

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
R. MITCHELL and J. MITCHELL, ) OTA NO. 240716787  
 )  
 APPELLANT. )  
 )  
 )

TRANSCRIPT OF PROCEEDINGS

Fresno, California

Tuesday, October 7, 2025

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Proceedings, taken at  
855 M Street, Suite 960, Fresno, California,  
93721, commencing at 1:09 p.m. and concluding  
at 2:55 p.m. on Tuesday, October 7, 2025,  
reported by Ernalyn M. Alonzo, Hearing Reporter,  
in and for the State of California.

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APPEARANCES:

Panel Lead:	ALJ VERONICA I. LONG
Panel Members:	ALJ SARA A. HOSEY HEARING OFFICER SETH ELSOM
For the Appellant:	R. MITCHELL MARCUS D. MAGNESS W. MCFEETERS
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD  CHRIS DAVIS JACKIE ZUMAETA

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-8 were received into evidence at page 7.)

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

(Department's Exhibits N-O were received into evidence at page 7.)

O P E N I N G   S T A T E M E N T

P A G E

By Mr. Magness 8

By Mr. Davis 49

APPELLANT'S

WITNESSES:

D I R E C T

C R O S S

R E D I R E C T

R E C R O S S

Mr. Mitchell 9

Mr. McFeeters 37

C L O S I N G   S T A T E M E N T

P A G E

By Mr. Magness 64

1                   Fresno, California; Tuesday, October 7, 2025

2                                   1:09 p.m.

3

4                   JUDGE LONG: We are going on the record.

5                   This is the appeal of Mitchell, OTA case  
6 No. 240716787. The date is October 7, 2025, and the time  
7 is 1:09 p.m. This hearing is being held in Fresno,  
8 California.

9                   I am Judge Long. I will be the lead  
10 Administrative Law Judge for the purposes of this hearing.  
11 My co-panelists, Judge Hosey and Hearing Officer Elsom,  
12 and I, are equal participants in deliberating and  
13 determining the outcome of this appeal.

14                   I'm going to ask the parties to identify  
15 themselves and who they represent, starting with Franchise  
16 Tax Board.

17                   MR. DAVIS: Chris Davis, representing Franchise  
18 Tax Board.

19                   JUDGE LONG: All right. Thank you.

20                   And Appellants.

21                   MS. ZUMAETA: Jackie Zumaeta, representing  
22 Franchise Tax Board.

23                   MR. MAGNESS: Marcus D. Magness, representing the  
24 taxpayers, Robert and Julie Mitchell.

25                   JUDGE LONG: All right. Thank you.

1           MR. MCFEETERS:   Wilfred McFeeters.   Wilfred John  
2   McFeeters, project management.

3           MR. MITCHELL:   And Robert Mitchell.

4           JUDGE LONG:   All right.   Thank you.

5           Now, I'm going to the preliminary issues.   OTA  
6   received Appellant's notice of errors regarding the  
7   Minutes and Orders.

8           Thank you for sending that.

9           We are agreed that Appellant's will provide  
10   witness testimony during the hearing; and second, there  
11   was a stipulation.

12           It sounds like you may have preferred a more  
13   narrow stipulation, I think at this point.

14           Unless the parties have prepared a joint  
15   stipulation, we're going to move forward with the issue  
16   statement as stated in the Minutes and Orders.   All right.

17           All right.   With that, as stated in the Minutes  
18   and Orders, the issue to be decided in this appeal is  
19   whether Appellant's are entitled to nonrecognition of gain  
20   from the sale of real property under Internal Revenue Code  
21   section 1033.

22           Appellants submitted Exhibits 1 through 8.   FTB  
23   did not object to the admissibility of these exhibits.  
24   Therefore, Exhibits 1 through 8 are admitted into  
25   evidence.

1 (Appellant's Exhibits 1-8 were received into  
2 evidence by the Administrative Law Judge.)

3 JUDGE LONG: FTB submitted Exhibits A through M  
4 at the prehearing conference. Appellants did not object  
5 to the admissibility of these exhibits. Therefore,  
6 Exhibits A through M are admitted into evidence.

7 (Department's Exhibits A-M were received into  
8 evidence by the Administrative Law Judge.)

9 JUDGE LONG: After the prehearing conference, FTB  
10 submitted exhibits N and O.

11 And, Appellants, do you have any objections to  
12 those two exhibits?

13 MR. MAGNESS: No.

14 JUDGE LONG: All right. With that, Exhibits N  
15 and O are now admitted into the record.

16 (Department's Exhibits N-O were received into  
17 evidence by the Administrative Law Judge.)

18 JUDGE LONG: Let's see. And Appellants indicated  
19 during the prehearing conference that Mr. Mitchell and  
20 Mr. McFeeters will be testifying as witnesses.

21 Is that still correct?

22 MR. MAGNESS: That is correct.

23 JUDGE LONG: Thank you.

24 With that, I'm going to place you both under oath  
25 so we can consider your statements as testimony, and you

1 will remain under oath throughout this hearing.

2 So I'm going to ask Mr. McFeeters to please raise  
3 your right hand.

4

5 W. MCFEETERS,

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

9

10

11 R. MITCHELL,

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

15

16 JUDGE LONG: Thank you.

17 With that, Appellants you have 1 hour and  
18 55 minutes for your presentation, and you may proceed  
19 whenever you're ready.

20 MR. MAGNESS: Thank you.

21

22 PRESENTATION

23 MR. MAGNESS: I'm going to open with  
24 Mr. Mitchell.

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Q Mr. Mitchell, you've already been introduced, and you've stated your name. Can you identify the property in question, please, by address?

THE HEARING REPORTER: I'm going to have to ask  
you to bring the mic closer to you.

MS. ZUMAETA: Ms. Alonzo, would it be helpful if we had them have two microphones? They can use our microphone during this time if that's helpful.

MS. ZUMAETA: Yeah.

MS. ZUMAETA: Absolutely.

Q All right. I'll repeat the question. Can you please identify the property in question by address, please?

THE HEARING REPORTER: Mr. Mitchell, I still need

1       you to get closer to the mic.

2               MR. MITCHELL:   Get closer.   Okay.

3               THE HEARING REPORTER:   And talk right into the  
4   microphone.

5               MR. MITCHELL:   Sure.   Oh, now I really hear it.

6               4974 East Clinton Way in Fresno, California.

7   BY MR. MAGNESS:

8               Q   Now, this piece of property, was it one address  
9   for the entire project?

10              A   Yes.

11              Q   The government is arguing that there are three  
12   different pieces of property or three different  
13   identifiable buildings.   Can you explain to me, when you  
14   purchased this property, were you purchasing as a whole,  
15   or were you purchasing it for the individual buildings?

16              A   It's one building, and I purchased it as a  
17   building.

18              Q   Was there anything that these three pods or three  
19   wings had in common that would identify them as a single  
20   building, as opposed to separate identifiable buildings?  
21   For example, do they have one roof?

22              A   Yes.   One APN.   One address.   Is that what you're  
23   asking?

24              Q   Well, yes.

25              A   Well, go ahead.   I didn't mean to --

1           Q    Do the -- does the project have common area  
2 amenities that were shared amongst the entire facility?

3           A    Yes.

4           Q    And what would those common area amenities be?

5           A    Primarily the women's and men's bathrooms  
6 upstairs, downstairs, the utilities, water, gas,  
7 electricity.

8           Q    So did all of the utilities come into one  
9 location on this property?

10          A    Yes.

11          Q    If you could, please -- I've brought a  
12 whiteboard. If you could simply draw to the best of your  
13 ability -- and I'm not asking you to be an artist. But  
14 draw to the best of your ability what this structure  
15 looked like.

16          A    Yes. And I'm not an artist. I'll do -- this  
17 half. All right. This is kind of like a courtyard, if  
18 that makes sense.

19          Q    All right. So, just so that we can locate, since  
20 all of the briefs refer to these pods or as the government  
21 calls them Buildings as A, B, and C, would you please mark  
22 what you understand to be A, B, and C?

23          A    So that was mostly for like suites in -- in  
24 location of delivery, but this would be A. This would be  
25 B, which kind of comes in there, and this would be C.

1 Q Okay.

2 A That's not exactly to scale.

3 Q Let's draw with a different color, if you can.

4 Can you show me -- was there a common equipment closet?

5 A Yes.

6 Q Where was that located?

7 A So all the utilities were in B, right here.

8 Q And so utilities came in from the street. That  
9 would be power?

10 A Yes.

11 Q Water?

12 A Yes, the meters. Everything -- everything was  
13 there in B.

14 Q Were the breaker boxes in that equipment closet?

15 A The main -- for everything, yes.

16 Q What about low voltage communications?

17 A Like AT&T, everything kind of came there 'cause  
18 it's one hub coming from the street and disbursed out  
19 through the tops of the rafters.

20 Q So they went through the connecting portions of  
21 building to pods A and C through B?

22 A Yes.

23 Q Okay. Was there a single parking lot for this  
24 entire project?

25 A Yes. It's just one parcel, one parking lot.

1           Q    If repairs needed to be done on the roof, how did  
2   you access the roof for pods A, B, and C?

3           A    Do you need me to keep writing or --

4           Q    Well, yeah, just draw it?

5           A    -- can I sit down?  Sorry.  Go ahead.

6           Q    Where would you access the roof if you needed to  
7   repair pods A, B, and C or to access the HVAC systems?

8           A    The main utility area, for all janitorial and  
9   everything, was there by the bathrooms.  And it's only a  
10   roof jack that lifts up, and there's a photo of it that  
11   you can lift up.  So you access there, and you walk --  
12   you could walk all around all three pods or wings.

13          Q    Okay.  You can have a seat, please.

14          A    Sorry.  I didn't mean to --

15          Q    Is it possible, without rebuilding A and C, if  
16   you were to demolish part B, for A and C to operate?

17          A    No, not -- not effectively.  I think we had one  
18   small bathroom in A, but all the bathrooms and everything  
19   are hubbed into B for the whole complex.

20          Q    So when you say a small bathroom, was this an en  
21   suite bathroom as part of a TI from an earlier tenant, or  
22   was this a common area bathroom that can serve an entire  
23   building?

24          A    It was just a build-out for -- it was preexisting  
25   when I was there, but it was just a small shared bathroom,

1       you know, just inside a suite.

2           Q     A single toilet?

3           A     Yes.   Single sink.   Single toilet.

4           Q     Within a separate office, an identifiable office?

5           A     Yes.   And there's one in C also, that same way.

6           Q     Okay.   The property was not owned free and clear;  
7       was it?

8           A     No.

9           Q     You had a mortgage?

10          A     Yes.

11          Q     Approximately how much did you owe on that  
12       mortgage?

13          A     The original note was for \$2 million, and it  
14       depreciated down.   I forget what they had down, but 1-9 --  
15       I mean, it was under \$2 million.

16          Q     Okay.   Had you not undertaken the reconstruction  
17       of pod B, would that have allowed the lender to foreclose  
18       on the project?

19          A     Yeah.   Well, I wouldn't had to -- yes.

20          Q     After the loss, did you pull new utilities to  
21       either A, B, or C?

22          A     No.

23          Q     Okay.   When you were evaluating the scope of the  
24       loss, was it your intent to reconstruct B?

25          A     Yes, 100 percent.   All the bids, everything,

1 shows that that was the intention. That's the only  
2 intention.

3 Q And isn't it true that the only intention to  
4 rebuild B is because A and C were worthless without B?

5 A Well, they function together, yes.

6 Q Okay.

7 A And it's one building. It's really -- it's  
8 deceiving when it says A, B, and C because it's just suite  
9 numbers, but it is one building in one parcel.

10 Q So let's put a time frame on this. At the time  
11 of the loss was the entire building leased?

12 A Yes.

13 Q How many tenants?

14 A One tenant.

15 Q What was the tenant's name?

16 A HOPE.

17 Q HOPE, meaning, if you recall?

18 A I think Helping Others -- Other People  
19 Employment. I forget. I -- I don't know the exact  
20 acronym. I apologize.

21 Q But it's a 501(c)(3)?

22 A Yes. It is, yes.

23 Q Okay. And when did that lease begin?

24 A February 1st, 2017.

25 Q Did that lease require the tenant to reimburse

1 the landlord for property taxes?

2 A Yes. As part of our negotiation, they were  
3 responsible for the property taxes. It was a triple net  
4 lease.

5 Q So were they required to reimburse you for  
6 insurance?

7 A Yes.

8 Q Were they required to pay rent?

9 A Yes.

10 Q How much was the rent initially?

11 A \$15,000 per month.

12 Q Did the lease require that the tenant pay all  
13 cost of maintaining the property?

14 A Yes.

15 Q And repairing the property?

16 A Yes.

17 Q Did the tenant ever pay you a dime?

18 A Because of the timing, no.

19 Q So when did the loss occur?

20 A So I believe it's mid-April. It's in -- in the  
21 record. So March -- you know, 45 days, 60 days after the  
22 signing the of the lease is when the Building Collapsed.

23 Q So mid-April 2017?

24 A Yes. Sorry, '17.

25 Q Did you tender the loss to your insurance



1 carrier?

2 A Yes.

3 Q How long did the insurance carrier take to adjust  
4 the loss?

5 A So in the records, it was, like, June of '18  
6 because there was so many -- it continued issues. I don't  
7 know if you're going ask me those or volunteer them but  
8 yes, 18 -- so 15 months.

9 Q 15 months --

10 A Yes.

11 Q -- there was no rent?

12 A Correct.

13 Q Okay. How could -- strike that.

14 Did HOPE continue to occupy any portion of the  
15 Building After the loss occurred?

16 A Yes.

17 Q Where did they -- what did they occupy?

18 A So in the small suite in A, where the one  
19 bathroom is, is where they were at. And, at that time, I  
20 think they had three employees. The records, I mean,  
21 should state that how many employees they had, three.

22 Q Okay. So there were three people occupying --

23 A Yes.

24 Q -- a 33,000 square-foot building?

25 A Correct.

1 Q And they paid no rent?

2 A Correct.

3 Q Did -- why did you let them stay in a suite  
4 within pod A if they weren't paying rent?

5 A Well, initially, I thought we would be  
6 rebuilding. You're just working with them and trying to  
7 cooperate. They were there for 45 days, and it collapsed.  
8 It wasn't their fault. But, eventually, it was to protect  
9 the building too because you have a vulnerable building  
10 that was collapsed. And so I felt them being there would  
11 be an advantage.

12 Q In the area where the building is located, has  
13 there been a history of vagrants moving into vacant  
14 building?

15 A Yes.

16 Q And had vagrants been setting fires within these  
17 buildings?

18 A Yes.

19 Q And had vagrants been stripping the buildings of  
20 anything valuable?

21 A Yes.

22 Q Did your efforts to prevent vagrants from moving  
23 into the building work by keeping HOPE, at least, in one  
24 suite?

25 A No.

1           Q    What happened?

2           A    So in part of the claim, you'll see that all --  
3   a lot of the copper wiring, all three air conditioning  
4   units were salvaged and damaged. And so they were just  
5   taking anything to -- that they could take.

6           Q    How did the vagrants access -- well, strike that.  
7               Where were the HVAC units located.

8           A    So in each wing of the building, there was a --  
9   an air conditioning unit on each wing.

10          Q    And how did those vagrants access those HVAC  
11   units?

12          A    So as the roof collapsed -- so what would happen  
13   is, we had a big storm. It was a hailstorm and rainstorm,  
14   and it clogged -- the hail clogged the drain and overflow.  
15   So there was so much rain. And there's pictures, I think,  
16   in the records. It was like 18 inches of water. The roof  
17   just collapsed because the drain was clogged. So half of  
18   that building just fell down on top of -- and as it fell  
19   down, it left kind of a place that they could climb up and  
20   get around. And they're just scavenging anything they can  
21   get, but that was at risk all the time. I mean, it's just  
22   not unique there. I'm sure you've heard stories that  
23   there's, you know --

24          Q    So --

25          A    Mostly copper. It -- it seems to be the hot item

1       there.  Sorry.  Go ahead.

2           Q    So did the vagrants simply open up the units and  
3       take the copper, or did they do something else?

4           A    No.  They went through the rafters.  Went  
5       through -- they pulled wire everywhere they could pull it.  
6       But you just don't know what's happening at the -- at the  
7       time.

8           Q    Isn't it true that the vagrants took the entire  
9       HVAC system, the units, off and threw them to the ground?

10          A    Yes, that is true.

11          Q    So how is it that, HOPE, having three or four  
12       employees in one suite in pod A, somehow were able to  
13       continue to occupy that suite in Fresno, California, with  
14       no HVAC?

15          A    So they had a little portable -- a portable air  
16       conditioning unit that they just took the rubber vent and  
17       just put it in exterior venting, is how they kept it cool.

18          Q    So they cut into the ceiling of A in order to put  
19       the HVAC --

20          A    Well, the --

21          Q    -- unit --

22          A    -- return vents, they just went up there.

23          Q    Had you had a conversation with them about it to  
24       becoming just a month-to-month tenancy at that point?

25          A    It -- pretty much the lease terminated because

1       their main function and use was the training center,  
2       because they were building it to employ -- help people get  
3       employment --

4           Q     Where were --

5           A     -- and train them.  Sorry.  Go ahead.

6           Q     Where was the training center going to be  
7       located?

8           A     It was located in B and C, but --

9           Q     Okay.  And, at any point, did the insurance  
10       company determine -- did they send anybody out to  
11       determine how much it would cost to repair the property?

12          A     Multiple times.

13          Q     And were you unsatisfied with the bids they were  
14       getting?

15          A     Yes.  That's why you -- why it took so long.

16          Q     Did you have an engineer look at the property?

17          A     Yes.

18          Q     Was -- were the walls still plumb on the exterior  
19       of pod B?

20          A     No.  When -- hard to describe, but there's a main  
21       beam that holds up the whole second floor on the first  
22       floor.  And when the roof collapsed, that whole beam was  
23       damaged, but it also lifted that beam up through the  
24       complex.  And the exterior windows all broke in that  
25       complex, and there was damage all around.  And I think

1       there's pictures of that that shows everything had to be  
2       boarded up and -- but it was damaged throughout.

3             Q     Isn't it true that they were bowing outward?

4             A     Multiple inches.

5             Q     Were there discussions with the engineers about  
6       whether that could be salvaged, or if it had to be  
7       completely destroyed and rebuilt?

8             A     That was kind of the -- the debate of, you know,  
9       what would be the best way to proceed.

10            Q     What was ultimately decided as the likely way to  
11       proceed?

12            A     The likely, because of the unknown part of the  
13       damage -- and I think we had different bids -- would be  
14       that potentially totally demolish it and come back from  
15       scratch to rebuild it because of the damage of the walls,  
16       the beam, the structure.

17            Q     And was that a risk analysis determining that, if  
18       you tried to salvage it and you determined you couldn't,  
19       you'd have to incur the same cost twice?

20            A     And those bids are in there. But yes, because  
21       you don't know until you dig into it what you're dealing  
22       with when you're talking about a structural beam.

23            Q     Okay. I'm gonna to hand you what has been marked  
24       as Appellants' Exhibit No. 1. Can you identify that  
25       document?

1           A    Yes.

2           Q    What is that document?

3           A    This was one of the bids that we received.  And I  
4   see it says June of 2017, so early -- fairly early on, to  
5   demolish and replace the building from Quiring, which is  
6   an outside company.

7           Q    Okay.  And Quiring was an outside company that  
8   provided a bid; correct?

9           A    Yeah.

10          Q    How much -- how much did they bid to repair the  
11   work in June of 2017?

12          A    I think it's included in evidence, so you -- you  
13   have it, but it's \$1,990,184, just under \$2 million.

14          Q    And would this -- the scope of work that they  
15   included in their build have replaced the Building B  
16   exactly as it was before the loss?

17          A    No.

18          Q    What would it not have covered?

19          A    So in a lot of insurance policies, you don't  
20   realize until you have a claim, but there's caps on what  
21   they'll cover, like coding -- code improvements.  So there  
22   was code work that they capped out.  So all the codes for  
23   fire and sprinkler -- because the whole complex had no  
24   fire and sprinkler in it because of its age.  But as you  
25   rebuild and pull permits, then you're required to upgrade

1 to the whole -- whole building. So we had also  
2 information on that.

3 There was also an exclusion for any hazardous  
4 waste. So we got another bid from another company that  
5 showed that there was asbestos and hazardous waste. There  
6 was mold. And to remove that, that was another bid, which  
7 was, I think, \$250,000 -- that's included in evidence --  
8 that was kind of unknown. And then ADA upgrades that  
9 you'd have to do in the complex as a whole. Because  
10 anytime you're doing something new, they require you to  
11 bring it up to code.

12 Q Okay. So I'm going to hand you Appellants'  
13 Exhibit No. 2. Can you identify this document?

14 A Yes.

15 Q And what does that document represent?

16 A As you see scope of work, it says asbestos and  
17 mold abatement, selective demolition. So this was  
18 selective just to take down some of the areas, not a full  
19 demo, just to see what kind of additional problem. And  
20 then they discovered, as you see, it's in the roof -- all  
21 the roofing, all the flooring, not including the model,  
22 because all the rain came down through the whole complex.

23 Q And their bid was?

24 A For that portion, \$176,000.

25 Q Okay. Let's hand you Appellants' Exhibit No. 3.



1 Can you identify that document?

2 A Yes.

3 Q What is that document?

4 A This was another bid -- or secondary bid to  
5 compare to Quiring's bid. And it was to selectively look  
6 at some of the demo and repair, and then overall  
7 replacement.

8 Q So there are two numbers. The selective  
9 demolition, if they were to come in and selectively demo,  
10 that was going to cost \$325,000; correct?

11 A That is correct.

12 Q And if they determined after that selective demo  
13 that they could not salvage the building, you would have  
14 to incur an additional \$255,000 to demolish the building?

15 A Correct.

16 Q Or you could decide to simply demolish the  
17 Building And save the \$325,000?

18 A Yes.

19 Q Okay. Did Bernards also provide a bid or an  
20 estimate of what it would cost to rebuild Building B?

21 A Yes.

22 Q And what was the amount or the range that they  
23 provided?

24 A Again, it's in evidence, but the range here is  
25 \$175 to \$225 per foot to rebuild it.

1           Q    And how many leasable square feet were in  
2   Building B?

3           A    I think that their bid or somewhere showed was  
4   just under 10,000 feet.

5           Q    Okay.  So if I were to take that number and  
6   multiple it by the 175 or the 225, that would be their  
7   estimated cost or the range of what it would cost to  
8   rebuild?

9           A    To rebuild but not tear down and demo, but yes.  
10   Go ahead.

11          Q    Okay.  And so if my math is correct, based on the  
12   9,300 square feet that Quirings had in their estimate,  
13   9,300 times the 225 gives you a \$2,092,500 number.  Is  
14   that math correct?

15          A    I'll take your word for it.

16          Q    So their total build on the high side would have  
17   been the 255 plus the 2,092,500?

18          A    Yes, the cost to demo it, and to rebuild it.

19          Q    So just to --

20          A    That -- that also excluded environmental.  So I  
21   still would have the environmental -- environmental side.

22                Every time I look, you --

23          Q    Right.

24          A    -- get close.

25          Q    And just to be fair, if we landed on the low

1 side, it would've been 175 times the same 9,300, which  
2 would put you about a million-six and a quarter; right?

3 A I believe so. I -- I trust your math.

4 Q Okay. Now, as the property owner, how many --  
5 you already stated how many months had elapsed since the  
6 loss. Were you still incurring cost of ownership of the  
7 property?

8 A Yes.

9 Q What were you incurring?

10 A Well, the mortgage payment is obvious. So that  
11 was consistent. I think that's also in evidence the State  
12 has. Normal insurance that we continued to pay.

13 Q How much were your mortgage payments?

14 A The mortgage payment was \$10,000 per month.

15 Q And how much was your annual insurance cost?

16 A What I have down here in my notes was about  
17 12,000 -- \$12,000 per year.

18 Q Per year?

19 A Yes.

20 Q Okay. And property taxes?

21 A I believe it was little bit north of \$24,000 per  
22 year.

23 Q Okay. So you are negative cash flowing  
24 throughout this period of time. You're losing money?

25 A Yes.

1           Q    Was it in your interest to get the property back  
2 reconstructed and relet?

3           A    Absolutely.

4           Q    Why didn't you lease any portion of parts A and C  
5 during this period?

6           A    As I previously said, because without the  
7 bathrooms and everything for a common area, it's  
8 impossible to lease the other part of the buildings. The  
9 one space that they were using had a small bathroom, but  
10 it wasn't for the public. So it was impossible for me to  
11 lease any buildings without bathrooms or air  
12 conditionings.

13          Q    When you undertook reconstruction, would you have  
14 had to cut the power to the whole project?

15          A    Well, 'cause all the power comes into one source,  
16 and that is the building that collapsed. Yes.

17          Q    So there would have been no power for the period  
18 during which Building B was reconstructed?

19          A    Correct.

20          Q    Isn't it true that had you attempted to let it  
21 and then you tried to rebuild it, you would have ended up  
22 in breach of contract to your new tenants?

23          A    Sure. If you got a demo building right out your  
24 window and rebuild it, then it would be very difficult for  
25 me to lease or retain them.

1           Q    Did you attempt to determine how much it would  
2   cost to install fire sprinklers in the project?

3           A    Yes, because I was informed that, not only do you  
4   have to put them into t-bar like you see 'em here, but you  
5   also have to put them in the attic. And then you also  
6   have to put them in the overhang all the way around on the  
7   exterior and then the exterior attic, because all the  
8   walkway. So it was substantially more than I thought as  
9   far as the total.

10          Q    And what -- do you recall what the total cost  
11   was?

12          A    And I -- I have notes down here, but it was over  
13   \$150,000 or more. I just put plus -- plus for the fire  
14   sprinklers. Because everything has to come in, in an  
15   existing structure to get up and get in, in there and do  
16   it. So everything has to kind of be removed in order to  
17   put it up and then replaced.

18          Q    So when you're talking about removing, you're  
19   talking about doing building parts A and C; correct?

20          A    Correct. Because the code upgrade required me to  
21   do the building, which include -- it is one building  
22   looked at. It's a city APN. So I would be required not  
23   to just do, quote, unquote, "One wing." They're saying  
24   that I'd have to upgrade the whole building.

25          Q    Now, you testified earlier that the HVAC units

1       for the entire building were gone. They were stolen.

2           A    Yes.

3           Q    Did you get a bid to replace all of those?

4           A    We did. And I think part of the bid, even the  
5       numbers I came up with -- with existing and some of the  
6       bids from B was in there, and I think it was 50,000 just  
7       for the B. But then it would also include A and C, or  
8       those wings of that part of the building.

9           Q    Okay.

10          A    So 150,000.

11          Q    Another \$150,000?

12          A    Yes.

13          Q    Ultimately, did you settle with the insurance  
14       company?

15          A    Yes.

16          Q    And what did the insurance company pay in total?

17          A    The total payment was -- and I don't have it in  
18       front of me -- but 1.7-something. I think the State has  
19       it in the --

20          Q    So about --

21          A    -- evidence.

22          Q    -- \$1.7 million; correct?

23          A    That's correct.

24          Q    Was the 1.7 million going to allow you to rebuild  
25       buildings B -- or part B, as well as reconstruct A and C

1 with the damage caused there?

2 A No.

3 Q Did you make a determination of approximately how  
4 much extra money it would take to get the project back  
5 where it was before the loss?

6 A The best you could, because there's a variable  
7 with asbestos and removals and how that goes. But I  
8 think -- you know, I had numbers of -- like, close to  
9 \$1 million additional cost of each of those items that  
10 I've discussed that were excluded from the bids and  
11 excluded from the insurance payment because I was capped  
12 on any of the improvements, and that doesn't include the  
13 lost revenue. It did include some of the payments that I  
14 was going to have continue paying as it was being rebuilt.  
15 So I don't know if you need that or wanting that with or  
16 without the payments but, yes.

17 Q Did you happen to have a million dollars laying  
18 around that you could put into a building or a project?

19 A No.

20 Q Did you go to a bank and ask to finance those --  
21 that work?

22 A I did talk to my banker and -- under the current  
23 condition, and I had a first trust deed already. There  
24 wasn't a sufficient amount of value in its current  
25 condition, or that it was permissible at that time. So

1       they said it wasn't a project they'd be interested in.

2           Q     So the loan to value ratio was already too low?

3           A     Yeah, in the current damaged position.

4           Q     Particularly if they were going to take a second  
5 priority --

6           A     Yes.

7           Q     Did you ever run the numbers to determine, if the  
8 project were rebuilt, whether the cash flow from the rent  
9 would even cover the mortgage payment with the second deed  
10 of trust?

11          A     Well, in that I knew the amount that I was  
12 getting in the lease, I knew it was deficient because I'd  
13 have to go get another loan on top of my existing loan,  
14 and it was barely covering as it was. So --

15          Q     So it was uneconomic --

16          A     It -- clearly.

17          Q     How long after you got the bids did you get your  
18 final payment from the insurance company?

19          A     Well, the one I -- I -- was June. And the  
20 insurance payment, that was June of 2017, and the  
21 insurance -- the final payment in the insurance was June  
22 of 2018. Again, I believe that's all in the records, so  
23 about a year later.

24          Q     Were you following what was happening in the  
25 construction industry in the Fresno area between 2017 and



1       2018?

2           A    Yeah.  Like a lot of areas, there was a lot more  
3       demand than there was supply.  And so everybody -- it was  
4       hard to get people to even give me bids.  And so  
5       construction costs continued to escalate.  And I think we  
6       did communicate that to the State that these costs were  
7       potentially even higher.

8           Q    Isn't it true that you spoke with one of the  
9       contractors that submitted a bid, and they said that those  
10      numbers were out of date?

11          A    Yeah.  I -- I -- because it was a year later.  
12      And they just said that that bid was no longer -- it was  
13      90-day valid, and it's past that time, and you're --  
14      everything has changed.  So I knew it was going to be  
15      higher than even what we've used here as examples, factual  
16      information.

17          Q    So the \$1 million deficiency, approximately,  
18      would have been greater?

19          A    Absolutely.

20          Q    When you sold the project, did you sell it  
21      because it could no longer be economically rebuilt?

22          A    Yes.  And reduce the price accordingly.

23          Q    What did you sell the project for?

24          A    Two million.

25          Q    Did you receive any cash on that sale?

1           A    No.  It was strictly a note.  It was to HOPE,  
2   which is the nonprofit, and it was interest only and no  
3   money down.  Actually, I -- I think the State has that I  
4   gave them money to try to help them with their air  
5   conditionings and what their intention.  And I don't mean  
6   to get ahead of anything that you're going to ask me.  But  
7   their intention was evaluate -- see if construction would  
8   be some of their training strategies for -- for their  
9   training.  So, go ahead.  I didn't mean to keep --

10          Q    It's all right.  And did you take the proceeds,  
11   that note, and assign it in a 1033 exchange for a property  
12   of consistent use?

13          A    I did.  And even in the purchase agreement, both  
14   the sales agreement and the purchase agreement of the  
15   replacement property, it's clearly stated both are aware  
16   that it was a 1033, that that exchange was coming over.  
17   And they pre-approved the note that they were accepting  
18   that as part of the exchange.

19          Q    By "they", you mean the seller of the replacement  
20   property pre-approved the note as --

21          A    That's correct.

22          Q    -- consideration?

23          A    Yes.

24          Q    Were you --

25          A    That's also in -- so a lot of this is in the

1 State's evidence that's highlighted. So it's there, but  
2 it's in the State's side. So it is there.

3 Q Were you required to personally guarantee HOPE's  
4 note to the seller of the replacement property?

5 A I was. To have that as terms to have the seller  
6 comfortably receive that as part of the exchange, I had to  
7 personally guarantee it.

8 Q Are you familiar with 1031 exchanges?

9 A Yes.

10 Q Isn't it true that you have engaged in multiple  
11 1031 exchanges in the past?

12 A Yes. And --

13 Q Isn't it -- isn't it true that you also had  
14 another property that you did a 1031 exchange into the  
15 same replacement property?

16 A Yes. Which 1031 clear, 1033, both of them were  
17 exchanged.

18 Q Had you believed that you needed to do something  
19 other than treat this as a 1033, you could have easily  
20 done a 1031; correct?

21 A Absolutely. Because --

22 Q And you would have, had you believed it be other  
23 than a loss because of the --

24 A I took a note --

25 THE HEARING REPORTER: I need you to please wait

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1 | until the question or answer is finished.
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2 | MR. MITCHELL: Okay.

3 MR. MAGNESS: So I'll -- I'll repeat my question.

4 THE HEARING REPORTER: Thanks.

5 BY MR. MAGNESS:

6 Q Had you believed that the sale was caused by any  
7 reason other than the damage caused by the rain, you would  
8 have done a 1031?

9	A Absolutely.
---	---------------

10 MR. MAGNESS: I've got no further questions of  
11 this witness.

12 JUDGE LONG: All right. Thank you.

13 We'll hold the questions until both witnesses  
14 have testified. So we'll go ahead and let you start with  
15 your second witness, please.

16 MR. MAGNESS: Do you want the State to ask  
17 questions of this witness, or how do you want to proceed?

18 JUDGE LONG: I had planned to hold questions  
19 until after both witnesses had testified. And it looks  
20 like Franchise Tax Board is in agreement with that.

21 MR. MAGNESS: That's fine.

22 JUDGE LONG: So we'll go ahead and have  
23 Mr. McFeeters testify, please. Thank you.

24 | ///

25 | ///

DIRECT EXAMINATION

BY MR. MAGNESS:

Q All right. Mr. McFeeters, you've been sworn.  
Can you please state your full name for the record?

A Yeah. Wilfred John McFeeters.

Q And are you currently employed?

A Yes. I'm semiretired.

Q Do you have a company?

A I have a company, yes.

Q What is the name of your company?

A Wilfred John McFeeters and Associates.

Q And what do you do in that business?

A I provide project management, real estate  
strategies.

Q What was your training in real estate?

A I've done lease and brokerage with Fortune 100  
companies for what they call corporate real estate.

Q Have you provided construction management  
services in the past?

A Yes, in construction management. It's mostly  
from large architectural firms on the architect side.

Q And isn't it true that you also were trained as  
an architect?

A Trained as architect, yes.

Q And when were you hired by Mr. Mitchell?

1           A     During -- during the early stages of 2017.

2           Q     I'm gonna to go back to Exhibit No. 1. Can you  
3 identify to whom that bid was submitted?

4           A     Yes, Quiring Engineering.

5           Q     And who was it sent to? Who is the name of the  
6 client?

7           A     Will McFeeters, me.

8           Q     So was it your job to seek or solicit bids to  
9 determine what it would take to reconstruct --

10          A     Yes.

11          Q     -- the damage?

12          A     Yes.

13          Q     And you solicited bids, from among others,  
14 Bernards and Quiring; correct?

15          A     Yes.

16          Q     And --

17          A     Also, the Bowen, but the Bowen was under me too  
18 for the asbestos and demo.

19          Q     Okay. As part of your assignment, did you  
20 actually go to the project, to the site?

21          A     Yes, I saw the site.

22          Q     Did you observe the buildings or the building  
23 within the project?

24          A     Yes. It's quite dangerous, so I didn't go too  
25 far into it. All of the trusses had collapsed.

1 Q And this is part B; correct?

2 A Yes, part B.

3 Q Did you go into parts A and C as well?

4 A No.

5 Q Okay. Did you determine that -- or did you make  
6 any recommendations about whether the building should be  
7 destroyed or attempt to salvage it?

8 A Yes. I mean, you -- you took a look at the  
9 damage, and you have to say well, you can't really make a  
10 determination on partial reconstruction because you'd have  
11 to -- to get through to see what's really happening. The  
12 truss is collapsed. The outside window is bowed. There  
13 was water damage throughout. There was mold. It was  
14 really pretty disastrous.

15 Q So when you say you have to get through it, are  
16 you saying you have to go into the building itself, remove  
17 the drywall to get to the structure?

18 A Yes. There is partial demo to even determine  
19 your cost of rebuild.

20 Q And that -- were bids submitted to do that  
21 partial demolition?

22 A We determined that instead of partial demolition,  
23 it would have cost way more to do that. It's better to  
24 rebuild new Building At that point within the Building A  
25 or B --

1           Q    Okay.

2           A    -- where the damage was done.  It was better just  
3   to rebuild the whole thing, rather than try to do partial  
4   because that would cost a lot more.

5           Q    And your recommendation was then?

6           A    Yeah.  Let's get bids to rebuild Building B, and  
7   that's what these are --

8           Q    Okay.

9           A    -- along with demo and asbestos.

10          Q    So as a project manager in 2017, 2018, were you  
11   familiar with what was happening in the building industry  
12   in Fresno at that time?

13          A    Yes.  Construction was high.  Lumber was really  
14   high.  Highest we'd ever seen it during that time.  And so  
15   it was difficult to get bids, but we managed to get some.  
16   And they could only hold them for so long because of costs  
17   were even going up.  So --

18          Q    So were you aware that Mr. Mitchell received an  
19   insurance settlement in June of 2017?

20          A    No.  That really wasn't part of my scope.  So,  
21   no, I don't.

22          Q    So your scope ended after you have solicited the  
23   bids.  You got the bids, and then you gave your  
24   recommendation to Mr. Mitchell?

25          A    Yes.



1 MR. MAGNESS: Thank you. No further questions.

2 JUDGE LONG: All right. Thank you.

3 FTB, do you have questions for either witness?

4 MR. DAVIS: I need the mic.

5 MR. MAGNESS: Oh, you need the mic.

6 JUDGE LONG: All right. Please return FTB's  
7 microphone. All right.

8 There you go. Please go ahead and begin when  
9 you're ready.

10 MR. DAVIS: Can I just take one moment to confer  
11 with co-counsel?

12 JUDGE LONG: Of course. Please go ahead.

13 MR. DAVIS: Respondent has no questions for  
14 witnesses.

15 JUDGE LONG: For either witness?

16 MR. DAVIS: For either witness, correct.

17 JUDGE LONG: All right. I'm going to turn to my  
18 co-panelists and ask if either have any questions. I'll  
19 begin with Hearing Officer Elsom.

20 Do you have questions for either witness?

21 HEARING OFFICER ELSOM: I do have a couple of  
22 questions.

23 And I'd just like to start with a little bit of a  
24 history behind this property with respect to your intent  
25 with holding the property.

1                   MR. MITCHELL: Yes.

2                   HEARING OFFICER ELSOM: Can you explain why the  
3 exchange was originally reported as a 1031 exchange? I  
4 know you'd mentioned that if you'd wanted to do a 1031  
5 exchange, you could've. And then at the time that you  
6 signed the lease agreement for this property, did the  
7 potential sale of the Clinton Property factor into your  
8 plans to purchase the Monterey property, which you  
9 eventually exchanged into?

10                  MR. MITCHELL: So first question, and it is filed  
11 in the tax return as an exchange. I think there might  
12 have been some confusion with the bookkeeper as far as  
13 saying 1033 or 1031 or the proper definitions of it. But  
14 all the information from my purchase agreements and  
15 everything that I forwarded to the State, emails, texts  
16 even to the bookkeeper, it was 1033. And I think they  
17 agreed to that early on, that they agreed that portion.  
18 And I think that's why they proceeded and allowed the  
19 insurance to move over, but decided that the building  
20 we're going to treat differently. But it was all in there  
21 that way.

22                  The second part with your question as far as the  
23 building, they had the intention to purchase. And there  
24 was a purchase agreement in the lease, an option to  
25 purchase, and that was at 3.3 million. But this was like

1     15 months later, and the Garden -- or the Monterey  
2     property wasn't even being considered at all because that  
3     was on another exchange. And if you are familiar with a  
4     1031, you only have a small window to identify and  
5     180 days to complete. My understanding in -- in the 1033  
6     is that you didn't have to use an accommodator. You have  
7     two years to do it. You still have to do it with  
8     like-type property, and you had to roll over all the  
9     money.

10           And in the State's information, you'll see that  
11     even in the escrow instructions, it actually notes -- or  
12     excuse me -- the closing statement has the total amount of  
13     insurance proceeds in there and the total amount of the  
14     sale. And I understood that there was a note, and it was  
15     a \$2 million note, and that was exchanged over. And  
16     actually, I never even took constructive receipt of it  
17     because it went from one escrow company to the other  
18     escrow company. So if it was -- when in retrospect, if  
19     the argument was that it didn't -- it wasn't 1033, I would  
20     have said I could have easily paid an accommodator to hold  
21     that note for -- I think it was -- don't hold me exactly,  
22     but I think it was less than 30 or 40 days. That  
23     transaction happened that fast.

24           So it wasn't like I held it, collected money from  
25     it, had any intent to do anything incorrectly. My intent,

1     100 percent all along was that it was 1033. And so the  
2     information that was submitted to the State early on, not  
3     to the investigators or what it would have been, showed  
4     texts, emails, you know, all -- the intent all the way  
5     through.

6             HEARING OFFICER ELSOM: Okay. Thank you. And  
7     just to follow up, this note, it was five years. It was  
8     interest only, and you had guaranteed the note. Was that  
9     note fully paid by HOPE?

10            MR. MITCHELL: So -- so what -- what -- because  
11     it was a nonprofit -- and you can see it's not in  
12     evidence, but I have that the City of Fresno, the State,  
13     and California Endowment provided \$800,000 capital  
14     project. The Community Foundation of Central Valley  
15     California gave them \$200,000, and the city council  
16     president, Tyler Maxwell, gave them \$500,000. And they  
17     are working with them to do the project because it was  
18     good for the community. It was good for, you know, to  
19     train. I mean, their intention is perfect and honorable  
20     and what we need. But I think it -- I think it was paid,  
21     and it was paid with grants and donations from multiple, I  
22     guess, you would say grants or 40 -- or 501(c) donations.

23            HEARING OFFICER ELSOM: Okay. Thank you. That's  
24     very helpful. Second question, again, I want to continue  
25     with the lease negotiations with HOPE. Can you just

1 provide a little more detail regarding the option -- the  
2 purchase option, why that was included in the lease  
3 agreement, and if you had any discussions about renewal  
4 terms? I believe it went month-to-month after the lease  
5 was --

6 MR. MITCHELL: Yeah. That was in there because  
7 their long-term intent was to purchase, and -- and I  
8 wasn't opposed for them to purchase it. We had a price  
9 of 3.3. After the damage I sold it for 2, because I  
10 discounted it exactly the same ratio. And even though I  
11 received 1.7, that 1.7 just made me whole on loss of rent,  
12 the taxes I've paid. So the net -- net, there was no  
13 profit in it. They benefited because they purchased the  
14 property for 2 million instead of 3.3.

15 The intention was they were hoping to do that,  
16 but they had -- they started with three employees. They  
17 had great aspirations, but they had support of the mayor.  
18 They had a lot of support within the community to be  
19 positive, and so I -- I was open to it.

20 HEARING OFFICER ELSOM: Okay. Thank you. And  
21 then last question, you've got a great diagram here,  
22 but --

23 MR. MITCHELL: When I look, it doesn't look so  
24 good. Sorry. I know it's live stream. So --

25 HEARING OFFICER ELSOM: Just purely for context,

1 can you provide or maybe explain some of the prior tenants  
2 that leased this property and how pod B factored into  
3 that, or how it was used?

4 MR. MITCHELL: Yeah. So in -- in pod B, it was  
5 a -- a large -- and I was involved in that at the same  
6 time -- and it was a large open, like, a mortgage  
7 processing thing. So it was a large open space. She  
8 looked at it as an opportunity to -- it was a large  
9 training room, and that was her structure and goal was.  
10 So it was a large open space that had cubicles in it. But  
11 when the roof collapsed, all the computes, all the, you  
12 know, all -- and that was part of the claim because that  
13 was still my -- my property at that time. It was only  
14 40 days that they had been in there.

15 Unfortunately, it was terrible timing for them  
16 and for -- obviously, for me, but it was a large open  
17 area. And so I was occupying it jointly and -- but that  
18 was shortly after '08 because it was mortgage pro -- you  
19 know, everything collapsed; so it had been vacant for a  
20 long time. I think the State even quotes in there that  
21 there was negative -- I think something said to the effect  
22 that I had negative losses previous to that in my tax  
23 return. So you'll see that it wasn't a profitable  
24 situation with a lot of tenants.

25 HEARING OFFICER ELSOM: Okay. And were there

1 customers coming in or, you know, use of that? It was  
2 just --

3 MR. MITCHELL: No. When she -- when they stay --

4 HEARING OFFICER ELSOM: -- mortgage --

5 MR. MITCHELL: -- or no, it was just an outbound.

6 THE HEARING REPORTER: Hold on. Let him finish  
7 his question.

8 MR. MITCHELL: I'm sorry.

9 HEARING OFFICER ELSOM: That's okay. Go ahead  
10 and just explain how --

11 MR. MITCHELL: No customers came in -- in that  
12 particular situation. It was incoming telemarketing or  
13 incoming processing center.

14 HEARING OFFICER ELSOM: Okay. Thank you.

15 MR. MITCHELL: Sorry.

16 JUDGE LONG: All right. Hearing Officer Elsom,  
17 does that conclude your questions?

18 HEARING OFFICER ELSOM: Sorry. No further  
19 questions.

20 JUDGE LONG: All right. Thank you.

21 Judge Hosey, do you have any questions?

22 JUDGE HOSEY: No questions from me. Thank you  
23 both for your time today. I appreciate your testimony.

24 MR. MITCHELL: Thank you.

25 JUDGE LONG: I also have no questions for your

1       either of you.

2               MR. MITCHELL:   Okay.

3               JUDGE LONG:    Thank you for your testimony.

4               Mr. Magness, would you like to continue your  
5 presentation?

6               MR. MAGNESS:   I think I will conclude simply by  
7 giving some closing arguments.

8               JUDGE LONG:    Absolutely, you are welcome to do  
9 that, or you could wait until after Franchise Tax Board's  
10 presentation, and then include all your time in your  
11 rebuttal.

12              MR. MAGNESS:   Then I'll reserve then.

13              JUDGE LONG:    All right. With that, we're going  
14 to go ahead and take a 10-minute recess. The time is  
15 12:02. We're going to return at -- sorry -- 2:12.

16              THE HEARING REPORTER: I'm fine without a break,  
17 if everybody is okay to continue.

18              JUDGE LONG:    Sure. Okay. In that case, we'll go  
19 ahead and continue.

20              FTB, do you need a break before we go to your  
21 presentation?

22              MR. DAVIS:    No.

23              JUDGE LONG:    All right. FTB, you may begin  
24 whenever you're ready.

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1 elevator.

2 In April 2017, the Clinton Property flooded  
3 following a storm. All three buildings were damaged,  
4 although, Building B was damaged more severely. HOPE  
5 continued -- or Respondent understands that HOPE continued  
6 to operate out of Buildings A and C but vacated  
7 Building B. Appellants have acknowledged this  
8 understanding in its opening briefs and its reply briefs  
9 and has never claimed that HOPE only operated out of  
10 Building A, until Mr. Mitchell's testimony today.  
11 Mr. Mitchell chose to let HOPE occupy the Clinton Property  
12 rent free following the storm damage hoping that this  
13 would deter thieves. It is not clear from the record  
14 whether this constituted a new lease or an amendment of  
15 existing lease.

16 Mr. Mitchell received roughly \$1.75 million in  
17 insurance proceeds for the damage to the Clinton Property.  
18 In 2018, Mr. Mitchell sold the Clinton Property to HOPE  
19 for \$2 million and used the proceeds to acquire the Garden  
20 Road Property for \$10 million. Following an audit of  
21 Appellants' 2018 tax year, Respondents -- Respondent  
22 determined that Appellants had a casualty gain on the  
23 receipts of the insurance proceeds and a capital gain on  
24 the sale of the Clinton Property to HOPE. The calculation  
25 of the casualty gain is shown in Exhibit O, and is an

1 insurance proceeds received less one third of the basis as  
2 provided by Appellants. And the casualty gain was  
3 \$1,230,000 -- sorry. It's \$1,230,627 million, and  
4 Respondent did not include this gain in Appellants'  
5 taxable income, and it's not a subject of this appeal.

6 Respondent then calculated the capital gain on  
7 the sale of the Clinton Property to HOPE. Respondent  
8 calculated the gain as being the sale proceeds of  
9 \$2 million less the remaining adjusted basis not used in  
10 the calculation of the casualty gain being one \$1,042,306  
11 for a taxable gain of \$957,694. And Respondent included  
12 this gain in Appellants' taxable income as seen in  
13 Exhibit N.

14 The burden of proof is on Appellants to prove  
15 that Respondent was incorrect in its assessment of  
16 additional tax. In general, taxpayers must recognize a  
17 gain on the sale of property in the year in which that  
18 gain is realized. Under section 1033, a taxpayer may  
19 defer a gain when the property is compulsory or  
20 involuntarily converted, as the result of destruction,  
21 into similar property within two years of the end of the  
22 taxable year in which the gain is realized. In limited  
23 circumstances, property that has not been destroyed may be  
24 sold alongside destroyed property, and the gain may still  
25 qualify for nonrecognition treatment under section 1033.

1           The Tax Court in the case of Masser versus  
2 Commissioner, laid out a four-part test to determine  
3 whether non-destroyed property may be sold alongside  
4 destroyed property and still qualify for nonrecognition  
5 treatment: First, all the sold property must have been  
6 used in taxpayer's business together as one economic unit;  
7 second, a piece of the property must have been  
8 involuntarily sold; third, continuation of the business on  
9 the non-destroyed property must have been impractical; and  
10 finally, the proceeds must be reinvested in similar  
11 property. Appellants must meet all four of the  
12 requirements. Failing any requirement means that the  
13 transaction does not qualify for gain deferral under  
14 Internal Revenue Code section 1033. In this appeal,  
15 Appellants and Respondent agree that the final requirement  
16 was satisfied by Mr. Mitchell's purchase of the Garden  
17 Road Property for \$10 million.

18           However, the Appellants have not met their burden  
19 of proof to show that the other three requirements were  
20 satisfied. Starting with the first requirement, all of  
21 the sold property must have been used together in  
22 Mr. Mitchell's leasing business as an economic unit. In  
23 Revenue Ruling 78-377, the Internal Revenue Service  
24 defined an economic unit as existing when there is a  
25 substantial economic relationship between the destroyed

1 property and the non-destroyed property. A substantial  
2 economic relationship exists when the non-destroyed  
3 property could not have been used without the destroyed  
4 property.

5 The case of Masser versus Commissioner provides a  
6 good example of an economic unit. In Masser, the Tax  
7 Court held that a loading Building And an adjacent parking  
8 lot were one economic unit because the parking lot was  
9 essential to the operation of the business. Appellants  
10 insist that the Clinton Property was an economic unit  
11 because it was one piece of real estate. According to  
12 them, the three -- excuse me. According to them, the  
13 three buildings could not be sold separately. However,  
14 that is not the test of an economic unit. Rather, the  
15 test requires an examination of whether the non-destroyed  
16 property could have practically been used without the  
17 destroyed property.

18 Here, it is clear that Buildings A and C, i.e.,  
19 the non-destroyed property, could have been used without  
20 Building B, the destroyed property, because Buildings A  
21 and C were, in fact, used without the destroyed property.  
22 Mr. Mitchell, continued leasing Buildings A and C to HOPE  
23 after the flooding, and HOPE continued operating out of  
24 the those building. Appellants place undue focus on the  
25 fact that HOPE did not pay Mr. Mitchell rent after the

1 flooding. This argument is misplaced. Mr. Mitchell chose  
2 to let HOPE operate out of the property rent free after  
3 the flooding.

4 The fact that Mr. Mitchell did not charge HOPE  
5 rent does not mean that Buildings A and C did not continue  
6 to be used in his rental business. In fact, Appellants  
7 own tax return supports this analysis. Appellants claimed  
8 expenses related to their leasing business for the Clinton  
9 Property on their 2018 tax return. This proves that they  
10 considered the leasing business to be ongoing after the  
11 flooding and until the sale of the property. HOPE clearly  
12 wanted to continue operating out of the Clinton property  
13 following the flooding, as evidenced by the fact that HOPE  
14 paid Mr. Mitchell \$2 million in 2018 to purchase the  
15 property without any repair work to Building B having been  
16 performed. Even with Building B in its damaged state,  
17 HOPE considered the property worth \$2 million. With this  
18 in mind, it is almost certain that Mr. Mitchell could have  
19 charged HOPE rent to use Buildings A and C, albeit at a  
20 reduced rate from the original \$15,000 a month.

21 The argument that Buildings A and C could not be  
22 used in a leasing business without Building B is,  
23 therefore, inaccurate. Appellants insist that Buildings A  
24 and C could not be used without Building B because the  
25 main bathrooms and utilities were located in Building B

1 with only small bathrooms in Buildings A and C. However,  
2 Appellants have not provided floor plans or other  
3 documentation supporting their contention that all  
4 bathrooms, electrics, communications, and data utilities  
5 were exclusively located in Building B. Moreover, it is  
6 undisputed that HOPE continued to occupy Building A and C,  
7 suggesting that it had sufficient access to bathroom  
8 facilities. Appellants have not explained how HOPE was  
9 able to operate out of Buildings A and C if it did not  
10 access to bathrooms or utilities. As a result,  
11 Building A, B, and C were not one economic unit for  
12 purposes of section 1033.

13 Under the second requirement, the destroyed  
14 property must have been involuntarily sold. In  
15 C. G. Willis, Inc. versus Commissioner, the Tax Court  
16 stated that there is an involuntary conversion when the  
17 taxpayer's property, through some outside force or agency  
18 beyond its control, is no longer useful or available to it  
19 for its purposes. The taxpayer must be compelled to give  
20 up the property. In other words, there cannot be an  
21 involuntary conversion when the taxpayer has a choice  
22 between keeping the property or selling it. In the case  
23 of C. G. Willis, Inc., the taxpayer chose to sell its  
24 damaged ship instead of repairing it, despite receiving  
25 insurance proceeds covering most of the cost of repair.

1           The Tax Court held that the taxpayer was not  
2       compelled to sell the ship because the ship was repairable  
3       and, therefore, the sale did not qualify as an  
4       involuntarily conversion. The Tax Court noted that the  
5       taxpayer may have exercised sound business judgement by  
6       selling the ship, but the mere fact that the taxpayer had  
7       a choice to make just proved that the sale was not  
8       involuntarily. In Revenue Ruling 78-377, the taxpayer  
9       received insurance proceeds for the damage to a shopping  
10      center that had been partially destroyed, but elected to  
11      sell the shopping center instead of repairing it. The IRS  
12      stated that this sale did not qualify for gain deferral  
13      under Section 1033 because the destroyed property could  
14      have been replaced, and the non-destroyed property could  
15      be used without the destroyed property.

16           The facts of this appeal are similar to the case  
17      of C. G. Willis, Inc., and the Revenue Ruling.  
18      Mr. Mitchell owned property that was partially destroyed,  
19      and he received insurance proceeds that covered the vast  
20      majority of the cost to repair. Mr. Mitchell could have  
21      repaired Building B, but instead, he chose to sell the  
22      entire Clinton Property, much like the taxpayer in  
23      C. G. Willis, Inc. Appellants place much emphasis on the  
24      supposed shortfall between the insurance proceeds and the  
25      cost to repair the entire building. However, there is no



1 evidence that a shortfall results in an involuntary  
2 conversion as we saw in the C. G. Willis, Inc., case.

3 Similarly, the amounts of insurance proceeds does  
4 not appear determinative to the outcome in the Revenue  
5 Ruling. Regardless, the cost to repair the Clinton  
6 Property is not known. Appellants submitted a bid showing  
7 a repair cost of just under \$2 million. They have not  
8 proven that any other costs were required beyond this, or  
9 proven that additional expenditures were necessary. The  
10 insurance proceeds were \$1.75 million, covering around  
11 88 percent of the estimated cost to repair. This is  
12 remarkably similar to the taxpayer's situation in  
13 C. G. Willis, Inc., where the insurance proceeds may have  
14 only covered 87 percent of the cost of repair. Regardless  
15 of the exact ratio of insurance proceeds to cost of  
16 repair, the second test states that the taxpayer must be  
17 compelled to give up the property due to circumstances  
18 beyond its control, and the property must no longer be  
19 available for its purpose.

20 Mr. Mitchell was not compelled to sell the entire  
21 Clinton property, as opposed to amending the lease or  
22 repairing Building B. As with the taxpayer in the case of  
23 C. G. Willis, Inc., Mr. Mitchell may have exercised sound  
24 business judgement by electing to sell the Clinton  
25 Property, but the mere fact that he had that choice means

1       he cannot be said to have involuntarily dispose of the  
2       property. Taxpayers cannot choose to pursue more  
3       profitable opportunities elsewhere and also claim the  
4       benefit of section 1033. As such, Appellants have not  
5       satisfied the second requirement of an involuntary  
6       conversion.

7               Under the third requirement of an involuntary  
8       conversion, the taxpayer must show that continuation of  
9       the business on the non-destroyed property was  
10      impractical. Returning to the case of Masser, we can see  
11      an example of when continuation of the business on the  
12      non-destroyed property was impractical. In Masser, the  
13      taxpayer was able to find an alternative parking lot, but  
14      it was a mile-and-a-half away from the main loading zone.  
15      The Tax Court found that operating the business in the  
16      manner would have been expensive, dangerous, and harmful  
17      to customer relationships, and would have led to traffic  
18      management issues in the area. The Court stated that  
19      tax -- excuse me -- the Court stated that the taxpayer  
20      would have had to go to extraordinary lengths to continue  
21      operating its business. And then even after going through  
22      these extraordinary lengths, its operations would have  
23      been incredibly inefficient. As such, continuing the  
24      business on the non-destroyed property was impractical.

25              Appellants' circumstances are markedly different.

1 Mr. Mitchell's leasing business for the Clinton Property  
2 seemingly continued automatically after the flooding.  
3 HOPE continued operating out of Buildings A and C. The  
4 fact that Mr. Mitchell chose to let HOPE lease the  
5 building rent free does not mean the leasing business did  
6 not continue. This is also evidenced by the fact that  
7 Mr. Mitchell continued reporting expenses for this leasing  
8 business into 2018 on Appellants' California tax return.  
9 Appellants insist that the test of impracticality under  
10 Masser is one of mere economics, and that Mr. Mitchell  
11 meets the impracticality test because he could not  
12 economically operate the business after the flooding, and  
13 that there would be a decrease in profits, and operations  
14 would become more difficult.

15 That is not how the Tax Court described  
16 impracticality in Masser. Similarly, the IRS in Revenue  
17 Ruling 78-377, does not consider the profitability of the  
18 taxpayer's business to be important to the issue of  
19 impracticality. Appellants have not provided any legal  
20 support for the notion that a mere reduction of  
21 profitability or an increase in the difficulty of business  
22 operations equates to impracticality. In C. G. Willis,  
23 Inc., the taxpayer incurred additional costs following the  
24 damage to its ship, and business operations were more  
25 challenging.

1           However, the Tax Court held that taxpayers cannot  
2     sell a property to pursue a more proper -- excuse me -- to  
3     pursue a more profitable opportunity elsewhere, and then  
4     claim a deferral of the gain under section 1033. Even  
5     assuming that profitability is important to the test of  
6     impracticality, there is no evidence that Mr. Mitchell  
7     could not have operated the Clinton Property at a profit  
8     after the flooding.

9           Finally, the Appellants argue that continued  
10    ownership of the Clinton Property was impractical because  
11    the Clinton Property would only have been worth \$3 million  
12    after all the repairs. There is no evidence to support  
13    this future-hypothetical evaluation. HOPE previously had  
14    an option to purchase the Clinton Property for  
15    \$3.3 million; however, that had already expired. It also  
16    did not include work done to bring the property up to  
17    modern Building Codes. A repaired and enhanced Clinton  
18    Property would therefore presumably have been worth well  
19    in excess of \$3 million.

20           Regardless, the test is that continued ownership  
21    of the entire property must be impractical. The test is  
22    not whether repairing the damaged portion of the property  
23    would generate a profit. As discussed, Buildings A and C  
24    were available for use even without Building B being  
25    repaired. As such, continued ownership of the Clinton

1       Property was clearly not impractical.

2               To conclude, there are four requirements for an  
3       involuntary conversion where non-destroyed property is  
4       sold alongside destroyed property. All four requirements  
5       must be satisfied. The failure to satisfy any one of  
6       these requirements means Appellants cannot claim a  
7       deferral of gain under Section 1033. Appellants' sale of  
8       the Clinton Property and subsequent purchase of the Garden  
9       Road Property failed to satisfy three of the four  
10      requirements for an involuntary conversion where  
11      non-destroyed property is sold alongside destroyed  
12      property. As such, Appellants have failed to satisfy  
13      their burden of proof and do not qualify for gain deferral  
14      under section 1033.

15             That is the end of my presentation. I would be  
16      happy to take any questions you may have. Thank you.

17             JUDGE LONG: All right. Thank you, FTB.

18             With that, I'm going to turn to my co-panelists  
19      and see if we have any questions for you. I'm going to  
20      begin with Hearing Officer Elsom.

21             HEARING OFFICER ELSOM: Hi. I just had one  
22      question. Appellant had dropped the option price for the  
23      sale of the Clinton Property from \$3.3 million to \$2  
24      million to account in part for this damage and stated the  
25      insurance proceeds were not paid off for 15 months. And

1       then there was problems obtaining a second loan, different  
2       hurdles associated with that. And even if they had, that  
3       cash flow shortage would have occurred.

4               So my question is just with FTB. Maybe at the  
5       audit level or some point during this process, did FTB  
6       obtain any analysis or information to show that Appellant  
7       could have charged rent at a reduced rate? Or is this  
8       being pulled from, basically, the case law that you've  
9       cited, and the fact that Pods A -- I believe only pod A  
10      was rented, according to Appellant's testimony, but the  
11      pod A and let's say pod C had the three to four employees.

12             MR. DAVIS: Yes. Yeah. We believe -- well,  
13      certainly, as we've been discussing in the briefings that  
14      Building A and C were being used, and that hadn't been  
15      challenged up until today. But I am not aware of any  
16      information in the audit record that talks about what  
17      amounts of rent could have potentially been charged. We  
18      just feel that some rent could have been charged using  
19      two-thirds of a property that was being rented for \$15,000  
20      initially. We accept that it wouldn't be the full amount.  
21      However, we would assume that Building A and C has some  
22      value to HOPE. And we think it has value to HOPE because,  
23      I mean, they bought it. So they clearly some value in --  
24      in operating out of it.

25             HEARING OFFICER ELSOM: Okay. Thank you. No

1 further questions.

2 JUDGE LONG: Judge Hosey, do you have any  
3 questions?

4 JUDGE HOSEY: No questions from me. Thank you  
5 for your presentation.

6 JUDGE LONG: All right. FTB I've got one  
7 question for you. I wanted to clarify my understanding of  
8 FTB's position about the Willis case. It sounds like  
9 you're saying the fact that property is repairable after a  
10 fire, flood, anything of that nature, means that the sale  
11 of it is not going to qualify for an involuntary  
12 conversion if the property is repairable; is that correct?

13 MR. DAVIS: Yes, I believe that's correct. I  
14 think to -- an example maybe of when, you know, if it's --  
15 if the property is condemned, for example, something like  
16 that, then -- then we would see an involuntary conversion.  
17 But I would say if it's repairable, then -- then yes.  
18 There's no involuntary conversion.

19 JUDGE LONG: I'd like to ask if there's any sort  
20 of limits on that argument. Because involuntary  
21 conversion isn't necessarily going to always be a  
22 condemnation or use of imminent domain, it can be other  
23 things, like flood in this instance. In the case where  
24 repair costs were astronomical, is there a limit to FTB's  
25 position about the cost to repair being required to be

1 sort of done before you can do an involuntary conversion?

2 MR. DAVIS: Perhaps. I'm not sure how. I would,  
3 again, point to the hypothetical. All the cases that I've  
4 seen are always about condemnations. So it's very  
5 difficult to say when that limit then might be if there  
6 were -- if the cost were so astronomical. I suppose it's  
7 possible, but I -- I think it would be a bit of a  
8 hypothetical. I struggle to answer that one.

9 JUDGE LONG: All right. I understand. Thank  
10 you, FTB.

11 With that, I believe we're going to go ahead and  
12 take a 10-minute break before we get to Appellants'  
13 rebuttal. So the time is 2:24. We will reconvene at  
14 let's say, at 2:35.

15 (There is a pause in the proceedings.)

16 JUDGE LONG: We are going to resume the record.

17 Let's see. Mr. Magness, are you ready to begin  
18 your rebuttal, your closing statement?

19 MR. MAGNESS: I am.

20 JUDGE LONG: All right. Please begin when you're  
21 ready.

22

23 CLOSING STATEMENT

24 MR. MAGNESS: I'd like to begin where the  
25 Franchise Tax Board left up. And let's go back to Masser



1 and take a look at what that case really stood for. It  
2 started with a statement that taxation is imminently  
3 practical. And when we are looking at relief provisions,  
4 such as 1033, we're supposed to liberally apply them, as  
5 opposed to deductions where it's a strict construction.  
6 So that's the start at the premise where we start, and  
7 that's where Masser started.

8 Masser also says that when you're looking at  
9 whether or not the reconstruction repair of damaged  
10 property is economic, you have to take into the -- into  
11 consideration the taxpayer's sound business judgment. So  
12 if you ignore that, then what you've done is you've  
13 basically gone to a straight construction which lays in  
14 the face of what U.S. Supreme Court said in Tyler versus  
15 United States, which says the taxation is imminently  
16 practical. Now, there's a continuum of the law on 1033.  
17 The Franchise Tax Board is ignoring the continuum. So you  
18 have a case such as C. G. Willis, where you have one item  
19 of property that is damaged.

20 You then have the -- the next level of the  
21 continuum where you have, let's say, Revenue Ruling  
22 77377 -- or 78377, that was quoted by the Franchise Tax  
23 Board, where you have one piece of property that is  
24 partially damaged or destroyed; and is it possible to use  
25 what's left excising what was damaged? And then you have

1 the cases, such as Masser, where you have totally separate  
2 properties, two totally legal separate parcels, but  
3 happened to be used in the same business. And that's  
4 where the Franchise Tax Board is living its argument that  
5 we happen to have multiple separate pieces of property, if  
6 you will. And they're arguing that whether you call them  
7 pods, separate building, separate whatever, you have one  
8 parcel of interconnected pieces of construction that only  
9 work together as one.

10 But let's go into what the law says as to each  
11 level of the continuum. So let's go to C. G. Willis. So  
12 what were the facts in C. G. Willis? In C. G. Willis, the  
13 analysis said that -- or the fact said that the -- the  
14 ship could be reconstructed or repaired for between  
15 \$105 -- \$100,500 and \$120,000. And the evidence also  
16 showed that the taxpayer received \$138,870 in insurance  
17 proceeds. So in that case, they received more than  
18 sufficient cash to do the reconstruction. Now, the  
19 Franchise Tax Board is arguing, well, they only received  
20 87 percent of what it actually cost.

21 But what did the case said? It said that where  
22 the restoration of damaged property to its pre-loss  
23 usefulness for the taxpayer's intended business purpose is  
24 not economic. The post-casualty sale of that partially  
25 damaged property is involuntarily. So where is it along

1       that continuum where it becomes uneconomic? Well, you  
2       have to take into consideration the taxpayer's position.

3               It's one thing if I am Bill Gates and I've got \$3  
4       billion that I can throw at a problem, and it's another  
5       thing if I'm Robert Mitchell and I don't have enough cash  
6       to reconstruct -- to do the reconstruction. So if you  
7       treat this Building As one building, this one legal  
8       parcel, one address, one lease, one set of utilities, all  
9       the utilities going into the portion of the building that  
10      was damage; if you treat it as one, was it economic having  
11      received less money and depending on which bids you're  
12      looking at were between \$250 and a million-plus -- and  
13      that's using one-year-old comps, one-years-old bids. So  
14      we knew it was going to be significantly more. And where  
15      you don't have the money and you go talk to your banker,  
16      and the banker won't lend you the money, then by  
17      definition it impracticable. It's uneconomic to undertake  
18      the reconstruction and therefore, the sale under the  
19      C. G. Willis analysis is involuntary.

20             Let's continue on the continuum. So 78377  
21      involved a shopping center. And in that shopping center  
22      you had a fire that partially damage it. That shopping  
23      center had multiple leases with multiple different  
24      tenants, and it was admitted in evidence that that  
25      shopping center could continue operational if you excised

1 the portion that was burned. And it also showed that it  
2 could operate at a profit, if you excised the portion that  
3 was burned.

4 Contrary-wise here, we have one project. And  
5 whether you call them three buildings, one building with  
6 three wings, three separate pods, they were  
7 interconnected. The property that was damaged, the  
8 center-piece, is where all of the utilities came in. If  
9 you excise that piece, you have no utilities for A and C.  
10 Now, the Franchise Tax Board tries to make a big deal out  
11 of the fact that the lease continued and that HOPE  
12 continued to occupy Buildings A and C. Well, that's a  
13 little overstepping what the testimony is, and the  
14 testimony is -- is that you had three employees of HOPE  
15 occupying one room in Building A. And the only way they  
16 could occupy that is because Building C -- or B had yet to  
17 be demolished.

18 They had yet to cut the power so they could  
19 either reconstruct or repair the facility, and they did so  
20 at no rent. So it's not like they were occupying a 10,000  
21 square-foot building or the whole 33,000 square feet of  
22 the building. They're operating out of one office that  
23 happened to have a toilet that would allow the three  
24 people to occupy it. And the evidence is even more  
25 startling that when the HVAC systems were stolen, the only

1 way they were able to occupy it is by putting in,  
2 essentially, a window unit where they vented out through  
3 the original HVAC's ducting. I mean, talk about a hoopty,  
4 right. I mean, it's not like you could go out and lease  
5 this facility in that condition to third parties for any  
6 amount of rent.

7 So what does the taxpayer have to show under  
8 Revenue Ruling 78377? The taxpayer showed the property  
9 sold could not practically have been used without the  
10 replacement of the damaged property. Clearly, this  
11 property could not have been used without the repair and  
12 reconstruction of Building B. As soon as that work  
13 started, nobody could be there. There would be no power.  
14 There would be no water, not until that work was  
15 completed. And the evidence shows that the cost of that  
16 work was more than the insurance proceeds and more than my  
17 client had. And therefore, using sound business  
18 judgement, which is going right back to Masser where we  
19 started, he determined that he had to sell the project and  
20 rolled that money into like replacement property.

21 So Masser, again, this is starting with the  
22 assumption that I have multiple different parcels that  
23 could be legally separated off and sold as separate  
24 parcels. We don't have that here. We have one parcel,  
25 one address, one access to the roof, one shared bathroom,

1 one shared set of utilities, one meter for electricity for  
2 water; and therefore, once that central portion into which  
3 all of those utilities came, is destroyed. The rest of  
4 the project is not usable. And then going back into  
5 Masser, we have to show that it's impracticable to  
6 rebuild.

7 The actual wording was, that we have to determine  
8 with the exercise of good business judgment, that you can  
9 economically operate in the after condition. We couldn't  
10 do that here. And therefore, even under Masser, if we  
11 assumed we had multiple different parcels, we would still  
12 qualify as the decision to sell after the loss once you  
13 determined what it would cost to rebuild. And, you know,  
14 there is a timing delay, right. Whenever you have a loss,  
15 the interest company is going to come in. They have to  
16 adjust the loss. Where there is a disagreement between  
17 the taxpayer and the insurer, as was the case here, you're  
18 going to have to continue to have negotiations between the  
19 insurer and the insured to determine how much would  
20 ultimately be paid.

21 Unfortunately, we were in a time where there was  
22 great inflation. The costs of construction were going up.  
23 The bids that were received to do the repair in June of  
24 2017 were obsolete by the time we received the money to do  
25 that repair. And even if I used the bids from a year

1 earlier, the money we received was insufficient to do the  
2 job. Did HOPE now see economic usefulness in the  
3 property? Yes. But their economic use of it is  
4 irrelevant. What their sources of funding are, what the  
5 purpose to which they were going to put the building is  
6 irrelevant. Because in every one of these 1033 cases,  
7 somebody is buying the damaged property. You always have  
8 a buyer.

9 Now, if it's a condemnation, it's a government  
10 agency that's buying it. They see usefulness to it in  
11 some way. Or it's a private buyer. That private buyer  
12 has a different set of economics than the seller. But  
13 from the purpose -- for the purposes of today, whether or  
14 not this exchange qualifies under 1033 for deferral, we  
15 aren't avoiding income tax. We're just deferring when  
16 it's recognized and when the tax is paid. You look at the  
17 economic situation of the taxpayer, and the evidence shows  
18 that it was uneconomic to repair and replace the center  
19 portion of this building pod B, Building B, however you  
20 want to label it. It could not be done by my client and  
21 make this still an economic viable business. You have to.

22 In all tax cases, I've never seen a tax case  
23 argued where it doesn't matter whether you make a profit  
24 or not. The only time I've ever seen that is when we're  
25 doing hobby losses, and the IRS comes in and says, you're

1     only losing money and therefore, it's not a real business;  
2     and therefore, you can't take the deductions. This isn't  
3     that. We have a piece of real estate that was leased --  
4     that was purchased to make money. That was the purpose of  
5     it. And in the end we suffered a casualty loss that  
6     basically precluded my client from making money with that  
7     project. Whether the buyer can make money on it or  
8     fulfill their charitable purpose, that's great. But for  
9     the taxpayer it was uneconomic, and he had to sell.

10           The sale was directly tied to the involuntary  
11     loss, the casualty loss and therefore, the findings of the  
12     Franchise Tax Board should be overturned. And the only  
13     decision, in my opinion -- and I'm being humble because  
14     it's your opinion that counts -- is that this wasn't  
15     involuntary conversion. The 1033 exchange should be  
16     allowed, and the Franchise Tax Board will have ample time,  
17     if and when my client sells, to recover whatever gain  
18     would -- was realized but not recognized in this  
19     transaction.

20           And with that, I will rest.

21           JUDGE LONG: All right. Thank you for your  
22     presentation. I do have one question just to confirm for  
23     the record. I want to make sure I understand. And this  
24     question is actually regarding the witness testimony. I  
25     want to understand if there was electrical for Building B



1 after the loss. I recall -- I apologize -- electrical for  
2 Building A where the HOPE tenants occupied, because my  
3 understanding is that Building B contained the electrical  
4 components, but they were able to operate a window air  
5 conditioning unit in Building A.

6 MR. MAGNESS: Yes.

7 MR. MITCHELL: Yes. So they stripped a lot of  
8 the stuff off B. The utility was still there. But if I  
9 had to come and demo it, along with the bathrooms and  
10 everything like that, but there was enough over there.  
11 But all the air conditioning was out, but they had enough  
12 conduit coming over because they stripped a lot of the  
13 stuff in between. The question is, as being stated, is  
14 once I demoed it, there would be no electricity available.  
15 But a large portion of everything else had no electricity  
16 because the conduit or the wires were removed.

17 JUDGE LONG: All right. Thank you. I just  
18 wanted to confirm.

19 And then I had one question for Mr. Magness.  
20 During FTB's presentation, they said that Appellants'  
21 return showed that expenses related to the Clinton  
22 Property were reported, and that showed that the leasing  
23 business was ongoing after the flooding. Would you like  
24 to respond to that argument of FTB's.

25 MR. MAGNESS: The taxpayer is required to report

1 all of their expenses. And the evidence shows that once  
2 the loss incurred, the expenses of the ownership and  
3 operation of the business continued, right. You have to  
4 maintain that property. You have to keep the -- the  
5 landscaping up. You have to keep the -- the premises  
6 clean. You have to make sure that the utilities are paid,  
7 the property taxes are paid, and the mortgage is paid.  
8 And the taxpayer is required to report all of those  
9 expenses. It also shows they didn't have any revenue.  
10 They had no income at that point in time. And so their  
11 expenses associated with that rental property would not  
12 have terminated until it was sold.

13 JUDGE LONG: All right. Thank you. That  
14 concludes my questions.

15 I'm going to turn to my panelists for other  
16 questions.

17 Hearing Officer Elsom, do you have any questions  
18 for either party?

19 HEARING OFFICER ELSOM: I have no additional  
20 questions. Thank you.

21 MR. MAGNESS: Thank you.

22 JUDGE LONG: All right. Judge Hosey, do you have  
23 any questions for either party?

24 JUDGE HOSEY: No questions from me. Thank you.

25 MR. MAGNESS: Thank you.

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JUDGE LONG: All right. With that, do we have any questions from either party before we close the record? All right. I'm seeing shaking heads.

So with that, this case is submitted on October 7th at 2:53 p.m. The record is now closed.

I want to thank everyone for participating today. The judges will meet, deliberate, and decide your case. We will issue a written an opinion within 100 days.

Today's hearing in the Appeal of Mitchell is now concluded.

(Proceedings concluded at 2:55 p.m.)

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I, Ernalyne M. Alonzo, Hearing Reporter in and for  
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That the foregoing transcript of proceedings was  
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I further certify that I am in no way interested  
in the outcome of said action.

I have hereunto subscribed my name this 23rd day  
of October, 2025.

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