tax somebody other than Mr. Farah who reported
15 100 percent of the income. They could have tried to tax
16 Ms. Farah on that in 2013. If they were going to try to
17 tax anybody other than Mr. Farah, which would be my
18 client. 2013 was the year, not 2015. Community didn't
19 get that income in 2015. They just split the asset.

20 And I'll come back to my last point, which is,
21 again, if this -- I think it's my last point. I'll ask
22 for a minute to review my notes.

23 But if you think about what's going to happen in
24 the Family Law community if this tribunal says, oh, we're
25 going to treat this as taxable income. It's gonna -- it's

1 gonna create nightmares, because now people -- all the
2 family law attorneys are worried are going to say under
3 what circumstances are these transfers going to be
4 taxable? 1041 says transfers among spouses incident to
5 divorce are not taxable. Period.

6 That's what this case involves. It involves the
7 transfer of assets. The income was in 2013. All that
8 happened in 2015 was -- there was an asset, an
9 equalization payment made because we're dealing with cash.
10 Okay. If -- if Mr. Farah had received a rare car in
11 compensation for some work he did, and the rare car was
12 worth a million dollars, well, you can't give her half a
13 car. You got to have equalization payment, but that's
14 what would have happened. And that's all that happened
15 here was a division of assets.

16 Now, if may I have one minute and just to consult
17 my notes?

18 JUDGE RIDENOUR: Absolutely.

19 MR. TAYLOR: Thank you. I'm good. Thank you.

20 JUDGE RIDENOUR: Thank you very much, Mr. Taylor.

21 FTB, do you have any questions of Ms. Farah or
22 Mr. Taylor as witnesses?

23 MR. KWOK: Not at this time, Judge Ridenour.

24 JUDGE RIDENOUR: Thank you.

25 Judge Johnson, do you have any questions?

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JUDGE JOHNSON: I do not. Thank you.

JUDGE RIDENOUR: Judge Wong, do you have any questions?

JUDGE WONG: I just had a couple of questions. So going back to Exhibit 10, which was, Mr. Taylor, your letter to the IRS --

MR. TAYLOR: Yes.

JUDGE WONG: -- from October 2016, so you didn't hear anything back from the IRS since that letter?

MR. TAYLOR: Nothing.

JUDGE WONG: Okay. And even up to this day, nothing.

MR. TAYLOR: To this day. And, again, I included the transcript for 2015. So you could see there's nothing there on the transcript for 2015.

JUDGE WONG: Okay. And during your presentation, you had given us your interpretation of what IRS' silence meant but there was -- is basically they were silent, right? So that's just your interpretation?

MR. TAYLOR: Well, if -- well, no, it's just not my interpretation. They backed off. I mean, you know, to get to my -- put my testimony hat back on. The -- the agent was really emphatic when I talked to him. He said, "Your client needs to report this. I'm gonna open up an audit." And he didn't really say I'm going to go and

1 impose penalties but -- you know, as an overt threat
2 because they're not supposed to do that. But he was
3 really unhappy.

4 He said, "Your client needs to report this. They
5 should have reported it." Okay. So he was pretty
6 emphatic and then silence. So I think the only possible
7 inference to be drawn from that is that he read my letter,
8 consulted with his manager and said, looks like Taylor is
9 right.

10 JUDGE WONG: Okay. And also regarding -- you
11 also referenced the case of Hardy and how that involves
12 innocent spouse relief. But at the end of your
13 presentation you mention that in your opinion it didn't --
14 this case doesn't qualify for innocent spouse relief.
15 So --

16 MR. TAYLOR: For 2013.

17 JUDGE WONG: For 20 --

18 MR. TAYLOR: Had they -- had they audited -- I
19 mean, if you read Hardy -- you know, it's on the list.
20 You have the cite. Hardy basically set -- it talks about
21 the test and, you know, it -- it's actually a conflict.
22 You know, you got to go look at all these different code
23 sections and you read through it. But Hardy, the
24 taxpayer, lost. So Hardy is good for understanding what
25 the elements of relief are under section 66(c). Okay.

1 But if you read the code, it literally requires my client
2 not know and had -- have any reason to know about the
3 income, okay, when they sign the return. Well, she knew
4 about it.

5 So, you know, I'm a magician sometimes, but I
6 can't change -- I can't change the word of the code, you
7 know. So -- so -- but my point is this. The FTB had an
8 opportunity to do something about this, if they really
9 wanted to do something. I don't think they should have
10 because Mr. Farah reported the entire amount on his
11 return. But if they wanted to, they could have.

12 JUDGE WONG: Got thank you. And also with
13 regards to 66(b), you alluded to that also. Doesn't that
14 also have kind of, like, a requirement that your client
15 would be in the dark about the settlement payment and --

16 MR. TAYLOR: I think -- I think it's more -- I
17 have a copy here. I think it's more that she didn't
18 benefit. You live a part of -- okay. Ah, here we go. I
19 printed on both sides. I'm sorry.

20 All it says is that Secretary may disallow the
21 benefits of community property law to any taxpayer, if the
22 taxpayer acted -- is if solely entitled to such income and
23 failed to notify the taxpayer spouse before the due date
24 of the return. Okay. Literally, the requirements are met
25 because Mr. Farah did not notify my client of anything.

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JUDGE WONG: Okay.

MR. TAYLOR: So, literally, those requirements were met.

JUDGE WONG: Got it. Okay. And then I just wanted to go back to your hypo. You talked about if like a court ordered during a divorce proceeding the sale of property. You mentioned commercial property, possibly. You were arguing that that sale would be nontaxable or nonrecognition?

MR. TAYLOR: Well, there's a difference between selling to a third party --

JUDGE WONG: Right.

MR. TAYLOR: -- and an interspousal transfer.

JUDGE WONG: Right.

MR. TAYLOR: My hypothetical was strictly like I'm -- you know, here's a piece of commercial property. There's a big fight over how much of this is community property. And I, Judge, I'm going to say 50 percent of this is community property, but I'm not -- but the parties don't want to sell it to a third party. They're fighting over it between themselves. And so the judge awards it to one party, and then orders that party to pay the value of the -- of the community property. It's a sale outside of 1041, outside of divorce --

JUDGE WONG: Got -- got it.

1 MR. TAYLOR: -- but under 1041 it's nontaxable.

2 JUDGE WONG: Okay. I understand. Thank you very
3 much. That's all the questions I have for now.

4 JUDGE RIDENOUR: Thank you. I'm going to hold my
5 questions until the very end. Okay.

6 The time is currently 10:27, and when you're
7 ready, Mr. Kwok, please begin your presentation.

8 MR. KWOK: Thank you, Judge Ridenour.

9

10 PRESENTATION

11 MR. KWOK: I think it's fair to say that I would
12 agree with most of the basic facts as presented by
13 Appellant. With respect to Appellant's share of the
14 arbitration award that was received by Michael Farah, we
15 can agree that it was community property. We agree that
16 Appellant actually received her share of the arbitration
17 award in 2015 after having to sue Michael Farah. And we
18 can also agree that IRC section 1041 is an exception to
19 the general rule of section 61 in that transfers between
20 ex-spouses are not recognized for tax purposes.

21 However, we can't forget that Section 1041 is
22 limited to only transfers of property. The wording of the
23 statute itself is strictly limited to transfers of
24 property. Now, read in its proper context section 1041's
25 use of the term of the phrase "transfer of property,"

1 means that ownership of the property has changed, not mere
2 possession. Every time the word "transfer" is used in
3 subchapter (o) of Internal Revenue Code, each time -- each
4 and every time, the word is used to convey a change of
5 ownership, not just mere possession. You might be
6 wondering how does he know that. That's because the word
7 "transfer, transfers, transferred, or transferring"
8 appears 67 times in subchapter (o). And in every single
9 instance, it refers to a change of ownership.

10 Now, admittedly, the IRS does not define the word
11 "transfer." So perhaps we have to rely on local law for
12 that definition. And under California Civil Code 1039,
13 the word "transfer" is defined as, quote, "An act of the
14 parties or of the law by which the title of property is
15 conveyed from one living person to another," closed quote.
16 So when we use the word "transfer" in Section 1041, it's
17 not a reference to possession. It clearly indicates a
18 change of ownership.

19 Allow me to illustrate the difference between the
20 two in a generic context. Let's say my cocounsel Nathan
21 and I agree to paint somebody's house for \$10 each. After
22 we spend a couple of days painting the house, the owner
23 pays Nathan \$20. And then a couple of days after that,
24 Nathan hands me my share, my \$10. Can I then say Nathan
25 transferred the \$10 to me? Can I say that I didn't

1 receive compensation from the homeowner, but I received it
2 from Nathan because there was a transfer? I -- I think
3 the answer is no to that. But let's put a little twist on
4 this. Let's say Nathan kept the \$20 with the intent of
5 trying to keep the entire \$20 for himself. But later I
6 confront him and he reluctantly gives me my \$10. Does
7 that somehow relieve me of my duty to pay tax on that \$10?
8 Again, I -- I don't -- I don't think it does.

9 In this appeal, Mr. -- Mr. Taylor appears to
10 believe that Michael Farah's payment of the \$1.5 million
11 to Appellant was a transfer of property that was intended
12 by 1041. We don't see it that way. Michael Farah's
13 payment to Appellant was a mere change of possession
14 because Appellant owned her share of the arbitration award
15 the moment it was required. If Michael Farah's payment
16 was a "transfer of property," quote, then sure, 1041 could
17 apply. But if Michael Farah's payment was simply turning
18 over possession of money to its rightful owner, then 1041
19 would not apply.

20 So to further this point, I'd like to just talk
21 about Balding and Witcher just once again. As Mr. Taylor
22 noted in Balding, the taxpayer relinquished her ownership
23 interest in her ex-husband's pension in exchange for cash.
24 And in that case, the Tax Court ruled that it fell under
25 1041. In Witcher, the taxpayer received distributive

1 income from her husband's pension while retaining
2 ownership. And the same Tax Court said their 1041 doesn't
3 apply.

4 So now we're faced with asking ourselves why did
5 the Tax Court treat the taxpayers differently in Witcher
6 and Balding. And the Tax Court tells us exactly why in
7 Witcher. They said, quote, "The case in hand can be
8 distinguished from Balding versus Commissioner. In
9 Balding, the taxpayer received cash payments directly from
10 her former spouse in consideration of her agreement to
11 relinquish all claims to the former spouse's military
12 retirement pay." And the court viewed the taxpayer's
13 release of the rights to the military retirement pay in
14 exchange for the settlement payments as a transfer of
15 property. The taxpayer in Witcher, in contrast, received
16 distributions as her result -- as a result of her retained
17 ownership interest in her former spouse's pension.

18 So this is all just to demonstrate that there
19 must be a change of ownership in order for there to be a
20 transfer of property. If there's no ownership change,
21 then there's no transfer of property. And if there's no
22 transfer of property, then 1041 can't apply. So what does
23 apply? Well, we would argue that IRC section 61. It
24 defines taxable grossable [sic] -- taxable gross income to
25 include all income from whatever sources. And since no

1 exception applies in this case, section 61 should govern
2 Appellant's receipt of her share of the arbitration award.

3 With respect to community income, such as this,
4 the U.S. Supreme Court has a very well-established rule
5 that's been around for about 100 years. This ruling can
6 be seen in cases such as U.S. versus Mitchell, U.S. versus
7 Malcolm, and Poe versus Seaborn, in that if the income in
8 question is community property, one half of the income is
9 attributable to each spouse, and each spouse must report
10 and pay tax on his or her respective one-half community
11 property in the income.

12 Now, because Appellant is a cash-method taxpayer,
13 income must be recognized when the income is actually or
14 constructively received. And since Appellant did not
15 actually receive the income until 2015, we would argue
16 that that is a proper year of taxation.

17 And to summarize, 1041 is an exception to the
18 general rule of IRC section 61, but 1041 only applies to
19 transfers of property. And in this appeal, there was no
20 transfer of property because Appellant always owns her
21 share of the arbitration award under California's
22 community property laws. The \$1.5 million that she
23 received from Michael Farah always belonged to her
24 legally. She simply didn't have possession of it until
25 2015, but the money was rightfully hers. Michael Farah

1 didn't act charitably out of the goodness of his heart
2 when he -- when he paid her the \$1.5 in 2015. He simply
3 handed it over to Appellant because that money always
4 belonged to her.

5 That's all we have at this moment. I'm happy to
6 answer any questions that the Panel may have.

7 JUDGE RIDENOUR: Thank you.

8 Judge Johnson, do you have any questions?

9 JUDGE JOHNSON: No question at this time. Thank
10 you.

11 JUDGE RIDENOUR: Okay. Judge Wong?

12 JUDGE WONG: I did have a question. Just going
13 back to your hypothetical about painting and the \$20. So
14 what if there was, like, a time difference? Because what
15 if Mr. Hale -- is that correct?

16 MR. KWOK: Hall.

17 JUDGE WONG: Hall. I'm sorry. -- earned the
18 money, \$20, in 2013, but he didn't pay you that money.
19 What would be his obligations for reporting that income in
20 2013? And then he didn't give it to you until 2015 after
21 you --

22 MR. KWOK: Hypothetically speaking, Mr. Hall
23 would have to -- may have to report that entire \$20 under
24 the claim of right doctrine if he was claiming that the --
25 that the entire income was his. But if he later had to

1 relinquish half of that money to me for my -- for my
2 services, then theoretically he can take a deduction under
3 the claim of right doctrine in the year that he paid it
4 back.

5 JUDGE WONG: Okay. Thank you. Let me just
6 double check one more thing. So I did a have question
7 with regards to a line in your brief. This is FTB's
8 additional brief from August 8th, 2023, and it's on page 1
9 of that brief. So it's after your introduction and you
10 mention that -- I'll just quote it, "Respondent would like
11 the reader to keep in mind the following points," and then
12 you list four points there, right? Do you see that?

13 MR. KWOK: Yes, Judge Wong.

14 JUDGE WONG: Okay. So I just have a question
15 about No. 4. So you said -- you wrote -- FTB wrote,
16 "However, because the transaction involving this chosen
17 action did not transpire as cleanly as it could have,
18 Appellant appears to misunderstand that while IRC
19 section 1041 would have applied to the transfer of the
20 chosen action, her receipt of over \$1.4 million in cash is
21 not excludable under IRC section 61."

22 So could you just kind of explain what you meant
23 that this chosen action did not transpire as cleanly as it
24 could have. Like, what do you mean by that, and how could
25 it have transpired ideally, I guess?

1 MR. KWOK: Thank you for that question,
2 Judge Wong.

3 Again, theoretically, had everything -- in
4 hindsight, if everything could have been redone, it would
5 have been advisable if Appellant -- if Michael Farah, when
6 he -- when he still had that arbitration claim against
7 Wedbush Securities, if he transferred half of that
8 interest to Ms. Farah by changing the character of the
9 property from his to community property, or maybe even
10 just outright give 50 percent of separate interest to
11 Appellant, then that transfer -- that would have been a
12 transfer of property under 1030 -- it could have been a
13 transfer of property under 1041.

14 JUDGE WONG: In 2013, if that transfer took place
15 in 2013 or --

16 MR. KWOK: Well, whatever year that the
17 arbitration award was instituted.

18 JUDGE WONG: Okay.

19 MR. KWOK: In other words, when that -- when that
20 arbitration claim became a chosen action, it would have
21 been a property -- it would have been property that he
22 could have split theoretically with his ex-wife during the
23 divorce proceedings.

24 JUDGE WONG: But because he didn't disclose it to
25 her until 2015 and she had to go to Family Court, then

1 that changes the character of the chosen action, so 1041
2 no longer applies?

3 MR. KWOK: Right. Because the chosen action now
4 gets reduced to cash, to income, and Appellant had a
5 community property right to the income from the get go.

6 JUDGE WONG: Okay. So, ideally, if she were a
7 party to his action against Wedbush, would that --

8 MR. KWOK: Yeah. Yeah. That would have been --
9 because then -- then 50 percent or her share of the
10 arbitration award would have been awarded directly to her
11 then.

12 JUDGE WONG: Okay. Got it. Thank you very much.
13 No further questions at this time.

14 MR. KWOK: Thank you, Judge.

15 JUDGE RIDENOUR: Thank you.

16 Mr. Kwok, I just have a follow-up question to
17 Judge Wong's. So if the arbitration was listed in the
18 ex-husband's assets and losses for the proceedings of
19 divorce, how would FTB's position be on it in that case?

20 MR. KWOK: Hypothetically, if the -- if Michael
21 Farah disclosed the arbitration claim during the divorce
22 proceedings, and then he transferred a 50 percent or
23 whatever percentage to Appellant, we would have treated
24 that or looked at that as if it was a transfer of property
25 under 1041. Once it got reduced to income at a later

1 point, at that point, than Ms. -- then Appellant would
2 have reported the income that she would have received in
3 connection with her ownership interest in the chosen
4 action.

5 JUDGE RIDENOUR: Okay. Thank you very much.

6 Mr. Taylor, I have a question for you with
7 regards to your house hypothetical. And then I believe
8 you said -- hold on. Let me -- when you, you know, spoke
9 of the basis and then cash, you said that basis of cash is
10 cash.

11 MR. TAYLOR: Is the cash, yes.

12 JUDGE RIDENOUR: Yes. So what is your position
13 on what the ex-husband's basis was in the cash that was
14 community property that was Ms. Farah's community
15 property.

16 MR. TAYLOR: He had reported the amount, his
17 income. His basis was equal to the amount of cash he had.

18 JUDGE RIDENOUR: Okay. Just wanted your
19 position. Thank you very much. You have time for your
20 rebuttal and closing. Originally you were given five
21 minutes. However, your original presentation was shorter
22 than you asked. So you can have an additional 25 minutes
23 or 30, should you choose to use that. So please proceed.

24 MR. TAYLOR: Thank you very much. Couple of
25 quick comments, and I'll be done.

1 taxable to her? I've never heard anybody make that
2 argument before. It has no merit. If it was hers and she
3 got it back, it's like I give her my car. I let her drive
4 my car. She gives it to back. Is it taxable? No. I own
5 it.

6 Their theory is she owned it in 2013, which means
7 it was taxable in 2013. They say well, she's a cash basis
8 taxpayer. She didn't get it until 2015. That's not what
9 Poe says. And if she owned it in 2013 as they allege,
10 okay, it had to be taxable in 2013 because that's the year
11 it was received. And that's what Poe says, what the
12 Supreme Court say. So if it was her property and she just
13 got it back, I don't see how it could be taxable to her
14 because it's already hers.

15 I have nothing further.

16 JUDGE RIDENOUR: Thank you very much.

17 Before we finalize this, I was wondering if any
18 of my Co-Panelists have any final questions.

19 Judge Johnson?

20 JUDGE JOHNSON: Yes. Thank you.

21 Going back to the hypothetical of had Mr. Farah
22 properly disclosed that interest that he had at the time
23 of time divorce, and had that been included, perhaps 50
24 percent could have allocated to Ms. Farah. Let's say she
25 did have 50 percent interest in the outcome -- or of the

1 community property portion of that outcome, and then the
2 payments came in 2013 and she got her payments directly
3 out of the action, what would be her tax obligations for
4 that payment at that time in 2013?

5 MR. TAYLOR: If the -- I -- I guess I'd need a
6 little more facts. Okay. In other words, if it was -- if
7 it was a division of the chosen action, if you will,
8 before any money was paid, and then in a later year she
9 was paid the money, I think you're in a -- in a -- in a
10 division of the chosen action, it's actually divided.
11 Okay. Then -- and she gets the money, then in a later
12 year it may be -- I have to think about this. It may be
13 that she has to report it as income, perhaps.

14 I need more facts, right. But certainly there's
15 a possibility. Okay. And I alluded to that possibility
16 before when I said the FTB could have gone back. I mean,
17 it doesn't -- the Poe line of cases doesn't depend on
18 whether she got the property that's community income.
19 Very clear on that. It's just like a partnership where
20 the partnership flows through income to the partners.

21 The money may be off in Timbuktu with no
22 distributions to the partners. They're still liable for
23 the tax. So what matters is, was it community income.
24 Okay. If it's community income in 2013, it has to be
25 split. That's the rule. So disclose or not, I don't know

1 that that changes.

2 JUDGE JOHNSON: And based on the Family Court's
3 determination, the portion that ultimately went to
4 Ms. Farah did come from community property interest they
5 decided, right?

6 MR. TAYLOR: When he say did come, he -- well, he
7 paid her money. Okay. I don't know where he got the
8 money. Money is fungible. Okay. He could have spent it
9 all and earned -- earned a bunch of money after that.
10 So --

11 JUDGE JOHNSON: Right.

12 MR. TAYLOR: -- the Court -- the Court ordered
13 that she get her community property share.

14 JUDGE JOHNSON: Right. And the calculation was
15 based on what it determined was community property --

16 MR. TAYLOR: Absolutely.

17 JUDGE JOHNSON: Okay. No questions. Thank you.

18 JUDGE RIDENOUR: Thank you very much.

19 Judge Wong?

20 JUDGE WONG: No other questions. Thank you.

21 JUDGE RIDENOUR: I have just one question,
22 Mr. Taylor, to go along with your 2013 through 2015.
23 Hypothetically, let's say someone works in December but
24 isn't paid until January. Can you give your position as
25 to how that -- and they're both cash. Your client and

1 this hypothetical person are both cash-method taxpayers.
2 Usually, the payment in January, the check, would be
3 included in that taxpayer's 2013 -- I mean, 2015 tax year,
4 even though they may have worked December 2014. Can you
5 provide your position as to how that scenario differs with
6 this scenario of community property?

7 MR. TAYLOR: Well, again, both Mr. Farah and my
8 client were cash basis taxpayers in 2013. So -- and the
9 proceeds were received from Wedbush in 2013. So -- and
10 they were received by one half of the community who was
11 not cooperating with the other half, okay, who treated it
12 as his own. But, ultimately, it was deemed to be
13 community property. So if it was taxable, it was taxable
14 in 2013, the year it was received.

15 If you get paid -- you know if -- I've had cases,
16 for example, where community property sits out there
17 'cause it's not divided for, like, 10 years after they get
18 divorced. Okay. And the community property is generating
19 income. That still gets split 50/50 in the year the
20 income is received. So the principles are you get cash,
21 or the community gets cash. Okay. Cash is taxable in the
22 year it is received. In this year -- in this case, it was
23 received in 2013.

24 JUDGE RIDENOUR: Thank you very much.

25 I want to thank everyone for participating in

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today's hearing. If there is nothing further, I'm now concluding the hearing.

The record is now closed. The judges will issue a written opinion of our decision within 100 days of today.

Today's hearing in the Appeal of Sally Farah is now adjourned.

(Proceedings adjourned at 10:51 a.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 by me and later transcribed by computer-aided 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 3rd day of October, 2024.

ERNALYN M. ALONZO
HEARING REPORTER