

19045, appellants appeal FTB's action, for the 2013 tax year, affirming its proposed \$37,100 reduction to the amount of appellants' passive activity loss carryovers.²

Office of Tax Appeals (OTA) Administrative Law Judges Greg Turner, Huy "Mike" Le, and Hearing Officer Erica Parker held a virtual hearing for this matter on March 19, 2025, at 9:30 a.m. At the conclusion of the virtual hearing, the record was left open for the panel members to deliberate on the need for any additional information. By order dated April 10, 2025, the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether FTB's proposed assessments for the 2004, 2005, 2007, or 2008 tax years are time-barred by the statute of limitations.
2. Whether the transactions at issue lacked economic substance and a business purpose.

FACTUAL FINDINGS

Introduction

1. Appellant-husband owned interests in four real estate properties or groups of properties: the Higgins Building; the 548 Building; the Sixth & Spring Property; and the Oklahoma Properties. According to appellants' documentation, appellant-husband transferred interests in the properties to A. Meieran Family Trust (AMFT) prior to the sales of interests in the properties to third parties. FTB determined that appellant-husband's transfer of interests in the properties to AMFT did not have economic substance or a business purpose and that AMFT was a sham. As a result, FTB proposed assessments reflecting its determination that appellants, rather than AMFT, realized gain on the sales of interests in the properties.

Individuals and Entities

2. Appellant-husband held real property interests through various entities. One of these entities was Albion Pacific Property Resources, LLC (APPR), in which appellant-husband owned a 99.95 percent interest.

² The resolution of the statute of limitations and economic substance issues regarding the other tax years at issue will resolve the passive activity loss carryover issue for the 2013 tax year.

3. Appellant-husband and APPR each held a 50 percent interest in Albion Oklahoma, LLC (Oklahoma LLC).³ Oklahoma LLC held apartments located in Tulsa, Oklahoma (Woodlake Apartments), a rental property in Temple Hill, Los Angeles (Temple Hill Property), and a property on Market Street in San Francisco (Market Street Property).
4. Appellant-husband conducted business with another individual, “BS.” BS controlled Manhattan Loft, LLC, Labar, LLC, and LA ABC, LLC.
5. According to appellants’ documentation, the Higgins Building was owned by LADT, LLC, which was owned 50 percent by APPR and 50 percent by BS.
6. According to appellants’ documentation, the Sixth & Spring Property was owned by Sixth and Spring, LLC, of which appellant-husband owned an 85 percent interest.
7. According to appellants’ documentation, the 548 Building was owned by 6th Street Loft, LLC, which was owned 50 percent by APPR and 50 percent by BS.
8. AMFT is an irrevocable trust created by appellants.⁴ Appellants selected an individual (AG) to serve as the trustee of the trust.
9. Greenberg Traurig, LLP (GT) and its attorney (CP) provided legal services to appellants, BS, and various related entities.
10. An individual (MA) was the general manager of APPR. MA worked with appellant-husband and notarized many documents relevant to the transactions at issue.

Engagement of Legal Counsel

11. According to an engagement letter dated June 20, 2003, appellants engaged GT to represent and advise them in preparing estate planning documents and providing “other legal services if and when requested by [appellants] and agreed to by GT.” Appellant-husband’s declaration, which is signed under penalty of perjury and dated September 1, 2022, indicates that the death of friends and associates, and his serving as an executor for one of them, caused him to believe he needed estate planning.

³ FTB refers to two properties, Market Street Property and the Woodlake Apartments, as the “Oklahoma Buildings,” as distinguished from the “Oklahoma Properties,” which also include the Temple Hill Property in Los Angeles. Unless otherwise stated, references to interests in the properties include both direct and indirect interests, such as through LLCs.

⁴ Because appellant-husband was identified by some of the documents as the settlor and the beneficiary of AMFT, the certainty of AMFT’s designation as “irrevocable” is somewhat uncertain. However, for purposes of our decision, we assume AMFT was structured as an irrevocable trust.

AMFT

12. Appellant-husband's declaration states that CP recommended he form the irrevocable trust for the benefit of their as yet unborn children. The declaration further states that, when he formed AMFT (which appellants' documentation indicates occurred on December 19, 2003), he intended that AMFT "would hold the properties [he] sold to it long-term so it could benefit from the anticipated appreciation of the property."⁵ Similarly, AG's declaration, which is signed under penalty of perjury and dated August 29, 2020, states: "My understanding was that [appellant-husband] intended for [his interests in the properties] to be held for the long-term and that [AMFT] would benefit from the anticipated appreciation in value of the properties while [appellants] would receive annual cash flow in the form of annuity payments."
13. The record includes documents executed on December 19, 2003, including: (1) a Purchase and Private Annuity Agreement, by which AG, as trustee of AMFT, and appellant-husband, on behalf of APPR, agree that APPR will transfer a 27.3973 percent interest in LADT, LLC to AMFT, in return for an annuity obligation and an exhibit which states that the fair market value of the interest is \$10 million; and (2) an Annuity Acknowledgment, signed by appellant-husband, on behalf of APPR, and by AG, on behalf of AMFT.⁶
14. The Trust Agreement states that AMFT is an irrevocable trust created to "hold, invest, reinvest and otherwise deal with" property contributed to it.
15. The Trust Agreement states that the trustee shall have no power to deal with trust principal or income for less than adequate and full consideration, that neither the trustee nor appellants can borrow from the trust without adequate interest or security, and that any loan to either appellant will be made by a trustee who is not "related or subordinate" to either appellant as such term is defined in Internal Revenue Code (IRC) section 672(c).
16. A schedule to the Trust Agreement indicates that appellants transferred \$10 to AMFT.

⁵ According to the Notary's certification, appellants executed AMFT on December 19, 2003, while the trustee (AG) did not execute the trust agreement until December 22, 2003.

⁶ These documents are not notarized.

AG

17. As noted above, appellants selected AG to be the trustee of AMFT. According to a declaration provided by appellant-husband, AG served as a project manager for a building owned in part by appellant-husband, and read scripts for appellant-husband, who engaged in film projects. AG assisted appellant-husband in many renovation and restoration projects by assisting in the transition of ownership, hiring contractors, and managing projects.

The Higgins Building

18. The Higgins Building was owned by LADT, LLC. APPR owned 50 percent of LADT, LLC. BS owned the remaining 50 percent interest.
19. Appellant-husband's declaration states that appellant-husband became concerned about BS as a business partner and decided to sell the property in the Spring of 2004. Appellant-husband's declaration similarly states that "[i]t was only following the establishment of AMFT" that he began to have serious concerns regarding BS which caused AG and him to discuss selling AMFT's interest in the properties.
20. On December 5, 2003, appellant-husband's controlled entity, APPR, and BS's controlled entity, Labar, LLC, signed an engagement letter with GT to represent and advise them on a deferred payment sale of the Higgins Building and the 548 Building.
21. According to appellants' documentation, effective as of December 19, 2003, and February 27, 2004, APPR transferred a 50 percent interest in LADT, LLC, to AMFT, through assignment agreements in which AMFT agreed to pay appellants an annual annuity payment. Then, effective August 20, 2004, AMFT sold its 50 percent interest in LADT, LLC, to LA ABC, LLC, an entity owned by BS. The assignment agreements and related transfer documents are not notarized.
22. The record in regard to these transfers from APPR to AMFT, and subsequently from AMFT to LA ABC, LLC, is not at all clear. Several of the documents provided by appellants are dated "effective as of" instead of having been executed on the date specified, others are not notarized, and appellants' counsel's billing records suggest meaningful parts of the work necessary to effectuate these transfers occurred long after their stated completion. It is clear from the record that certain transfers were made

inconsistent with appellants' representations that were subsequently reversed. The purchase agreement supplied by appellants purporting to transfer AMFT's interest in LADT, LLC to LA ABC, LLC was apparently not the first, but reflected a correction from a prior purchase agreement and recordation of deeds (supplied by appellant-husband's CPA to FTB) purporting to transfer the LADT, LLC interest *from APPR* to LA ABC, LLC. Appellant-husband explains by affidavit that these numerous discrepancies were related to errors made by GT, evidenced by two disputes initiated by appellant-husband and AMFT against GT.⁷

The 548 Building

23. As noted previously, the declarations of AG and appellant-husband indicate that appellant-husband planned to hold the 548 Building (and the Higgins Building) for the long-term. However, they indicate that they became concerned about BS and decided to sell AMFT's interest in the 548 Building (and the Higgins Building) after the formation of AMFT.
24. On December 5, 2003, APPR and Labar, LLC, an entity controlled by BS, engaged CP and GT to assist in the sale of the 548 Building. The engagement letter is signed by appellant-husband and BS.
25. According to appellants' documentation, AMFT was formed on December 19, 2003.
26. According to appellants' documentation, the following transactions occurred, or became effective, during a seven-day period in July 2004.

⁷ First, appellant-husband and APPR settled a dispute with GT on June 23, 2006. The dispute concerned GT's services in connection with the 548 Building, the Sixth & Spring Property, and the Higgins Building. As part of that settlement agreement, appellant-husband, APPR, and GT agreed that GT would advise appellant-husband in tax planning for the sale of the Oklahoma Properties at a reduced rate. Second, on October 23, 2008, AMFT filed a lawsuit against GT. The complaint alleges that GT and CP failed to prepare a Contingent Assignment related to the sale of the Higgins Building and further that they deliberately withheld this error from AMFT. Appellant-husband and AG, as trustee of AMFT, settled the lawsuit with GT on February 15, 2011. (See *Greenspan v. LADT, LLC* (2010) 185 Cal.App.4th 1413, 1423 (*LADT 1*); see also *Greenspan v. LADT, LLC* (2010) 191 Cal.App.4th 486, 497, 500 – 504, 515 (*LADT 2*) [stating that on August 20, 2004, AMFT sold its interest in LADT, LLC to LA ABC, LLC, and discussing the purchase agreement]; *Greenspan v. LADT LLC*, 2006 WL 6593733 [complaint listing agreement as exhibit 1]; *Greenspan v. LADT LLC et al.*, 2006 WL 6621925 [purchase agreement listed as exhibit 1].)

- a. According to a deed dated “effective” July 12, 2004, BS and APPR each contributed a 50 percent interest in the 548 Building to 6th St. Loft, LLC.⁸
 - b. On July 14, 2004, APPR assigned its 50 percent interest in 6th St. Loft, LLC to AMFT in exchange for an annuity.
 - c. On July 19, 2004, AMFT sold its 50 percent interest in 6th St. Loft, LLC to BS for \$3,860,000 in cash to be paid by wire transfer.⁹
27. In his declaration, appellant-husband states that the documents selling his interest in 6th St. Loft, LLC should have been executed in February 2004 but instead were “dated July 14, 2004.” He further states that he negotiated the sale of the 50 percent interest to BS on behalf of AMFT, that AG authorized the sale, and that “[o]n July 14, [2004],¹⁰ the sale documents were signed by [AG] as trustee of [AMFT].”
28. The timing of the transactions involving the 548 Building is not clear. Billing records from GT indicate that the transaction was still being revised and structured in 2005.¹¹

The Sixth & Spring Property

29. According to appellants’ documentation, appellant-husband owned 85 percent of Sixth and Spring LLC, which owned the Sixth & Spring Property. At some point, he or an entity controlled by him engaged GT for tax advice and to facilitate the sale of the Sixth & Spring Property.
30. In 2004, BS expressed an interest in buying the Sixth & Spring Property, according to an arbitrator’s decision.

⁸ MA’s notarization indicates that appellant-husband and BS appeared before her on July 12, 2004, to acknowledge their signatures on the document. It was recorded in 2005.

⁹ An assignment agreement states that the assignment of the interest from AMFT to BS was “made and entered [into] effective as of [July 19, 2004].” The record does not include a wire transfer confirmation or escrow statement showing the date when the funds were transferred.

¹⁰ In an apparent typographical error, the declaration states the year as 2014.

¹¹ A GT invoice to appellants indicates that, on March 25, 2005, it prepared an annuity agreement and other documents for the 548 Building. In an invoice to APPR, a billing entry on April 1, 2005, indicates that GT revised “the 548 Spring transaction to conform to 6th Street Loft transaction including new terms agreed to by the parties.” A billing entry dated April 4, 2005, indicates that a GT attorney conferred with BS “re: 548 St. Transaction and LLC he will be transferring the property” Another entry indicates that, on April 8, 2005, GT “[c]hange[d] structure of 548 Spring Street to avoid relief of indebtedness income and grantor trust status for deferred sales transaction.” (*Id.* at p. 13.) Another billing entry indicates that, as of September 21, 2005, GT was still trying to get the purchase agreement for the “6th Loft 7/19/05 transaction” signed.

31. It is not clear when the sale of the property occurred. A standard form purchase agreement, dated February 25, 2005, indicates that BS (or his assignee) agreed to purchase the Sixth & Spring Property from Sixth and Spring LLC for \$13 million. The agreement is signed by appellant-husband on behalf of Sixth and Spring LLC, and initialed by BS. While it is difficult to read, it appears to contemplate a closing on or about May 2005. It is not notarized.
32. Billing records from GT indicate that, as of April 28, 2005, GT was responding to a client inquiry regarding the property and “researching facts on the 215 transaction,” apparently referring to the sale of the Sixth & Spring Property. The records further indicate that, on April 29, 2005, GT was revising a purchase agreement for the sale of the Sixth & Spring Property.
33. Another standard form purchase agreement for the sale of the Sixth & Spring Property is dated May 10, 2005. It appears to contemplate a closing on June 7, 2005. Like the first purchase agreement, it lists a sale price of \$13 million. It lists the buyer as Manhattan Loft, LLC (or its assignee). BS controlled Manhattan Loft, LLC. Like the first agreement, it appears to be signed by appellant-husband. The signature line does not print the name of the seller or indicate if appellant-husband is signing on behalf of Sixth and Spring LLC or another entity. However, an attached addendum, dated July 5, 2005, indicates the seller as Sixth and Spring LLC and appellant-husband, with appellant-husband signing on behalf of Sixth and Spring, LLC and on his own behalf.
34. According to an Assignment Agreement and a Purchase and Private Annuity Agreement, appellant-husband owned 85 percent of Sixth and Spring, LLC, and he and AMFT agreed that AMFT would buy 65 percent of Sixth and Spring, LLC in return for an annuity. Each of these documents indicates on the first page that it was “made and entered [into] effective as of [June 1, 2005].”¹²
35. GT invoices indicate that, in December 2005, GT was revising documents regarding the Sixth and Spring transactions.

¹² The signature pages to the documents do not bear a signature date, but refer back to the date first written on the first page of the document, and are not notarized. The Purchase and Private Annuity Agreement is signed by appellant-husband and AG, on behalf of AMFT. The Assignment Agreement is also signed by appellant-husband and AG. It also contains two signatures, one by MA and another by an individual with the initials GW, that appear to be witnesses’ signatures.

36. AG's declaration indicates that he authorized appellant-husband, as agent for AMFT, to negotiate the sale. It further states that, on behalf of AMFT, he accepted an offer by Manhattan Loft, LLC, which was controlled by BS, to purchase the Sixth & Spring Property.¹³ Appellant-husband's declaration also states he negotiated the sale.
37. Appellant-husband's declaration states that his interest in the Sixth & Spring Property "should have been transferred to [AMFT] as part of [his] estate plan[.]" but GT failed to prepare documents to transfer "the property" to AMFT "until 2005" It further states that, around the time he determined BS was the best purchaser for the property, he "realized that [CP] and [GT] had failed to prepare the paperwork for the sale of [his] interest in the property to [AMFT]" According to the declaration, CP initially prepared documents to sell 65 percent of the Sixth & Spring Property to AMFT but, "immediately prior to the sale to [BS's] entity Manhattan Loft, LLC, [CP] . . . prepared paperwork by which we transferred our interests in the property to [AMFT] and [AMFT] sold the property to Manhattan loft."
38. A California court of appeal stated that escrow closed in July 2005 and that, while the seller was identified as [Sixth and Spring LLC], "concurrent sale documents demonstrate that, on the day escrow closed, Sixth and Spring [LLC] transferred the property to its three members, and they simultaneously transferred the property to [AMFT], which transferred the property to Manhattan Loft." (*Greenspan v. Manhattan Loft, LLC, et al.*, 2009 WL 3740703, at * 2-3 [unpublished] (*Manhattan Loft*).
39. Appellant-husband's declaration states that, due to CP's and GT's errors in the Higgins Building transaction and the Sixth & Spring Property transaction, he sued them for malpractice.

The Oklahoma Properties

40. On June 23, 2006, appellant-husband and APPR settled a dispute they had with GT. The settlement agreement states that appellant-husband "has now engaged [GT] to render tax advice and facilitate the sale of [the Oklahoma Properties,]" and provides that, as part of

¹³ At protest, appellants stated that appellant-husband sold a 65 percent interest in Sixth and Spring, LLC to AMFT, and the LLC distributed interests in the Sixth and Spring Property to its members, who then sold the property. According to the documentation provided by appellants, the property was owned by Sixth and Spring, LLC, not AMFT, and AMFT only acquired an interest in Sixth and Spring, LLC, rather than a direct interest in the property.

the settlement, GT would represent appellant-husband “in the tax planning and sale of [the Oklahoma Properties] for a reduced legal fee”

41. An engagement letter dated June 27, 2006, states that appellant-husband engaged GT to assist “with tax planning respect to the sale of [the Oklahoma Properties]”
42. In June 2006, APPR transferred the Market Street Building to Oklahoma LLC. The deed for the transfer is dated and notarized June 20, 2006, but was not recorded until August 2, 2006.
43. According to documentation provided by appellants, APPR sold two interests in Oklahoma LLC to AMFT “as of July 13, 2006.”
 - a. A Purchase and Private Annuity Agreement indicates that APPR sold a 28.235169 percent interest in Oklahoma LLC in return for an annual annuity.
 - b. A Purchase Agreement indicates that AMFT acquired a 71.714831 interest in Oklahoma LLC in return for a \$10 million promissory note. A promissory note, also dated July 13, 2006, indicates that AMFT promises to pay APPR \$10 million.
44. AG, on behalf of AMFT, signed a term sheet, dated August 7, 2006, for AMFT to sell one of the Oklahoma Properties, the Market Street Property, to a third party.
45. Appellants provide a grant deed dated December 20, 2006, indicating that Oklahoma LLC sold the Market Street Property.
46. On July 30, 2007, appellant-husband signed a purchase agreement on behalf of Oklahoma LLC for the sale of the Woodlake Apartments for \$16,800,000. On September 13, 2007, the sale of the Woodlake Apartments was completed.

Payments from AMFT

47. The annuity agreement dated December 19, 2003, which was in exchange for the transfer of appellant-husband’s 27.3973 percent interest in LADT, LLC (held by APPR) which owned the Higgins Building, called for an annual payment from AMFT to APPR of \$487,190, and that any annuity amount not paid by that date will accrue interest. According to appellants’ documentation, AMFT did not make a payment on this annuity until December 28, 2006, and that payment was for \$193,871, rather than \$487,190.
48. The annuity agreement dated February 27, 2004, which was in exchange for the transfer of appellant-husband’s remaining 20.5834 percent interest in LADT LLC (held by APPR) which owned the Higgins Building, called for an annual annuity payment of

- \$295,828 (rounded), with interest accruing on payments made thereafter. However, appellants' records do not show an annuity payment being made until April 21, 2006, and the amount paid was only \$145,654.
49. The annuity agreement dated July 14, 2004, which was in exchange for the transfer of appellant-husband's 50 percent interest in 6th St Loft LLC (held by APPR) which owned the 548 Building, called for a first payment by July 14, 2005, or by no later than April 15, 2006, with interest added for the late payment. However, AMFT did not make the first payment until July 6, 2006, which was beyond the outer deadline for payment, and that payment did not include interest. AMFT's payments from 2007 to 2009 were also late and did not include interest. Its payment for 2010 failed to include interest, and its payments for 2011 and 2012 were each \$77,512 less than the amount owed.
50. The annuity agreement dated June 1, 2005, which was in exchange for the transfer of appellant-husband's 65 percent interest in Sixth & Spring, LLC which owned the Sixth and Spring Property, called for a first payment by June 1, 2006, or by no later than April 15, 2007, with interest added for the late payment. Applying the annuity rate of 5.4132 percent to the value assigned to the interest would result in annual payments of \$457,415.40. However, AMFT only paid \$269,834 as its first annuity payment, which was paid in May 2006. It paid this same amount in its next two annual payments.
51. The annuity agreement dated July 13, 2006, which was in exchange for the transfer of appellant-husband's 28.2351694 percent interest in Oklahoma LLC (which owned various properties), required annual payments of \$255,463 on July 13, or by no later than April 15 of the following tax year. The first annuity payment was due on July 13, 2007 (or by no later than April 15, 2008, with accrued interest paid). The note is dated July 13, 2006, and provides for payment of interest on the anniversary date of the note and allows prepayments. According to appellants' documentation, AMFT did not make its first payment until October 2007, and it did not include accrued interest. In 2008 and 2009, AMFT made one or more payments totaling \$255,463, without accrued interest, after the applicable anniversary date.

Litigation Involving Manhattan Loft, LLC

52. On August 14, 2006, AMFT initiated arbitration proceedings against Manhattan Loft, LLC, and BS, alleging breaches of the purchase agreement dated May 10, 2005, and its addendum dated July 5, 2005. The arbitrator ruled in favor of AMFT, and against Manhattan Loft, LLC and BS, in the contractual dispute, and a California superior court affirmed the award with modifications.
53. On November 10, 2009, a California Court of Appeal issued an unpublished decision in the dispute. (*Manhattan Loft, supra.*) The decision states that appellant-husband, “or an entity he controlled,” sold the Sixth & Spring Street Property to Manhattan Loft, LLC. (*Id.* at p. *1.) It explains that: “In broad terms, [appellant-husband] sold [the Sixth & Spring Street Property], but retained the right to build a bar in the basement.” (*Ibid.*) It indicates that, shortly after the July 2005 addendum, Sixth and Spring LLC sold the Sixth & Spring Property to Manhattan Loft, LLC. (*Id.* at p. *2.) “However,” it states, “concurrent sale documents demonstrate that, on the day escrow closed, Sixth and Spring transferred the property to its three members, and they simultaneously transferred the property to the Trust, which transferred the property to Manhattan Loft.” (*Ibid.*) It summarizes that, “while the purchase contract identified Sixth and Spring as the seller, Manhattan Loft’s immediate transferor was [AMFT].” (*Ibid.*) It indicates that AMFT only possessed fee title to the property for a “brief moment” before transferring it to Manhattan Loft, LLC. (*Id.* at p. *3, fn. 5.) The court concluded that the original arbitration award in favor of AMFT should be confirmed. (*Id.* at p. * 8.)

Management of AMFT

54. AG signed documents on behalf of AMFT.
55. AMFT made 33 transfers of cash, totaling \$7,685,000, to appellant-husband or entities controlled by him, and described the transfers as loans or investments. None of the loans were secured by real property, and some of the loans were not evidenced by a promissory note. During 2011, AMFT advanced appellant-husband \$1,500,000 with no corresponding promissory note or security, and, at the end of the year, treated these amounts as annuity payments.

56. Appellant-husband appeared on behalf of AMFT in litigation, mediation, and arbitration proceedings.
57. On November 5, 2007, an arbitrator issued a decision in litigation between AMFT and BS. The decision indicates that appellant-husband negotiated with BS regarding the sale of the Sixth & Spring Property and the Higgins Building, and that he and MA continued to negotiate with BS regarding the properties into 2006, which was after appellants transferred their interests in the properties to AMFT.¹⁴ The decision also indicates that appellant-husband and MA testified at the arbitration hearing, but AG did not testify.
58. On June 25, 2010, a California Court of Appeal issued a decision in litigation between AMFT and LADT, LLC, concerning the Higgins Building. (*Greenspan v. LADT, LLC* (2010) 185 Cal.App.4th 1413 (*LADT 1*)).) The opinion describes appellant-husband negotiating and participating in mediation with BS in 2005 and 2006, which was after the August 20, 2004 date on which, according to appellants' documentation and the Court of Appeals' opinion, AMFT acquired its interest in the Higgins Building. (*Id.* at p. 1424.) The opinion indicates that appellant-husband signed a handwritten document reflecting agreements between AMFT and an entity controlled by BS. (*Ibid.*)
59. On December 30, 2010, the court issued a second opinion. (*Greenspan v. LADT, LLC* (2010) 191 Cal.App.4th 486 (*LADT 2*)).) This opinion also describes appellant-husband negotiating with BS concerning disputes with AMFT during 2005. (*Id.* at pp. 497-498.) It indicates that appellant-husband and BS signed an agreement to resolve the disputes. (*Ibid.*)
60. In *LADT 2*, AMFT argued that it was not bound by the arbitration agreement because it did not sign it. (*LADT 2, supra*, at p. 498.) However, the court noted that the trial court found that AMFT was bound by the agreement. (*Ibid.*)
61. The settlement agreement in respect to the suit filed by AMFT against GT on February 15, 2011, states that "Meieran caused Plaintiff [AMFT] to sue GT"¹⁵

¹⁴ Appellants' documentation indicates that appellants had transferred all their indirect interests in the Higgins Building to AMFT by February 2004, and that they transferred a 65 percent indirect interest in the Sixth and Spring Property in mid-2005.

¹⁵ Appellants point out that the agreement defines "Meieran" as including appellant-husband and AMFT. However, in the above clause, the agreement appears to refer to appellant-husband individually, as it would be nonsensical to refer to appellant-husband and AMFT causing AMFT to sue GT.

62. Appellant-husband's declaration states that AG "acted independently and made all decisions concerning [AMFT] and its operation." In support, the declaration provides email documentation, some of which are described below.
- a. In emails exchanged November 11-14, 2011, AG, in his capacity as trustee of AMFT, emailed appellant-husband to explain that he would like to have AMFT loan funds to a friend of AG "if you're okay with the deal." Appellant-husband raised concerns, requested information, and suggested they discuss the transaction. AG stated that "I need to let them know today. So let me know if you think it's a deal with [sic] should do or not." Appellant-husband stated that "of course you [AG] have the final say" and that he will look at the information as soon as he gets it. AG assured appellant-husband that "I would never do a deal that involves trust money without your agreement. But, you already knew that." Appellant-husband responded that "[w]ell, you're completely within your rights to do so, but I know you trust and value my judgement and input!"
 - b. In emails on October 6, 2010, MA and appellant-husband discuss asking AG if he will allow AMFT to loan appellant-husband additional funds. She estimated he needs \$90,000. Appellant-husband suggested she ask for \$250,000. MA then asked AG to advise "today" if AMFT will loan appellant-husband \$250,000. She stated: "It is my understanding that the annuity payments have been calculated incorrectly so [AMFT] owes [appellant-husband] a great deal of money. We are having this corrected and will adjust as necessary upon receipt of corrected documents." Within an hour of her email, AG responded: "Yes. Loan [appellant-husband] the money he's requested."
 - c. In emails sent May 16-17, 2013, an individual emailed AG asking him to review and sign documents, copying appellant-husband. AG raised several concerns regarding the documents and asked whether the company is an accounting company. Appellant-husband responded that he trusts the provider and suggests that he and AG speak. Then AG responded "[n]o problem, but they need to make certain changes." He then stated that the "bigger problem" for him "was a company and person sending me a contract, referring to it as something I requested, and I've never heard of the individual or the company." He outlined

several concerns, including concerns about the company being given check-writing authority, stating that one of the ways he keeps track of AMFT's activities is to understand the checks going out. AG asked appellant-husband whether he wants AG to handle the matter, stating that it "will be handled properly and never reflect negatively on [appellant-husband]."

63. AG's declaration similarly asserts that he exercised "independent judgment" in approving transactions on behalf of AMFT.
- a. AG provides an email, dated December 11, 2006, and states that the email shows he advised a third party that appellant-husband was not authorized to approve contract changes. The signature line of the email indicates he sent it; however, the email address in the "from" line of the email indicates that it was sent by someone else, and lists the same email domain (bmpla.com) from which appellant-husband sends his email. The email discusses the sale of the Market Street Property, which is one of the Oklahoma Properties, and states that AMFT is selling the property, that appellant-husband is not the seller or an agent of seller, and that any potential changes to the contract are solely AG's responsibility, as trustee.
 - b. In emails dated October 25, 2006, AG and appellant-husband discuss the selection of an arbitrator in the dispute with BS involving the Sixth & Spring Property.
 - c. In emails dated September 17-19, 2008, appellant-husband asked AG to contact MA to arrange a meeting "ASAP" to discuss AMFT's position in light of "the current economic crisis." AG then asked MA to schedule the meeting at a time that is convenient for appellant-husband, stating that AG will fit it into his schedule, and he requested a copy of relevant documents. He also asked MA to contact an attorney about the sale of an Alabama property to AMFT and indicated he would like to add this to the discussion. MA then replied to appellant-husband, but not AG, and asked if he wanted to join the call, and appellant-husband responded that he should be on the call with the attorney. AG's declaration offers this email as evidence that he required he "be fully informed of any project that was a potential investment for [AMFT]."

- d. As support for the statement that AG only authorized reasonable loans to appellant-husband's entities, the declaration points to the previously noted emails from October 2010, in which he approved appellant-husband's request for a \$250,000 loan.
- e. AG's declaration states that he "exercised control and oversight over all litigation [AMFT] was involved in" As support, and to corroborate the statement that appellant-husband "relied on [his] advice and authorization" regarding negotiations with BS, the declaration attaches an email from appellant-husband to AG in which appellant-husband says he is working on a settlement and will call to discuss terms and "what you think should happen."
- f. AG's declaration states that he would reject lending opportunities if they did not meet his criteria for AMFT and that appellant-husband accepted his decision. In support, the declaration points to his approval of a \$250,000 loan to appellant-husband. The declaration also points to an email chain dated March 19, 2012, in which appellant-husband argues for a loan to a borrower earning \$2 million a year who wants the money to buy a house. AG objects that the loan is not collateralized and does not make sense. Appellant-husband responds that he thinks it is safe but he will have MA "correct the paperwork and . . . get the funds back to [AMFT] so there are no issues."

Procedural History

64. FTB began its examination on July 17, 2009.
65. FTB issued a Preliminary Determination Letter explaining its findings. FTB's primary position was that the transactions were shams coordinated by appellant-husband with the help of CP of GT. FTB stated that gains from the transactions would be recognized by the original owner of each of the properties, with a deduction for private annuity income or installment income reported by appellant-husband and his affiliated entities in the year of each adjustment. FTB stated that its alternative position was that AMFT was a sham trust and that this position results in the same adjustments to income.
66. On February 24, 2016, FTB issued Notices of Proposed Assessment (NPAs) reflecting its determinations for the 2004, 2005, 2007, 2008, and 2011 tax years.

67. On February 26, 2016, FTB also issued a Notice of Proposed Adjusted Carryover Amount (NPACA) for the 2013 tax year to appellants.
68. Subsequently, appellants filed a timely protest.
69. Then, FTB issued a Final Determination Letter affirming its prior determinations.
70. On November 12, 2020, FTB issued Notices of Action affirming its NPAs. On this same date, FTB also issued a Notice of Action – Affirmation affirming its NPACA for the 2013 tax year.
71. Appellants then filed this timely appeal.

DISCUSSION

Issue 1: Whether FTB’s proposed assessments for the 2004, 2005, 2007, or 2008 tax years are time-barred by the statute of limitations.

I. The General Statute of Limitations (R&TC, § 19057)

R&TC section 19057(a) requires FTB to mail an NPA within four years of the date the tax return was filed. FTB issued its NPAs on February 24, 2016. Because FTB’s NPAs for the 2004, 2005, 2007, and 2008¹⁶ tax years were not issued within four years of the date appellants filed their returns, those NPAs are not timely under the general four-year statute of limitations provided by R&TC section 19057(a). None of this is in dispute.

II. Background on the Statutory Framework of Abusive Tax Avoidance Transactions (ATATs)

In 2003, California enacted a voluntary compliance initiative (VCI-1)¹⁷ focused on tax avoidance and abusive tax shelters. (Assem. Bill No. 1601 (2003-2004 Reg. Sess.) and Sen. Bill No. 614 (2003-2004 Reg. Sess.) (double-jointed bills comprising virtually identical provisions).) In 2011, California enacted another voluntary compliance initiative (VCI-2) amending some terms associated with VCI-1 and enacted a uniform definition of “abusive tax avoidance transactions.” (Sen. Bill No. 86 (2011-2012 Reg. Sess.).) California’s evolving statutory

¹⁶ The timely issuance of FTB’s NPAs for the 2011 and 2013 tax years are not in dispute.

¹⁷ A “voluntary compliance initiative” is a program, here administered by FTB, designed to encourage taxpayers to willingly report underpayments of tax or other forms of tax compliance irregularities in exchange for lower penalties or in the face of specific penalty enhancements or both. Voluntary compliance is a major provision of the bills, and thus, for simplicity, we refer to the bills as VCI-1.

structure becomes relevant in the matter here which encompasses tax years beginning in 2004 and NPAs not issued until February 2016.

III. Eight-Year and 12-Year Statute of Limitations for ATATs (R&TC, § 19755)

As implemented by VCI-1, R&TC section 19755 extends the statute of limitations to eight years after the return was filed for proposed assessments related to ATATs. For notices related to ATATs mailed on or after August 1, 2011, VCI-2 extends the statute of limitations to 12-years. The 12-year limitation, however, only applies to “taxable years that have not been closed by a statute of limitations, *res judicata*, or otherwise, as of August 1, 2011.” (R&TC, § 19755(b).) To apply the 12-year statute of limitations, we must determine for each of the years at issue, whether each was closed by a statute of limitations or otherwise as of August 1, 2011.¹⁸ For tax years 2007 (filed on or about October 15, 2008) and 2008 (filed on or about October 15, 2009), the regular four-year statute of limitations would have ensured those years remained open as of August 1, 2011. Consequently, our only remaining issue for the 2007 and 2008 tax years is whether the NPAs were related to an ATAT as that term is used in R&TC section 19755, as amended by VCI-2.¹⁹

Under VCI-2, an ATAT is defined in R&TC section 19777 to mean any of the following:

- 1) a tax shelter in reference to IRC section 6662(d)(2)(C).
- 2) a reportable transaction defined in IRC section 6707A(c)(1).
- 3) a listed transaction defined in IRC section 6707A(c)(2).
- 4) a gross misstatement within the meaning of IRC section 6404(g)(2)(D).
- 5) any transaction to which R&TC section 19774 applies (the “noneconomic substance transaction understatement” penalty).

¹⁸ Appellants present no arguments that “*res judicata*” or any other basis serves to close any of the years at issue to R&TC section 19755’s extension.

¹⁹ OTA finds that the definition of ATATs in R&TC section 19777(b) applies to notices mailed on or after August 1, 2011, for taxable years that have not been closed by a statute of limitations, *res judicata* or otherwise, as of August 1, 2011. The Senate Budget and Fiscal Review Committee Analysis for SB 86 (VCI-2), dated March 17, 2011, states that the extended 12-year statute of limitations was intended for “abusive tax avoidance transaction activity” and “[e]nacts a *uniform definition* of an abusive tax shelter to simplify administration and avoid confusion.” (Italics added.) Additionally, VCI-2 amended R&TC sections 19116(d)(8) (accrual of interest) and 19504(c)(2) (subpoenas) to specifically reference the definition of ATATs as used in R&TC section 19777(b).

R&TC section 19774 applies to transactions that lack economic substance. As discussed under Issue 2, the transactions at issue in this appeal fail to meet the economic substance requirements, thereby qualifying as ATAT under VCI-2.

For the 2004 and 2005 tax years, OTA must determine whether the NPAs were related to ATAT as defined under VCI-1. The 2004 and 2005 tax returns were filed on or about the extended due date of October 15, 2005,²⁰ and October 15, 2006, respectively. Given these dates, the eight-year statute of limitations could ensure that those years remained open as of August 1, 2011, thereby allowing the extended 12-year statute of limitations to apply—validating FTB’s NPAs issued in 2016.

Under VCI-1, R&TC section 19755 extends the statute of limitations from four years to eight years for proposed deficiency assessments related to an “abusive tax avoidance transaction, as defined in subdivision (c) of Section 19753” R&TC section 19753(c) defines ATAT to mean “a plan or arrangement devised for the principal purpose of avoiding tax.” However, the specific words and phrases used in this definition—such as “plan or arrangement” and “devised for the principal purpose of avoiding tax”—have not been further defined within the statute.

In the absence of statutory definitions, words should be interpreted in their ordinary sense, relying on dictionary meanings where necessary. (*George v. Susanville Elementary School Dist.* (2024) 103 Cal.App.5th 349, 356.) Plan means “a method for achieving an end.” (“Plan,” *Merriam-Webster Online Dictionary*, as of June 5, 2025.) Arrange²¹ means “to make preparations for.” (“Arrange,” *Merriam-Webster Online Dictionary*, as of June 5, 2025.) The phrase “devised for the principal purpose of avoiding tax” is not defined under statute. However, as discussed further under Issue 2, because appellants engaged GT to form AMFT for the purpose of manufacturing installment sales in preparation for selling the properties to third parties, OTA finds that the definition of ATAT under VCI-1 is satisfied. Consequently, R&TC section 19755 extended the statute of limitations for appellants to eight years, keeping the 2004 and 2005 tax years open as of August 1, 2011, and allowing the extended 12-year statute of limitations under R&TC section 19755(a)(2) to apply—validating FTB’s NPAs issued in 2016.

²⁰ The record does not include appellants’ 2004 return. However, both parties agree that the 2004 return was not filed late. So, OTA presumes for this analysis that the 2004 return was filed on October 15, 2005.

²¹ Arrangement means “the state of being arranged.” (“Arrangement” *Merriam-Webster Online Dictionary*, as of June 5, 2025.)

Furthermore, R&TC section 19753(c) states that “[a]busive tax avoidance transactions include, but are not limited to, ‘listed transactions’ as described in subdivision (a) of Section 18407.” R&TC section 18407(a)(4) defines a “listed transaction” as “a transaction specifically identified” by the IRS or FTB as a tax avoidance transaction. The phrase “include, but are not limited to, ‘listed transactions,’” confirms that listed transactions are not the only abusive tax avoidance transactions—other abusive tax avoidance transactions not specifically identified by the IRS or FTB may also qualify.

Despite this statutory language, the partial dissenting Opinion attempts to narrow the definition of ATAT to “plans or arrangements *identified* by the IRS or the FTB as ‘potentially abusive tax shelters’ or ‘as having a potential for tax avoidance or evasion.’” (Italics added.) To support this argument, the partial dissenting Opinion references the 100 percent interest penalty provision in R&TC section 19777. However, R&TC section 19753, which defines ATAT under VCI-1, makes no reference to the 100 percent interest penalty provision in R&TC section 19777, undermining the dissent’s position. Furthermore, under VCI-1, R&TC section 19777(b) defines the term “potentially abusive tax shelter,” not ATAT.

In summary, the extended 12-year statute of limitations under R&TC section 19755(a)(2) applies to the 2004, 2005, 2007, and 2008 tax years, ensuring that these years are not time-barred.

Issue 2: Whether the transactions at issue lacked economic substance and a business purpose.

I. Legal Framework²²

“To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.” (*Commissioner v. Court Holding Co.* (1945) 324 U.S. 331, 334.) It is well established that “the simple expedient of drawing up papers . . . [is not] controlling for tax purposes when the objective economic realities are to the contrary.” (*Frank Lyon Co. v. U.S.* (1978) 435 U.S. 561, 573 (*Frank Lyon Co.*), internal citation omitted.) Intercompany

²² Appellants argue that FTB bears the burden of proving that the transactions in question lacked economic substance and a business purpose. Consequently, they contend that the extended 12-year statute of limitations cannot be applied. However, as detailed further below, OTA finds that the preponderance of the evidence sufficiently supports the conclusion that the transactions lacked both economic substance and a business purpose. Therefore, OTA need not determine which party bears the burden of proof. (*Blodgett v. Commissioner* (8th Cir. 2005) 394 F.3d 1030, 1039.)

arrangements that do not affect third parties are subject to “particularly close scrutiny.” (*Coltec Industries, Inc. v. Commissioner* (Fed. Cir. 2006) 454 F.3d 1340, 1357 (*Coltec*)). However, where “there is a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached, the Government should honor the allocation of rights and duties effectuated by the parties.” (*Frank Lyon Co., supra*, at pp. 583-584.)

In determining whether a transaction has economic substance, OTA considers: (1) whether the taxpayer has demonstrated a business purpose for engaging in the transaction other than tax avoidance; and (2) whether the taxpayer has shown that the transaction had economic substance beyond the creation of tax benefits. (*Appeal of La Rosa Capital Resource, Inc.*, 2020-OTA-220P (*La Rosa*), citing *Casebeer v. Commissioner* (9th Cir. 1990) 909 F.2d 1360, 1363 (*Casebeer*)).

II. The Transaction That Created the Tax Benefit

Generally, in the economic substance analysis, the transaction to be considered is the one that gave rise to the alleged tax benefit. (See, e.g., *La Rosa, supra*, citing *Coltec, supra*, at p. 1356.) This transaction is not necessarily the ultimate transaction that took advantage of the tax benefit. (See *Coltec, supra*, at pp. 1356-1357.)

In the transactions at issue here, the claimed tax benefits arose from appellants’ transfer of interests in properties to AMFT, in return for AMFT’s obligation to make annuity payments. Rather than directly selling their interests in the properties to a third party, appellants claim to have first transferred their interests to AMFT, so that subsequent sales of the properties (or interests in them) were attributable to AMFT, rather than appellants.

III. Business Purpose

The business purpose factor requires an examination of the subjective factors that motivated the taxpayer to engage in the transaction at issue. (*La Rosa, supra*.)

Appellant-husband states that the deaths of three close friends, one of whom named him executor of their poorly planned estate, led him to recognize the need for his own estate planning. Additionally, appellant-husband asserts that he created AMFT to hold properties long-term and benefit from their appreciation.

If OTA accepts appellants' argument that AMFT and the property transfers in exchange for private annuity contracts were intended to provide assets for their future children and secure long-term income, OTA would expect those assets to be retained and managed through the trust over time. Similarly, the annuity contracts should have been fulfilled, at least substantially, according to their terms. However, the weight of the evidence does not support these expectations. Instead, the evidence indicates that appellants transferred, or purported to transfer, property interests at various times—often shortly before those same properties were sold to third parties. None of the properties at issue appear to have been placed in the trust for long-term management and growth on behalf of its beneficiaries. Rather, in each instance, AMFT acquired its interest only months, sometimes mere days, before the subsequent sale of the property to a third party. AMFT's role in these transactions, to the extent it played one at all, appears to be purely nominal, serving little substantive purpose. In at least one case, AMFT's involvement materialized only after the property had already been sold to a third party.

For the Higgins Building, appellants' documentation indicates that they transferred indirect interests in the property to AMFT in December 2003 and February 2004, and AMFT sold the interests in August 2004. For the 548 Building, appellants' documentation indicates that APPR assigned its indirect interest in the property *five days* prior to the subsequent sale of that property to BS in 2004. As to the Sixth & Spring Property, BS expressed interest in buying the property, and, by February 25, 2005, the sale price was agreed, and a purchase agreement was signed. However, appellants' documentation indicates that they assigned their interest in the property to AMFT "effective as of [June 1, 2005,]" and the property was sold to a third-party in June 2005. According to appellants' documentation, they transferred indirect interests in the Oklahoma Properties to AMFT on July 13, 2006. Less than a month later, AG signed a term sheet for the sale of one of the Oklahoma Properties, the Market Street Property, which sale closed in December 2006.²³ Appellant-husband signed a purchase agreement for the sale of the

²³ Appellant-husband's declaration states that, "[i]n the Fall of 2006, [AMFT] began negotiations for the sale" of the property, which was motivated by recent damage to the property from a windstorm and the need for AMFT to have sufficient funds to pursue litigation against BS. He states that he negotiated on behalf of AMFT, though the ultimate decision to sell was up to AG. However, AG's declaration states that, as indicated in the December 11, 2006 email he provides, appellant-husband was "not an agent of the seller." While appellant-husband's declaration states that negotiations began in the Fall of 2006, the record includes a term sheet for its sale dated July 13, 2006, and the June 23, 2006 settlement agreement with GT indicates that, at that time, appellant-husband already intended to sell the Market Street Property and the other Oklahoma Properties.

Woodlake Apartments, another one of the Oklahoma Properties, on July 30, 2007, and that transaction was completed on September 13, 2007.

Prior to the formation of AMFT, appellant-husband signed an engagement letter, dated December 5, 2003, engaging GT to advise appellant-husband's controlled entity, APPR, and BS's controlled entity Labar, LLC, regarding "a deferred payment sale" of the Higgins Building and the 548 Building.²⁴ This suggests that, contrary to the statements in appellant-husband's and AG's declarations, prior to the formation of AMFT, appellant-husband and his business partner, BS, already planned for these properties to be sold.

The appeal record contains no evidence that AMFT's assets were retained for the long-term benefit of the trust's beneficiaries. In fact, the trust's real property holdings appear to be, at best, temporary. While appellants have articulated a legitimate non-tax purpose—namely, estate planning—their actions do not align with that stated objective as a genuine motivating force. Instead, the evidence suggests that AMFT functioned as an artificial vehicle designed to fabricate installment sales, in anticipation of selling the properties to third parties. Accordingly, OTA concludes that there was no valid non-tax business purpose for engaging in these transactions.

IV. Economic Substance

"The economic substance factor involves a broader examination of whether the substance of a transaction reflects its form, and whether from an objective standpoint the transaction was likely to produce economic benefits aside from a tax deduction." (*Bail Bonds by Marvin Nelson, Inc. v. Commissioner* (9th Cir. 1987) 820 F.2d 1543, 1549.) In determining whether a transaction has objective economic substance, courts examine "whether the transaction has any practical economic effects" other than creating tax benefits. (*ACM Partnership v. Commissioner* (3d Cir. 1998) 157 F.3d 231, 248.)

A. The Properties

The trust's significant assets consisted of four properties or interests in entities holding real estate: the Higgins Building; the 548 Building; the Sixth & Spring Property; and the

²⁴ BS also signed the engagement letter, on behalf of his interests in the properties, which indicates that the sale contemplated by the engagement letter was a sale of both BS's interests and appellants' interests in the properties, rather than simply a sale of appellants' interests in the properties to AMFT.

Oklahoma Properties. The transfer of these properties by appellants to AMFT had no practical economic effects other than creating tax benefits.

1. Higgins Building

According to appellants, on December 19, 2003, and February 27, 2004, APPR transferred interests in LADT, LLC, to AMFT, through assignment agreements in which AMFT agreed to pay appellants an annual annuity payment. Then, effective August 20, 2004, AMFT sold its interest in LADT, LLC, to LA ABC, LLC, an entity owned by BS. In support, appellants provided assignment agreements and purchase agreements.

While the sale of LADT, LLC purportedly happened in August 2004, documents suggest that the assignment agreements were still being completed in December 2004, well after the sale.²⁵ Appellants provided two conflicting purchase agreements for the sale to LA ABC, LLC. One showed the sale *of the property* by APPR, signed by appellant-husband. Another showed the sale by AMFT of LADT, LLC (rather than the property), signed by AG, on behalf of AMFT. Neither appear to have been executed in August 2004.²⁶

What the totality of these errors illustrates is that the involvement of AMFT in the sale was artificial. The record does not establish that AG participated in the decision to sell the Higgins Building or negotiated the terms and conditions of the sale to BS or anyone else for the benefit of the trust and its beneficiaries.

The assignment agreements by which AMFT purportedly acquired interests in LADT, LLC require AMFT to make annual annuity payments to appellants. AMFT did not make annuity payments in accordance with the terms of the annuity agreements. For example, the first annuity agreement called for annual payments of \$487,190. However, AMFT did not make the first payment until December 28, 2006, and it only paid \$193,871.

Transferring real property to AMFT only to have the property sold within months serves no economic benefit. The only reason to effectuate the transfer of property to AMFT, with an eye on its subsequent sale, was the tax benefit of deferral on the capital gains. Consequently, the transaction lacked economic substance.

²⁵ Billing records from GT indicate that documents were still being drafted as of October and November 2004, and that documents and payment schedules were still being revised as of December 23, 2004.

²⁶ Billing records from GT show that its attorneys were still preparing a purchase agreement for the transaction during November 2004, and it was not signed until December 2, 2004.

2. The 548 Building

AMFT only held an indirect interest in the 548 Building for *five days*, between July 14, 2004, and July 19, 2004. Appellant-husband already intended to sell the property when, according to appellants' documentation, he transferred an indirect interest in the property, in the form of an interest in 6th Street Loft, LLC, to AMFT.

A grant deed dated "effective" July 12, 2004, indicates that APPR and BS contributed their interests in the property to 6th Street Loft, LLC. A notary acknowledgment by MA indicates that, on July 12, 2004, appellant-husband and BS appeared before her to acknowledge their signatures on the deed on July 12, 2004. However, GT's billing records indicate that GT was still preparing sales documentation for the transaction on April 13, 2005, and the deed was not recorded until April 18, 2005.

The assignment agreement by which AMFT purportedly obtained an indirect interest in the property indicates that it was "made and entered [into] effective as of [July 14, 2004]." However, it is not notarized and because it was not made in exchange for cash, there is no wire transfer or similar documentation to show that it occurred on July 14, 2004.

The record includes a July 19, 2004 purchase agreement whereby BS purchased AMFT's indirect interest in the property for cash and the assumption of debt. It states it was "entered into effective as of July 19, 2004." However, like the assignment agreement, it is not notarized, so it is not clear when it was executed. While the purchase agreement calls for a wire transfer of cash consideration, the record does not include wire transfer records or an escrow statement showing the transfer of funds.

None of the documentary evidence establishes the role of AMFT in the decision to sell the property or participating in establishing the terms and conditions of that sale. Appellant-husband acknowledges that he negotiated the sale of the indirect interest in the property to BS. He asserts that he did so on behalf of AMFT, but there is no contemporaneous documentation of him reporting back to AMFT with respect to sale negotiations or of AMFT directing appellant-husband's negotiations on its behalf.

The assignment agreement by which AMFT purportedly acquired an indirect interest in the property requires AMFT to make annual annuity payments to appellants. AMFT did not make annuity payments in accordance with the terms of the annuity agreement. For example, the terms of the annuity agreement called for a first payment by July 14, 2005, or by no later than

April 15, 2006, with interest added for the late payment. However, AMFT did not make the first payment until July 6, 2006, which was beyond the outer deadline for payment, and that payment did not include interest. AMFT's payments from 2007 to 2009 were also late and did not include interest. Its payment for 2010 failed to include interest, and its payments for 2011 and 2012 were each \$77,512 less than the amount owed.

In sum, there was no economic benefit to the transaction, and it therefore fails on economic substance grounds.

3. The Sixth & Spring Property

Appellants' documentation indicates that they assigned their indirect interest in the property to AMFT "effective as of [June 1, 2005,]" and the property was sold in June 2005. However, GT's billing records indicate that, in late December 2005, it was still revising documents for the sale.

The appeal record includes two purchase agreements for the sale of the Sixth & Spring Property. The first agreement is dated February 25, 2005, signed by appellant-husband on behalf of Sixth and Spring LLC, and initialed by BS. It lists a sales price of \$13 million.²⁷

The second purchase agreement is dated May 10, 2005. It appears to contemplate a closing on June 7, 2005. Like the first purchase agreement, it lists a sale price of \$13 million, and appears to be signed by appellant-husband. The signature line does not print the name of the seller or indicate if appellant-husband is signing on behalf of Sixth and Spring LLC or another entity. However, an attached addendum, dated July 5, 2005, indicates the seller as Sixth and Spring LLC and appellant-husband, with appellant-husband signing on behalf of Sixth and Spring, LLC and on his own behalf.

Thus, if the effective dates shown on appellants' assignment agreements are correct, and the property was sold pursuant to the second purchase agreement, AMFT obtained an interest in Sixth and Spring, LLC *after* the sale price had been determined and less than a month prior to the closing of the sale.

AG's declaration indicates that, on behalf of AMFT, he accepted an offer by Manhattan Loft, LLC, which was controlled by BS, to purchase the Sixth & Spring Property. However, according to the available documentation, the property was owned by Sixth and Spring, LLC, not

²⁷ While it is difficult to read, it appears to contemplate a closing on or about May 2005. It is not notarized.

AMFT, and AMFT only acquired an interest in Sixth and Spring, LLC, rather than a direct interest in the property. Appellant-husband's declaration states that "immediately prior to the sale to [BS's] entity . . . [CP] . . . prepared paperwork by which we transferred our interests in the property to [AMFT] and [AMFT] sold the property to Manhattan Loft." However, there is no sales documentation in the appeal record that shows AMFT sold an interest in the Sixth & Spring Property, or an interest in Sixth and Spring, LLC, to Manhattan Loft, LLC. Instead, as noted previously, the two purchase agreements in the record indicate a sale by Sixth and Spring LLC, rather than a sale by AMFT, of an interest in the Sixth & Spring Property.

Adding to the uncertainty, a California Court of Appeal found that, while the seller was identified as [Sixth and Spring LLC], "concurrent sale documents demonstrate that, on the day escrow closed, Sixth and Spring [LLC] transferred the property to its three members, and they transferred the property to [AMFT], which transferred the property to Manhattan Loft." (*Manhattan Loft, supra.*)

The assignment agreement by which AMFT purportedly acquired interests in Sixth and Spring, LLC required AMFT to make annual annuity payments to appellants. AMFT did not make annuity payments in accordance with the terms of the annuity agreement.

Consequently, the transaction lacked economic substance.

4. The Oklahoma Properties

By June 23, 2006, appellant-husband and APPR intended to sell the Oklahoma Properties, as evidenced by the terms of the settlement agreement between appellant-husband, APPR, and GT. According to appellants' documentation, on or effective as of July 13, 2006, their controlled entity, APPR, transferred interests in Oklahoma, LLC to AMFT in return for an annuity from AMFT and a promissory note for \$10 million. The promissory note provides that interest will be paid annually, and principal will be paid in a balloon payment in 20 years. Neither document is notarized and there is no call for immediate cash payments and therefore no payment records or similar documentation to show whether the transfers actually occurred on July 13, 2006.

On August 7, 2006, AG, on behalf of AMFT, signed a term sheet for the sale of one of the Oklahoma Properties, the Market Street Property, to a third party, and that sale appears to have closed on December 20, 2006. On July 30, 2007, appellant-husband, on behalf of Oklahoma LLC, signed a purchase agreement for the sale of another of the Oklahoma Properties,

the Woodlake Apartments, and that sale closed on September 13, 2007. The third Oklahoma Property, the Temple Hill Property, was listed for sale on November 16, 2007, but apparently was not sold.

The record does not show that AMFT made payments in accordance with the terms of the annuity agreement. AMFT payments from 2007 through 2009 were late and did not include interest that was owed.

In short, the record does not show that the transferred interests in Oklahoma, LLC to AMFT had practical economic effects.

B. Appellant-Husband's Relationship with AMFT

Appellants contend that AMFT was independent of appellant-husband. The declarations of AG and appellant-husband similarly contend that AMFT acted independently. However, the record suggests that AMFT was primarily controlled by appellant-husband, who easily obtained funds from AMFT.

AMFT made 33 transfers of cash, totaling \$7,685,000, to appellant-husband or entities controlled by him, and described the transfers as loans or investments. The record does not demonstrate that AG conducted significant due diligence or negotiated favorable terms for AMFT in these transactions, or that loans and advances were repaid in accordance with their terms.

To demonstrate that AMFT was independent of appellant-husband, appellants provide copies of numerous email exchanges. While some of the emails are helpful to appellants, the weight of the emails undermines appellants' contention that AMFT was independent of appellant-husband.

An email exchange on November 14, 2011, is instructive. It indicates that, while appellant-husband stated that AG was in control, the reality was that AG would "never" act without appellant-husband's approval. AG, in his capacity as trustee of AMFT, emailed appellant-husband to explain that he would like to have AMFT loan funds to a third party "if you're okay with the deal." Appellant-husband raised concerns and requested additional information, and AG responded. Appellant-husband, who was presumably aware of the ongoing audit by FTB, then stated that "of course you [AG] have the final say." AG then assured appellant-husband that "I would never do a deal that involves trust money without your agreement. But, you already knew that."

In emails on October 6, 2010, MA, the general manager of appellants' entity, APPR, and appellant-husband, discussed asking AG if he will allow AMFT to loan appellant-husband additional funds. MA then asked AG to advise "today" if AMFT will loan appellant-husband \$250,000. She stated that "[i]t is my understanding that the annuity payments have been calculated incorrectly so [AMFT] owes [appellant-husband] a great deal of money. We are having this corrected and will adjust as necessary upon receipt of corrected documents." Within an hour of her email, AG responded as follows: "Yes. Loan [appellant-husband] the money he's requested." This is the entirety of AG's response. He raises no questions about the use of the funds and does not ask to see the calculations which MA references or require appellant-husband to execute a promissory note.

By directing MA to loan AMFT funds, AG's response suggests that he had previously granted MA, an employee of appellants' entity, APPR, the ability to loan funds out of AMFT's accounts. MA's statement that "we" (apparently referring to her and appellant-husband) are correcting the unpaid annuity payments further suggests that she and appellant-husband were overseeing the annuity payments. If AG were an independent trustee, acting on behalf of AMFT, he would have been performing these functions, not appellant-husband and an employee of one of appellant-husband's controlled entities. AG's failure to ensure that AMFT complied with its annuity obligations, while immediately loaning appellant-husband \$250,000 without any due diligence, indicates that he did not conduct independent oversight of AMFT.

Appellants point to an email exchange during May 16-17, 2013, where AG raised concerns about the engagement of an accounting firm. An individual emailed AG asking to review and sign documents concerning AMFT's engagement of a new accounting firm, copying appellant-husband. AG raised several concerns regarding the documents and asked appellant-husband for his thoughts. Appellant-husband responded that he trusts the provider and suggests that he and AG speak. Then AG responded "[n]o problem, but they need to make certain changes[,] and raised concerns, including concerns about the company being given check-writing authority. AG explained that he reviews checks to understand the funds going out of AMFT. He stated that his "bigger problem" was a company he had never heard of asking him to sign a document. AG also asked appellant-husband whether he wanted AG to handle the matter, stating that it "will be handled properly and never reflect negatively on [appellant-husband]."

Based on these emails, AG was not familiar with the accounting firm recommended by appellant-husband for AMFT and had not been involved in discussions regarding the engagement of the firm. It appears that appellant-husband selected the firm and then he or someone else asked that the papers be forwarded to AG for signature on behalf of AMFT. This suggests that appellant-husband, not AG, handled the selection of a new accounting firm for AMFT. AG's declaration states that he determined that AMFT should replace its CPA, but the emails do not indicate that this is the case, and there is no documentary evidence to corroborate the statement.

It is striking that, in the emails, AG asked appellant-husband if AG can handle the engagement of a new accounting firm for AMFT. If AG were an independent trustee, he would have been telling appellant-husband who would handle the selection of a new accounting firm, not asking for permission to handle the matter.

It is also striking that, when seeking permission from appellant-husband to handle the matter, AG assured appellant-husband that he will handle it properly and in a manner that will "never reflect negatively on [appellant-husband]." AG's statement underlines that appellant-husband would determine who would handle the engagement of a new accounting firm for AMFT and suggests that one of AG's first concerns was that he not reflect poorly on appellant-husband.

Portions of this exchange are potentially helpful to appellants. For example, if AG's statement that he tracked AMFT's checks is viewed as credible, that might be viewed as evidence that he exercised independent oversight of AMFT. However, AG's failure to ensure that AMFT complied with its annuity obligations, and his failure to exercise any due diligence before loaning appellant-husband \$250,000, suggest that he did not closely supervise AMFT or exercise independent control over it.

Appellants also offer an email, dated December 11, 2006, in which AG purportedly emailed a third party to chastise them for contacting appellant-husband, rather than AG, regarding a potential contract extension. The email states that AMFT is seller, that appellant-husband is not the seller or an agent of the seller, and that it is AG's sole responsibility to approve and make changes to the contract. However, appellant-husband's declaration states that he negotiated on behalf of AMFT, though the terms and ultimate decision to sell was up to AG. Also, the seller was Oklahoma LLC, not AMFT, and appellant-husband signed a document

on behalf of Oklahoma LLC after the purported transfer of interests in it to AMFT. It is not clear why the email so vigorously criticizes the third party for contacting appellant-husband, rather than AG, regarding potential contract changes, since, according to appellant-husband's declaration, he negotiated the transaction, and the documentation for another sale by Oklahoma LLC was signed by him.

Also, while the signature line of the email indicates it was sent by AG, the "from" line of the email indicates it was sent by someone else (with the initials "DB") from the same email domain from which appellant-husband sent his emails. Prior communications and responses to the email are not in the appeal record. As it is not clear that AG sent the email, and the surrounding circumstances are not clear, OTA does not give the email great weight.

Appellants also provide emails where AG and appellant-husband discuss the selection of an arbitrator, emails where MA states that AG has questions about a loan to a radio celebrity, emails where AG and appellant-husband discuss having a meeting to discuss matters related to AMFT, an email in which appellant-husband says he is working on a settlement and will call to discuss terms and what AG "thinks should happen[.]" and emails showing AG reviewing and revising a letter to the Department of Real Estate. These emails indicate that AG had input into AMFT's affairs, but they do not show that he independently controlled AMFT.

Appellants also provide an email in which appellant-husband argues that AMFT should loan \$200,000 to a third party to buy a house. AG objects to the loan, and appellant-husband states he will have MA "correct the paperwork and . . . get the funds back to [AMFT] so there are no issues."

While the record does not include subsequent emails or any further evidence that the loan was withdrawn, the emails do appear to show AG overriding appellant-husband on this transaction, which is helpful evidence for appellants. However, the emails also suggest that MA and appellant-husband moved funds from AMFT without first obtaining approval from AG.

Appellants also provide emails dated September 17-19, 2008, in which appellant-husband asked AG to contact MA "ASAP" to arrange a meeting. AG asked MA to contact an attorney and MA then asked appellant-husband if he would like to join the call, and appellant-husband responded that he should be on the call. However, there is no documentation of what was decided on the call, or who made the decisions. It is notable that appellant-husband initiated the meeting, that he instructed AG to arrange the meeting, that AG was careful to have the meeting

scheduled at a time that was convenient for appellant-husband, and that appellant-husband ensured that AG did not talk with the outside attorney without appellant-husband. While the emails show AG had some input in the decision-making process, they do not establish that he controlled the process.

To summarize, some of the emails and other documents provided by appellants are helpful to appellants' position. They indicate that AG signed documents on behalf of AMFT and provided input on transactions recommended by appellant-husband. In one instance, they appear to show AG overriding appellant-husband's decision to loan funds from AMFT to a third party. However, they also suggest that appellant-husband and MA controlled AMFT's funds and managed the accounting of AMFT's annuity obligations, that AG approved a \$250,000 loan to appellant-husband without any apparent due diligence, and that AG promised appellant-husband that he would "never" act without appellant-husband's approval. When viewed as a whole, the emails suggest that AMFT was primarily controlled by appellant-husband, rather than AG.

Appellant-husband also appeared on behalf of AMFT in legal proceedings. In litigation between AMFT and an entity controlled by BS, a California Court of Appeal treated AMFT as an entity controlled by appellant-husband. (*Manhattan Loft, supra*, at pp. **1, 2, 13, fn. 5 [unpublished].) AMFT settled a lawsuit against GT on February 15, 2011, and the settlement agreement, which is signed by AG and appellant-husband, states that appellant-husband "caused" AMFT to sue GT.

Appellant-husband and AG assert or imply that appellant-husband acted at the direction of AG, but there is no credible evidence that this is the case. Appellant-husband negotiated the sales of the properties and negotiated with BS concerning disputes regarding the properties, even though AMFT purportedly owned a controlling interest in the properties. (*LADT 1, supra*, at p. 1424; *LADT 2, supra*, at pp. 497-498.) There is no credible evidence that AG helped negotiate the sale price for the properties, determined which offers to accept, or negotiated with BS or other buyers.

In summary, the record suggests that appellant-husband primarily controlled AMFT and that it routinely transferred funds to appellant-husband and entities controlled by him without significant oversight by AG. Consequently, the transfer of properties to AMFT is without meaningful economic impact and did not practically change appellant-husband's relationship over the properties.

C. Appellants' Payment of Taxes

Appellants argue that they properly reported tax on the payments they received from AMFT. However, appellants' payment of some tax does not demonstrate that the transactions had economic substance. Even in a transaction without economic substance, a taxpayer may incur real economic outlays, such as the payment of interest. (See, e.g., *Casebeer, supra.*) The payment of tax in accordance with the stated form of a transaction is not sufficient to demonstrate that the transaction has economic substance. (See, e.g., *Gregory v. Helvering* (1935) 293 U.S. 465 [finding a transaction lacked economic substance though the taxpayer paid tax in accordance with the form of her transaction].)

D. Private Annuity Cases

Appellants argue that their use of an irrevocable trust and private annuities should be respected under *La Fargue v. Commissioner* (9th Cir. 1982) 689 F.2d 845 (*La Fargue*), and *Stern v. Commissioner* (9th Cir. 1984) 747 F.2d 555 (*Stern*). However, those cases are distinguishable because, in those cases, the trust was independent of the taxpayer. Unlike appellant-husband, *La Fargue* “did not take an active role in trust management” (*La Fargue, supra*, at p. 848.) Similarly, in *Stern*, the trustee followed Stern’s investment advice “only once” in a “relatively small investment.” (*Stern, supra*, at p. 559.) Here, in contrast, at appellant-husband’s request, AG repeatedly caused or allowed AMFT to loan funds to appellant-husband and entities controlled by him, and assured appellant-husband that he would “never” act without appellant-husband’s approval.

V. Conclusion

The evidence belies appellants’ contention that they transferred assets to AMFT for estate planning purposes. The timing and circumstances of the transfers suggest that they were conducted in anticipation of planned sales of property, rather than for estate planning purposes. AMFT’s ownership of the transferred assets did not have any substantial economic effect. While appellants assert that AMFT acted independently, appellant-husband was actively involved in its management, and it appears that AMFT’s trustee, AG, advanced funds to appellant-husband without significant due diligence or independent oversight. The record does not show that, in substance, appellant-husband relinquished control of the properties and proceeds from them.

Therefore, OTA finds by the preponderance of the evidence that the transactions at issue lacked a business purpose and economic substance.²⁸

HOLDINGS

1. FTB's proposed assessments for the 2004, 2005, 2007 and 2008 tax years are not time-barred by the statute of limitations.
2. The transactions at issue lacked economic substance and a business purpose.

DISPOSITION

FTB's determination is modified pursuant to its concessions to remove the NEST penalties and IBPs, and its concession to reduce its proposed assessment of additional tax for the 2008 tax year from \$321,838 to \$110,689. In all other aspects, OTA sustains FTB's proposed assessments.

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Huy "Mike" Le

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Huy "Mike" Le
Administrative Law Judge

I concur:

DocuSigned by:

Erica Parker

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Erica Parker
Hearing Officer

²⁸ OTA therefore does not address FTB's alternative position that AMFT was a sham entity. To the extent appellants have raised arguments that this Opinion does not address, OTA has considered the arguments and found them without merit.

G. TURNER, Administrative Law Judge, concurring in part and dissenting in part:

I respectfully part ways with the majority regarding application of the statute of limitations to tax years 2004 and 2005, as their interpretive approach to Revenue and Taxation Code (R&TC) section 19753(c) is methodologically perplexing. The majority professes fidelity to the statute's plain meaning yet concedes its key phrase—"devised for the principal purpose of avoiding tax"—is undefined and thus ambiguous. When statutory language permits more than one reasonable construction, courts are obligated to construe it by examining legislative intent through its context and history, not construe the language in a vacuum. (*People v. Pennington* (2017) 3 Cal.5th 786, 795.)¹ "[U]nderstanding whether [a statute's] meaning is plain is not a project well served by reading statutory provisions in isolated fragments." (*Poole v. Orange County Fire Authority* (2015) 61 Cal.4th 1378, 1393.) From the uncertainty the majority concludes that "because appellants engaged [the services of counsel] for the purpose of manufacturing installment sales" the terms of R&TC section 19753(c) are satisfied.

The conclusion raises troubling questions: Does a taxpayer's intent to avoid taxes, paired with counsel's guidance, trigger the extended statute of limitations even if the transaction has economic substance? Conversely, if the same transactions at issue here, with the same flawed execution, lacked counsel's involvement, would it escape the statute's reach? In other words, does the majority's rule hinge on the absurdity of retaining counsel or the absurdity of the taxpayer's motivation alone? (See *Gregory v. Helvering* (1935) 293 U.S. 465, 469 ["the question for determination is whether what was done, *apart from the tax motive*, was the thing which the statute intended," italics added].)

If the majority's meaning behind "manufacturing installment sales" is simply a crude embrace of the noneconomic substance doctrine as a constructive proxy for the undefined terms, the majority's opinion is both circular in its reasoning (it defines the rule by its conclusion) and unsupported by legislative intent.

The answer to the uncertain application of the statute is not for the Office of Tax Appeals (OTA) to craft its own meaning but to undertake the rigorous task of examining its language in

¹ "If the words appear susceptible of more than one reasonable construction, we look to other indicia of legislative intent, bearing in mind the admonition that '[t]he meaning of a statute may not be determined from a single word or sentence' and that apparent 'ambiguities often may be resolved by examining the context in which the language appears and adopting the construction which best serves to harmonize the statute internally and with related statutes.'" (*People v. Pennington, supra*, at p. 795.)

the context of its enactment to ascertain *legislative* intent. The simple fact is that contextual examination of the statute reveals no support for the majority’s construction that all tax motivated transactions are subject to the extended statute of limitations or that the economic substance doctrine was intended to serve as an unstated proxy for the statute’s scope.

Statutory interpretation entails ascertaining the intent of the Legislature to effectuate the purpose of the law. (*People v. Mendoza* (2000) 23 Cal.4th 896, 907.) The analysis begins “by examining the statute’s words, giving them a plain and commonsense meaning.” (*Ibid.*) “In doing so, however, we do not consider the statutory language ‘in isolation.’” (*Ibid.*) Rather, the words of the statute are construed “‘in context, keeping in mind the nature and obvious purpose of the statute’” (*West Pico Furniture Co. v. Pacific Finance Loans* (1970) 2 Cal.3d 594, 608.) In other words, OTA “must harmonize ‘the various parts of a statutory enactment . . . by considering the particular clause or section in the context of the statutory framework as a whole.’” (*People v. Mendoza, supra*, 23 Cal.4th at p. 908.) And “[OTA] must also avoid a construction that would produce absurd consequences, which [OTA] presume[s] the Legislature did not intend.” (*Ibid.*)

In 2003, California enacted a voluntary compliance initiative (VCI-1)² focused on “tax avoidance” and “abusive tax shelters.”³ VCI-1 added Chapter 9.5, “Tax Shelters,” to Part 10.2 of Division 2 of the Revenue and Taxation Code. While VCI-1 encouraged taxpayer reporting of abusive tax avoidance transactions (ATATs) to avoid imposition of enhanced penalties, it also extended the statute of limitations for the Franchise Tax Board (FTB) to issue proposed deficiency assessments related to ATATs to eight years. In addition to defining the scope of VCI-1 (R&TC section 19751), the term “abusive tax avoidance transaction” was used in R&TC section 19752 (defining the choices of taxpayers electing to participate in the voluntary compliance initiative), R&TC section 19753 (defining “abusive tax avoidance transaction” for

² Stats. 2003, ch. 654 (A.B. 1601) and Stats. 2003, ch. 656 (S.B. 614) (double-jointed bills comprising virtually identical provisions). A “voluntary compliance initiative” is a program, here administered by the Franchise Tax Board, designed to encourage taxpayers to willingly report underpayments of tax or other forms of tax compliance irregularities in exchange for lower penalties or in the face of specific penalty enhancements or both.

³ The Legislative Counsel’s summary for both measures provides that “this bill would, in modified conformity with federal income tax laws, increase the penalties imposed with respect to tax avoidance and abusive tax shelters.” Although the Legislative Counsel’s summaries, like legislative committee reports, are not binding, “they are entitled to great weight.” (*Jones v. Lodge at Torrey Pines Partnership* (2008) 42 Cal.4th 1158, 1170.) The California Supreme Court has also explained that “[i]t is reasonable to presume that the Legislature amended [the statute at issue] with the intent and meaning expressed in the Legislative Counsel’s digest.” (*Ibid.*, quoting *People v. Superior Court of Orange County* (1979) 24 Cal.3d 428, 434.)

Chapter 9.5), R&TC section 19754 (application of the voluntary compliance initiative to certain taxpayers), and R&TC section 19755 (defining the extended eight-year statute of limitations).

As adopted in VCI-1, an ATAT was defined in R&TC section 19753(c), as “a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, ‘listed transactions’ as described in subdivision (a) of Section 18407.”⁴ The majority’s plain reading of the statute would produce the absurd result that mere intent to avoid tax is sufficient for a transaction to fall within the extended statute of limitations. If its subtle reference to “manufacturing” installment sales is intended to avoid the absurdity by imbuing “devised for the principal purpose of avoiding tax” with the cloak of “noneconomic substance transactions,” the legislative history does not support that construction. As the Legislative Analyst noted⁵ in their mandated reporting on VCI-1,⁶ “[t]he cornerstone of [S.B. 614] was the VCI, a *targeted amnesty* which allowed businesses and individuals who had participated in *specific identified* [abusive tax shelters] to pay the tax liability associated with this ATS and thus avoid any future tax enforcement actions and noncompliance penalties.”⁷ (Italics added.) The Senate Committee analysis similarly described the measure as “a comprehensive set of changes that increase the penalties for investors, promoters, and organizers of abusive tax shelters”⁸ not merely those engaged in *transactions* they primarily intended to reduce their tax liability.

A contextual analysis of the measure reveals a similar result. The Legislature enacted R&TC section 19774 to impose substantial penalties for those engaged in “noneconomic substance transactions.” R&TC section 19774, however, makes no reference to ATATs at all, nor does R&TC section 19753(c), which defines ATATs, reference R&TC section 19774, or by any other means “noneconomic substance transactions.”

⁴ Stats. 2003, ch. 656, § 13.

⁵ Where the words of a statute themselves provide no definitive answer, it is appropriate to refer to extrinsic sources for evidence of legislative intent. (*Long Beach Police Officers Assn. v. City of Long Beach* (1988) 46 Cal.3d 736, 743.)

⁶ Stats. 2003, ch. 656, § 16.

⁷ Legislative Analyst, “Abusive Tax Shelters: Impact of Recent California Legislation,” January 27, 2006.

⁸ California Bill Analysis, S.B. 614 Sen., 09/03/2003.

Additionally, in 2011, California enacted a second voluntary compliance initiative (VCI-2),⁹ amending some terms associated with VCI-1¹⁰ and directing the program more broadly towards an expanded definition of “abusive tax avoidance transactions.”¹¹ Among other things, VCI-2 added four new articles to Chapter 9.5: Article 1 “Voluntary Compliance Initiative One”; Article 2 “Statute of Limitations for Abusive Tax Avoidance Transactions”; Article 3 “Voluntary Compliance Initiative Two”; and Article 4 “Penalties and Interest.” While the definition for ATAT in R&TC section 19753(c) was retained, that section was amended to be expressly applicable only to Article 1 (“Voluntary Compliance Initiative One”), not Article 2, wherein the revised R&TC section 19755 resides.

VCI-2 added a new and expanded definition for “abusive tax avoidance transaction” in R&TC section 19777 (Article 4) to mean any of the following: (1) a “tax shelter” referencing Internal Revenue Code (IRC) section 6662(d)(2)(C); (2) a “reportable transaction” defined in IRC section 6707A(c)(1); (3) a “listed transaction” defined in IRC section 6707A(c)(2); (4) a gross misstatement, within the meaning of IRC section 6404(g)(2)(D); and (5) any transaction to which R&TC section 19774 applies (the “noneconomic substance transaction understatement” penalty). However, this definition of ATAT was expressly applicable only to R&TC section 19777. (R&TC, § 19777(b).) R&TC section 19763(c) (exclusions from “Voluntary Compliance Initiative Two”) was also added to provide that “[f]or purposes of *this article* [Article 3, Voluntary Compliance Initiative Two], an ‘abusive tax avoidance transaction’ has the same meaning as in Section 19777, as amended by the act adding this section.” (Italics added.) Consequently, upon the enactment of VCI-2, two references to “abusive tax avoidance transactions” existed with different definitions, one with respect to VCI-1 and the other with respect to VCI-2. Only VCI-2’s definition of ATAT referenced “noneconomic substance transactions.” By engineering the definition of ATAT in VCI-1 to be defined by tax motivation

⁹ Stats. 2011, ch. 14 §§ 21-24 (S.B. 86).

¹⁰ Stats. 2011, ch. 14 §§ 10-20.

¹¹ The Legislative Counsel’s summary provides: “The bill would also require the Franchise Tax Board to develop and administer a voluntary compliance initiative, as specified, to be conducted during the period from August 1, 2011, to October 31, 2011, inclusive, and to apply to tax liabilities attributable to the use of *abusive tax avoidance transactions* and unreported income from the use of offshore financial arrangements, as specified, for taxable years beginning before January 1, 2011.” (Italics added.) California’s “noneconomic substance transaction” doctrine incorporates the IRS’s codification of “economic substance” in IRC section 7701(o). (See R&TC, § 19774(c)(2).)

alone or even “noneconomic substance transactions,” the majority assumes the restructured article and expanded statute were entirely idle. But the Legislature is presumed not to engage in idle acts. (*Stafford v. Realty Bond Service Corp.* (1952) 39 Cal.2d 797, 805.) Tax motivation alone would be such a broad interpretation that revisions to the definition of ATAT in VCI-2 could only be construed as *narrowing* the statute’s reach.

Perhaps most telling is R&TC section 19777, which at the time of VCI-1 imposed a 100 percent penalty where a taxpayer was *contacted* by FTB regarding a “potentially abusive tax shelter” which was defined as either (1) a “tax shelter” as defined in IRC section 6111, or (2) “any entity, investment plan or arrangement, *or other plan or arrangement* which is of a type that the Secretary of the Treasury or the Franchise Tax Board *determines by regulation as having a potential for tax avoidance or evasion.*” (Italics added.) Given the absurd result of applying the express language of R&TC section 19753(c), and the lack of any foundation for the majority’s possible insertion of “noneconomic substance transactions” as a proxy for the ambiguous language, a more reasonable construction, consistent with the context of the Legislature’s enactment of VCI-1, and its later expansion of the definition of ATAT in VCI-2, is that the Legislature’s reference to a “plan or arrangement” in R&TC section 19753(c) was intended to capture only those transactions *identified* by the IRS or FTB as “potentially abusive tax shelters” or “as having a potential for tax avoidance or evasion.” Neither of which are applicable to the transactions at issue here.¹²

The majority’s dismissal of consistent interpretations for similar phrases across related statutes disregards the established canon of *in pari materia*,¹³ a cornerstone of statutory construction. When statutes address similar subjects or are enacted contemporaneously, as with provisions at issue here, the *in pari materia* rule requires that their terms—particularly parallel phrases like “plan or arrangement”—be construed harmoniously to reflect a unified legislative intent. (*U.S. v. Stewart* (1940) 311 U.S. 60; *Cox v. City of Oakland* (2025) 17 Cal5th 362; *In re*

¹² The majority would suggest that that R&TC section 19753(c)’s reference to “including but not limited to listed transactions” suggests this construction too narrow on the false premise that listed (or perhaps listed and reportable transactions) are the only potentially abusive tax avoidance transaction that can be identified by the IRS or FTB.

¹³ Statutes are considered *in pari materia* when they relate to the same person or thing, to the same class of persons or thing, or have the same purpose or object. (*Lexin v. Superior Court* (2010) 47 Cal.4th 1050, 1091; see *Erlenbaugh v. U. S.* (1972) 409 U.S. 239, 244 [application of the rule *in pari materia* “makes most sense when the statutes were enacted by the same legislative body at the same time”].)

Bittaker (1997) 55 Cal.App.4th 1004, 1009; 2B Sutherland Statutory Construction § 51:3 (7th ed.) The majority, however, inexplicably insists that absent an express linkage, these phrases bear divergent meanings, a stance that fractures the statutory scheme and invites the absurd outcome of taxpayer intent to avoid taxes being the sole driver of the extended statute of limitations. Favoring a fragmented reading over a cohesive one defies both precedent and reason, undermining the Legislature’s intent and further exposing the misadventure of the majority’s construction of R&TC section 19753(c). OTA’s inquiry, however, is not at an end. R&TC section 19058 provides for a six-year statute of limitations “[i]f the taxpayer omits from gross income an amount properly includable therein which is in excess of 25 percent of the amount of gross income stated in the return” Extending the statute of limitations to six years to tax years 2004 and 2005 would mean those tax years were “open” as of August 1, 2011, and therefore subject to the extended 12-year statute of limitations. (R&TC, § 19755). However, “[i]n determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if the amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Franchise Tax Board of the nature and amount of the item.” (R&TC, § 19058(b)(2).)

Without evidence of the 2004 return,¹⁴ either when it was filed or what the taxpayer reported as gross income,¹⁵ FTB has failed to meet its burden of producing sufficient evidence to support a reasonable and rational determination of liability. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Without the supporting records, FTB fails to establish the foundation of the

¹⁴ The majority by footnote suggests that the parties do not dispute the 2004 return was “timely filed.” However, that does not establish when the return was filed nor whether the taxpayer’s reporting brought the return within the reach of R&TC section 19058’s six-year of statute of limitations. For simple illustration, a “timely filed” return in July 2005 (for the 2004 tax year) would be outside the statute of limitations in R&TC section 19755, which requires the statute of limitations remain open as of August 1, 2011, for the extended 12-year statute to apply.

¹⁵ FTB relies on federal reported “AGI” (adjusted gross income) as their baseline for determining whether the underreporting for 2004 exceeded 25 percent. Because so many factors can implicate the difference between federal AGI and state “gross income,” this basis is insufficient to apply R&TC section 19058’s six-year statute of limitations. What is more, without the return, OTA has no basis upon which to determine whether there was an omission from income.

assessment, rendering it erroneous. (*U.S. v. Janis* (1976) 428 U.S. 433, 441-442).¹⁶

Consequently, OTA has no basis upon which to conclude the 2004 tax year remained open on August 1, 2011, by application of R&TC section 19058, and thereby expose that year to the extended 12-year statute of limitations enacted as part of VCI-2.

The 2005 tax return was filed on or about October 15, 2006. If R&TC section 19058 applies, that year would be open on August 1, 2011. On their 2005 California personal income tax return, appellants reported California adjusted gross income of \$3,684,652, and FTB determined that appellants underreported \$11,560,879 in capital gains. On this basis, FTB argues that the amount “omitted” from gross income was more than 25 percent of the amount of gross income stated in the return.


Here, appellants reported \$11,050,000 on the sale of the 6th and Spring Office Building on Form 4797. As to appellants’ 20 percent interest, they reported \$2.6 million in gross sales price and total gain. As to the 65 percent interest appellants transferred to the Andrew Meieran Family Trust, appellants reported the \$8.45 million as gross sales price and gain on the sale of property on Form 4797 and as Installment Sale Income on Form 6252. FTB’s determination is based almost entirely on challenging the installment sale as a sham and thereby attributing to appellants capital gain that was reported as an installment sale. However, appellants reported not only the sale of the property but also the installment sale treatment. Consequently, appellants reported the sale in a manner adequate to apprise FTB of the nature and amount of the item and did not “omit [] from gross income an amount properly includable. (R&TC, § 19058(b)(2); see *Colony, Inc. v. Commissioner* (1958) 357 U.S. 28 (*Colony*).)¹⁷

¹⁶ An assessment without the supporting records necessary to establish the basis of the assessment is one “without rational foundation and excessive,” and stands as proof the assessment is “arbitrary and erroneous.” (*U.S. v. Janis, supra*, at p. 442.) FTB simply assumes appellants filed their return sometime in or around October 2005 in keeping with their subsequent practice. However, a determination must bear some connection to appellants’ actual circumstances and constitute more than assumptions shielded by the presumption of correctness. (*Appeal of Rogers* (78-SBE-024) 1978 WL 3937.)

¹⁷ In *Colony*, the U.S. Supreme Court held that the extended limitations period in the predecessor statute to IRC section 6501(e)(1)(A) (substantially similar to R&TC section 19058 and therefore persuasive authority under *Appeal of Calegari*, 2021-OTA-337P) did not apply where a taxpayer understated gross profits earned on the sale of real property because they erroneously overstated their basis in the property. As the Court noted, the extended limitations period was meant to address “the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes.” (*Id.* at p. 33.) “Omit” was defined by the court as “to leave out or unmentioned.” (*Id.* at p. 32.) While the Court’s determination that an overstatement of basis did not constitute an “omission” was supplanted by subsequent legislation, the Court’s construction of what constitutes an “omission” remains intact. (See *U.S. v. Home Concrete & Supply, LLC* (2012) 566 U.S. 478, 482.)

Because FTB cannot establish when the 2004 tax return was filed (only that it was filed before the deadline), nor make the return available for inspecting whether an omission occurred, I would conclude that FTB has failed to meet its basic burden of proof, rendering the assessment erroneous. I would also conclude that FTB's NPA for the 2005 tax year is not timely because that year was not "open" as of August 1, 2011, and therefore not subject to the extended 12-year statute of limitations.

I agree with the majority that the transactions at issue here lack economic substance. However, it would be remiss to suggest the essence of appellants' strategy is naturally suspect as a noneconomic substance transaction. While transfers of real property from individuals to independent trusts and then to third-party buyers raises no apparent red-flag, the evidence reveals that the trust was choreographed into the transactions as an artifice—sometimes inserted after a decision to sell, providing no discernable value to the trust or its beneficiaries, but solely to manufacture the tax deferral benefit.

Signed by:

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Greg Turner
Administrative Law Judge

Date Issued: 7/11/2025