

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.)
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TRANSCRIPT OF PROCEEDINGS

Fresno, California

Tuesday, October 7, 2025

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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2 STATE OF CALIFORNIA

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14 Transcript of Proceedings, taken at
15 855 M Street, Suite 960, Fresno, California,
16 93721, commencing at 1:09 p.m. and concluding
17 at 2:55 p.m. on Tuesday, October 7, 2025,
18 reported by Ernalyne M. Alonzo, Hearing Reporter,
19 in and for the State of California.

1 APPEARANCES:

2

3 Panel Lead: ALJ VERONICA I. LONG

4

5 Panel Members: ALJ SARA A. HOSEY
HEARING OFFICER SETH ELSOM

6 For the Appellant: R. MITCHELL
MARCUS D. MAGNESS
W. MCFEETERS

7

8 For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

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10 CHRIS DAVIS
JACKIE ZUMAETA

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

6

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

8

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

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APPELLANT'S
WITNESSES: DIRECT CROSS REDIRECT RECROSS

17

Mr. Mitchell 9

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Mr. McFeeters 37

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By Mr. Magness 64

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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.

(Appellant's Exhibits 1-8 were received into 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.)

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.

With that, I'm going to place you both under oath
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:

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R. MITCHELL,

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JUDGE LONG: Thank you.

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PRESENTATION

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STATE OF CALIFORNIA OFFICE OF TAX APPEALS

DIRECT EXAMINATION

2 | BY MR. MAGNESS:

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

6 A Yes. 4 -- I have to get it. Sorry.

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

9 MR. MITCHELL: Oh, okay.

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

15 MS. ZUMAETA: Yeah.

16 THE HEARING REPORTER: That we be helpful. Thank
17 you.

18 MS. ZUMAETA: Absolutely.

19 BY MR. MAGNESS:

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

23 A Yes. 4974 East Clinton Way in Fresno,
24 California.

25 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

1 until the question or answer is finished.

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. McFeeeters testify, please. Thank you.

24 ///

25 ///

DIRECT EXAMINATION

2 | BY MR. MAGNESS:

3 Q All right. Mr. McFeeeters, you've been sworn.

4 Can you please state your full name for the record?

5 A Yeah. Wilfred John McFeeters.

6 Q And are you currently employed?

7 A Yes. I'm semiretired.

8 Q Do you have a company?

9 A I have a company, yes.

10 Q What is the name of your company?

11 A Wilfred John McFeeters and Associates.

12 Q And what do you do in that business?

13 A I provide project management, real estate
14 strategies.

15 Q What was your training in real estate?

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

18 Q Have you provided construction management
19 services in the past?

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

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

24 A Trained as architect, yes.

25 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 A 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.

25 ///

PRESENTATION

2 MR. DAVIS: Good afternoon. I am Chris Davis,
3 representing Respondent Franchise Tax Board, and I'm here
4 with my co-counsel Jackie Zumaeta.

5 This issue in this case is whether Appellants are
6 entitled to defer the recognition of a capital gain, of
7 roughly \$2 million, as an involuntarily conversion under
8 Internal Revenue Code section 1033. During '27 -- excuse
9 me. During 2017 and 2018, Mr. Mitchell, one of the
10 Appellants, owned a piece of real estate, referred to as
11 the Clinton Property. The Clinton Property consisted of
12 three interconnected buildings, referred to as Building A,
13 Building B, and Building C. These are -- excuse me.
14 Sorry. These were the names used by the -- the taxpayer
15 as we can see in Appellants' opening brief where they
16 mentioned that those are the terms used by the taxpayer
17 for those buildings.

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 involuntarily 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 involuntarily 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 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.

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

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

6 I want to thank everyone for participating today.

7 The judges will meet, deliberate, and decide your
8 case. We will issue a written an opinion within 100 days.

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

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

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HEARING REPORTER'S CERTIFICATE

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

5 That the foregoing transcript of proceedings was
6 taken before me at the time and place set forth, that the
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12 I further certify that I am in no way interested
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14 I have hereunto subscribed my name this 23rd day
15 of October, 2025.

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HEARING REPORTER