

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
S. FARAH) OTA Case No. 220810976
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OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: A. Lavar Taylor, Attorney

For Respondent: Peter Kwok, Attorney

S. RIDENOUR, Administrative Law Judge: On July 10, 2025, the Office of Tax Appeals (OTA) issued an Opinion sustaining the action of respondent Franchise Tax Board (FTB) proposing additional tax of \$137,171 and applicable interest for the 2015 tax year. In the Opinion, OTA held that appellant’s receipt of her community property interest in an arbitration award is includable in her gross income for the 2015 tax year.¹

On August 11, 2025, appellant timely filed a petition for rehearing (petition) with OTA under Revenue and Taxation Code (R&TC) section 19048 on the basis that OTA’s Opinion is contrary to law since OTA “committed multiple legal errors.” Upon consideration of appellant’s petition, OTA concludes that the ground set forth in her petition does not constitute a basis for granting a new hearing.

OTA will grant a rehearing where one of the following grounds for a rehearing exists and materially affects the substantial rights of the party (here, appellant) seeking a rehearing: (1) an irregularity in the appeal proceedings which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise, occurring during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered evidence, material to the appeal, which the party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient

¹ The Opinion separately held that (1) appellant’s receipt of her community property interest in an arbitration award is includable in her gross income, and (2) the amount appellant received is includable in her gross income for the 2015 tax year.

evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law in the OTA appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Shanahan*, 2024-OTA-040P.)

The “contrary to law” standard of review shall involve a review of the Opinion for consistency with the law. (Cal. Code Regs., tit. 18, § 30604(b).) The question of whether a decision is contrary to law is not one that involves a weighing of the evidence, but instead requires a finding that the decision is “unsupported by any substantial evidence;” that is, the record would justify a directed verdict against the prevailing party. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 907; *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.) This requires a review of the Opinion in a manner most favorable to the prevailing party (here, FTB) and indulging in all legitimate and reasonable inferences to uphold the Opinion. (*Appeal of Shanahan*, *supra*.) A rehearing may be granted when, examining the evidence in the light most favorable to the prevailing party (here, FTB), with all legitimate inferences to uphold the Opinion, the petitioning party (here, appellant) establishes that the Opinion incorrectly stated or applied the law and, therefore, is contrary to law. (*Ibid.*)

Appellant contends that OTA’s holdings “are without merit.” Appellant asserts that: (1) OTA’s Opinion “impermissibly based its holding on facts that never occurred”; (2) there is no case law to support a finding that “community income earned in 2013 is taxable to [a]ppellant in 2015”; and (3) OTA’s holdings “will wreak havoc among Family Law Practitioners and Family Law Courts in California” if they are allowed to stand.

Appellant argues that OTA’s finding that there was a transfer of the arbitration claim to appellant in 2015 “is based on ‘facts’ that never occurred.” Appellant contends that the “‘claim’ no longer existed” in 2015 since it was “satisfied by the payment of money” to M. Farah, appellant’s former spouse, in 2013, and what was transferred to appellant in 2015 “was cash, not a “claim.” Appellant asserts that “[n]othing was transferred to [her] prior to 2015, and it was legally improper” for OTA to conclude otherwise. Appellant, referring to the Opinion,² argues that since OTA “acknowledged that [M. Farah] never transferred to her an unliquidated

² Appellant references the following portion of the Opinion:

Moreover, at the time of the divorce, the possible outcome of the arbitration claim, let alone any possible community property interest in the outcome, was unknown. As such, appellant and M. Farah could not have “reached this settlement at the time of their divorce.” At most, appellant and M. Farah could have reached a settlement at divorce agreeing that M. Farah would transfer an interest in the arbitration claim to appellant. [Footnote] **However, that did not transpire, . . .** (Bold added by appellant.)

arbitration claim, it is nonsensical” for OTA to have found that such a transfer occurred for purposes of resolving the appeal. Appellant argues that since appellant “received cash” rather than “a ‘claim’ that generated cash in a later taxable year,” it “is likewise nonsensical” that OTA distinguished the present matter from *Balding v. Commissioner* (1992) 98 T.C. 368 (*Balding*), and found it similar to *Witcher v. Commissioner*, T.C. Memo. 2002-292 (*Witcher*).

OTA finds appellant’s reliance on the spouse in *Balding* receiving settlement payments (i.e., cash) rather than “a ‘claim’ that generated cash in a later taxable year” to contend that this matter is more akin to *Balding*, as opposed to *Witcher*, to be misplaced. As elucidated in the Opinion, in *Balding*, the taxpayer’s *release of rights* to military benefit pay in exchange for settlement payments was found by the tax court to be a transfer of property. In *Witcher*, the taxpayer did not relinquish her rights to a retirement plan; rather, the retirement plan was divided among the spouses and the taxpayer received her share directly. The tax court in *Witcher*, distinguishing it from *Balding* since the taxpayer in *Witcher* received her payments “as a result of her retained ownership interest in her former spouse’s military pension,” stated that even if it was “to assume, arguendo, that the division of the military pension effected a transfer of property to [the taxpayer] subject to [Internal Revenue Code (IRC)] section 1041, [the taxpayer] has no basis in such property, and thus the full amount of the pension distribution to her is includable in her income.” (*Witcher, supra*, at p. *3.) Here, appellant did not release her rights to the arbitration claim, let alone the arbitration award, in exchange for payment (i.e., like the taxpayer in *Balding*); rather, appellant received her payment “as a result of her retained ownership interest” in the community property portion of the arbitration claim (i.e., like the taxpayer in *Witcher*).

As discussed in the Opinion, since appellant and M. Farah did not reach a settlement at divorce agreeing that M. Farah would transfer an interest in the arbitration claim to appellant,³ the Minute Orders adjudicated *the omitted asset* (i.e., the arbitration claim). The Superior Court for the County of Orange (Superior Court) found that appellant had a community property interest in the omitted *arbitration claim*, and as such, transferred to appellant her portion of the arbitration claim. Since the Superior Court issued the Minute Orders after the arbitration claim was already converted to an arbitration award, the Minute Orders ordered that appellant receive payment from the arbitration award for her retained interest in the arbitration claim. As such,

³ As explained in the Opinion, in such a situation, while the transfer of an interest in the arbitration claim at the time of divorce may have qualified for nonrecognition treatment under IRC section 1041, the amount appellant thereafter received would nevertheless be includable in her gross income. (See *Witcher, supra*.)

OTA correctly found that it was the transfer of the arbitration *claim* that qualified for nonrecognition treatment under IRC section 1041, not the resulting payment for appellant's retained interest of the arbitration award. The Opinion expounded on this by noting that since neither appellant nor M. Farah had a basis in the arbitration claim, while the division of the arbitration claim effected a transfer of property to appellant subject to IRC section 1041, appellant had no basis, transferred or otherwise, in such property, and thus the full amount of the arbitration award she received is taxable and therefore includable in her income.

Appellant also argues that OTA's findings that the amount is includable in her gross income for the 2015 tax year is "clearly wrong" and "violates well-established principles" set by the U.S. Supreme Court regarding taxation of community property. In support, appellant refers to *U.S. v. Mitchell* (1971) 403 U.S. 190 (*Mitchell*) and *Bagur v. Commissioner* (5th Cir. 1979) 603 F.2d 491 (*Bagur*). In *Mitchell*, the Supreme Court held that a married woman domiciled in the community property state of Louisiana was personally liable for the federal income tax on half of the community income realized during the existence of the community despite exercising her statutory right to exonerate herself from debts contracted during the marriage "by renouncing the partnership or community of gains." (*Mitchell, supra.*)

In *Bagur*, a consolidated appeal of *Bagur* and *Hansen*, the court held that although the wife in both situations had no control over their husband's income, and no knowledge of what it was or where it went, they were nevertheless responsible for the income tax due on one-half of their husband's income, even when the spouses lived in separate residences. The court noted that a wife domiciled in the community property state of Louisiana "has a present, vested, undivided one-half ownership of the property acquired during the marriage, including her husband's earnings." (*Bagur, supra*, 603 F.2d at p. 493.) The court stated that "a marriage contracted in Louisiana 'superinduces a partnership or community' of gains" (*Id.* at p. 497), and in that partnership is "the status of the wife as a partner and her ownership of half of the community property from the instant of its acquisition is unaffected" (*Id.* at p. 499, quoting *T. L. James & Co., Inc. v. Montgomery* (La. 1975) 332 So.2d 834). The court further stated that at "the dissolution of a marriage [i.e., the partnership] the effects that compose the community are divided into equal portions. . . ." (*Bagur, supra*, 603 F.2d at p. 497.)

Appellant asserts that *Mitchell* and *Bagur* affirm the principle that each spouse in a community property state must report 50 percent of community income in the year in which one of the spouses receives the community income, even if the spouse that did not receive any portion of that community income during the applicable tax year, has no means of ascertaining the amount earned, never receives his or her share of community income, and never receives a

benefit from the earnings. Appellant contends that both cases and their progeny “make it clear that, in the present case, the receipt of community income by [M. Farah] in 2013 meant that [a]ppellant’s share of that community income was reportable on her 2013 tax return” and that such “income cannot possibly be taxed in 2015, or in any other year.”

OTA finds that appellant’s reliance on *Mitchell* and *Bagur* is misplaced. In both cases, the spouses were married when the community received the amounts in question: A. and E. Mitchell married in 1946 and A. Mitchell sued for marital separation in 1961, which was after the 1955 through 1959 tax years at issue; B. and D. Hansen were married and living together during 1971, the tax year at issue, and it was not until 1972 that the couple began to live separately and obtain legal separation; and, A. and P. Bagur were married during the 1960 through 1966 tax years at issue, and while the couple separated in 1962, they did not obtain a legal “separation from bed and board” prior to their divorce in 1968.⁴ (*Mitchell, supra; Bagur, supra.*) In other words, for each couple there remained the *existence of the “community” during the tax years at issue.*

Here, however, when appellant and M. Farah divorced in 2012, they dissolved the community that they had formed upon marriage. As noted in the Opinion, once the marriage is dissolved, the marital community no longer exists and, therefore, the “community” cannot own property. (*Henn v. Henn* (1980) 26 Cal.3d 323, 330 (*Henn*)). While appellant states that “each spouse in a community property state must report 50 percent of community income in the year in which one of the spouses receives the community income,” appellant then argues that “in the present case, the receipt of community income by [a]ppellant’s former husband in 2013 meant that [a]ppellant’s share of that community income was reportable on her 2013 tax return.” (Italics added.) OTA is not persuaded by appellant’s attempt to interchange “spouse” with “former” spouse in such context. While the Superior Court found in 2015 that a portion of the arbitration award was community property, the character of the property does not change the fact that when M. Farah received it, the marital “community” no longer existed.

Despite appellant’s contention to the contrary, IRC section 451(a) and Treasury Regulation section 1.451-1(a) are controlling as to when the amount appellant received is includable in her gross income. As noted in the Opinion, once the marriage is dissolved, the “community” cannot own property; instead, unadjudicated community property is held post-dissolution by the parties as tenants-in-common. (*Henn, supra*, 26 Cal.3d at p. 330.)

⁴ According to former Louisiana Civil Code Article 2356, as applicable when *Bagur* was decided, “[t]he legal regime of community property terminates by the death of a spouse or by a judgment of divorce, separation from bed and board, or separation of property.”

Upon appellant’s and M. Farah’s divorce, they were no longer a “single economic unit”—i.e., there was no “marital community” between them—such that appellant could be found to have constructive receipt of community property acquired post-divorce and in M. Farah’s possession. Since appellant did not constructively receive the income prior to her actually receiving it in 2015, the amount at issue is includible in appellant’s gross income for the 2015 tax year, the year appellant actually received the funds. (IRC, § 451(a); R&TC, § 17551; Treas. Reg. § 1.451-1(a).)

As for appellant’s contention that OTA’s holdings “will wreak havoc among Family Law Practitioners and Family Law Courts in California,” such an argument is not a ground for a rehearing. Moreover, OTA’s role in the appeals process is to determine the correct amount of the taxpayer’s California income tax liability based on the law. (*Appeal of Robinson*, 2018-OTA-059P.)

For the aforementioned reasons, OTA finds that appellant has not established a ground exists for a rehearing pursuant to California Code of Regulations, title 18, section 30604(a). Furthermore, as to appellant’s repeated arguments which were considered and rejected in the Opinion, they do not constitute grounds for rehearing. (*Appeal of Shanahan, supra.*) Likewise, appellant’s dissatisfaction with the outcome of the appeal is not grounds for a rehearing. (*Ibid.*) Accordingly, appellant’s petition is denied.

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Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

We concur:
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Erica Parker
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Erica Parker
Hearing Officer

DocuSigned by:
Asaf Kletter
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Asaf Kletter
Administrative Law Judge

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