

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 230312734
J. RICE AND)
F. RICE)
_____)

OPINION

Representing the Parties:

For Appellants: Andre Helms, Representative
F. Rice

For Respondent: David Hunter, Attorney

For Office of Tax Appeals: Oliver Pfof, Attorney

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Rice and F. Rice (appellants) appeal an action by the Franchise Tax Board (respondent) proposing additional tax of \$96,597 and applicable interest for the 2016 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Josh Lambert, Teresa A. Stanley, and Sheriene Anne Ridenour held a virtual oral hearing for this matter on April 16, 2025. At the conclusion of the hearing, the record was held open to allow the parties to provide additional briefing. After briefing was completed, the record was closed on November 26, 2025, and this matter was submitted for an opinion.

ISSUE

Whether appellants have established entitlement to additional basis in real property located in La Jolla, California?

FACTUAL FINDINGS

The La Jolla Property

1. Appellants purchased a vacant lot in La Jolla, California, for \$495,000.
2. In 1993, appellants built a three-story, 5,327 square foot home on the vacant lot (the La Jolla property), which served as appellants' principal residence from 1993 to 2016.

3. On September 1, 2016, appellants sold the La Jolla property to E. Bastarache for \$3,340,000.

Appellants' 2016 California Tax Return

4. Appellants filed a joint 2016 California Resident Income Tax Return (California return) reporting a long-term capital gain of \$440,000 from the sale of the La Jolla property.
5. Specifically, appellants reported a sale price of \$3,340,000, and claimed a tax basis of \$2,900,000 in the La Jolla property, calculated as follows: \$495,000 for the cost of purchasing the vacant lot; \$830 for land purchase fees; \$2,175,000 for the cost of constructing the residence; \$31,843.50 for capital improvements to the residence; and \$197,326.50 for closing costs paid in escrow.
6. Appellants applied the principal residence exclusion, which excluded long-term capital gain of \$440,000 from appellants' gross income.¹ (Internal Revenue Code (IRC), § 121; R&TC, § 17131.)

Respondent's Examination

7. Respondent examined appellants' California return, and requested appellants provide source expenditure documentation, such as invoices, receipts, credit card statements, bank statements, and construction contracts to substantiate their reported basis.
8. Appellants provided respondent with a closing statement and a seller's final settlement statement, which included purchase fees and closing costs. Appellants also provided 41 checks totaling \$38,062.64, dated April 18, 2007, to August 26, 2016, to substantiate the \$31,843.50 in claimed capital improvements.
9. Appellants informed respondent that upon sale of the La Jolla property, they left the drawings, receipts, and documents related to its construction with E. Bastarache, who kept them in the basement, but the documents were destroyed in late 2017 due to flooding.²

¹ Internal Revenue Code (IRC) section 121, to which California conforms, provides gross income will not include gain from the sale of property if during the five-year period ending on the date of the sale, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. Spouses making a joint return who qualify for the exclusion, like appellants, may exclude up to \$500,000 of gain from the sale of their principal residence from gross income. (R&TC, § 17131; IRC, § 121(a), (b)(1); Treas. Reg. § 1.121-2(a)(3).)

² The record indicates a flood date of September 29, 2017, but also October 1, 2017, as the date of loss. Since the exact date of the flood does not impact the analysis, OTA will state "late 2017" when discussing the flood.

January 2020 Bradford Report

10. Due to lack of records, appellants hired Bradford Fox Builders (Bradford), a San Diego-based California construction company, to provide a construction cost estimate for the La Jolla property. Bradford created its first report on December 2, 2019, which it updated on January 15, 2020 (January 2020 Bradford Report).
11. The January 2020 Bradford Report lists various phases which are each subdivided into divisions (i.e., Phase 1: Setup, Division 1: Plans and Permits; Phase 2: Preparation, Site Work, Division 1: Site Preparation). Each division has a list of items that do not provide itemized prices. Rather, after the list, a single total price for the division is provided. For example, under Phase 24: Floor Covering, is the following:
 - Slate stone tile 24"x24"
 - Carpet floor, including pad and carpet
 - Concrete faux finish on bathroom floors

There is no indication of a glass bridge in this estimate.³ At the end of the list, there is a Division and Phase Total of \$108,420⁴ for Floor Covering, which is the only amount provided under Floor Covering.

12. The January 2020 Bradford Report estimates a subtotal of \$2,907,160. After adding tax, overhead, and profit, the January 2020 Bradford Report estimates a construction cost of \$3,529,082 for the property.
13. In lieu of source documentation to substantiate the claimed basis in the La Jolla property, appellants provided respondent with the January 2020 Bradford Report. Appellants also provided a printout, dated January 16, 2020, from the Consumer Price Index (CPI) inflation calculator available at the U.S. Bureau of Labor Statistics website,⁵

³ For ease of comparison between the various reports, OTA opted to discuss the glass bridge in the La Jolla property. While the glass bridge does not appear to be included in the January 2020 Bradford Report, it is found in a subsequent Bradford report under Floor Covering, as discussed below.

⁴ Amounts relating to estimated construction costs are rounded.

⁵ See https://www.bls.gov/data/inflation_calculator.htm.

indicating that \$3,529,082 in August 2016 has the same buying power as \$2,126,103 in September 1993.⁶

2020 Swift Residential Report

14. On May 8, 2020, respondent's Valuation Team used software from CoreLogic, specifically the CoreLogic – SwiftEstimator/Residential Estimator – Standard Report (Swift Residential program), to prepare its own cost estimate for the La Jolla property (2020 Swift Residential Report).
15. Respondent utilized the CPI Historical Cost Index as of 1993 in preparing the 2020 Swift Residential Report.
16. The 2020 Swift Residential Report indicates a "Cost as of" date of September 1993 for a three story "Single-family Residence" with a floor area of 5,327 square feet and uses "excellent" for both quality and condition of the La Jolla Property. The report has four columns under Cost Data: Description; Units; Unit Cost; and Total. For example, "Microwave Oven" includes two units at a unit cost of \$655, for a total of \$1,310. The 2020 Swift Residential Report does not include a cost for a glass bridge.
17. The 2020 Swift Residential Report estimates a 1993 construction cost of \$885,382 for the La Jolla property.

July 2020 AIPS

18. On July 2, 2020, respondent issued appellants an Audit Issue Presentation Sheet (July 2020 AIPS) discussing its findings.
19. Respondent verified that appellants satisfied the requirements for the IRC section 121 principal residence exclusion and found that appellants provided documentation substantiating the land purchase cost (\$495,000), the land purchase fees (\$830), the sale price (\$3,340,000), and the closing costs paid in escrow (\$197,327) of the La Jolla property.

⁶ OTA, noting the 2016 date used in the CPI inflation calculator, asked appellants to clarify why they "chose to compare August 2016 to September 1993, as opposed to comparing the actual date the Bradford Fox Report was completed (2019 or 2020) to 1993" (i.e., the year of construction). Appellants responded that:

[T]he home was constructed in 1993 and sold in 2016. As to 2020, it was this year that the relevant, detailed Keystone construction cost assessment, using the proper CoreLogic Segregated Estimator software, was completed with costs in 2020 dollars. In order to properly estimate the original 1993 construction costs, the CPI calculator was utilized to discount these 2020 dollar construction costs to 1993 dollar construction costs. 2016 is relevant only as the sale year of the house.

20. As for the checks totaling \$38,062.64, respondent found that 16 checks, totaling \$28,383, substantiated appellants' claimed capital improvement costs, and disallowed the remaining as repair costs.⁷
21. Respondent informed appellants of its 2020 Swift Residential Report and the estimated 1993 construction cost of \$885,382 for the La Jolla property.
22. Respondent also informed appellants that after reviewing the January 2020 Bradford Report, respondent added \$10,027 in specialties⁸ and \$8,247 in clean-up, which were not included in the 2020 Swift Residential Report.
23. In total, respondent determined that at the time of sale, appellants' adjusted basis in the La Jolla property was \$1,625,196,⁹ and that appellants understated their gain by \$1,214,804,¹⁰ for additional tax due of \$140,402.

December 2020 Bradford Report

24. Subsequently, Bradford created its third report on October 14, 2020, which it updated on December 5, 2020 (December 2020 Bradford Report).
25. The December 2020 Bradford Report lists various phases, each with eight columns: Specification, Qty, Unit, Material, Labor, SubC, Other, and Price. For example, under Phase 24: Floor Covering, is the following:
 - Marble floor tiles 24"x24" and slabs stair treads from France
 - Qty: 2,546; Unit: SF; Material: \$41.25; Labor: \$15.92; SubC: \$0; Other: \$0; Price: \$145,561
 - Carpet floor, including pad and carpet
 - Qty: 2,180; Unit: SF; Material: \$7.51; Labor: \$2.01; SubC: \$0; Other: \$0; Price: \$20,755
 - Concrete faux finish on bathroom floors
 - Qty: 221; Unit: SF; Material: \$5.78; Labor: \$41; SubC: \$0; Other: \$0; Price: \$10,393
 - Glass Floor Bridge: 1/2" clear temp/0.060 laminate/1/2" clear temp/0.060 laminate/1/2' clear temp
 - Qty: 1; Unit: EA; Material: \$0; Labor: \$0; SubC: \$13,800; Other: \$0; Price: \$13,800

⁷ See IRC sections 263(a), 1011, 1016, and R&TC sections 17260(b), 18031.

⁸ The January 2020 Bradford Report includes Phase 23: Specialties which includes such items as a recessed medicine cabinet and two tempered glass shower doors.

⁹ The \$1,625,196 amount consists of: \$495,000 (land purchase cost) + \$830 (land purchase fees) + \$28,383 (capital improvements) + \$197,327 (closing costs) + \$885,382 (2020 Swift Residential Report construction cost estimate) + \$10,027 (specialties) + \$8,247 (clean-up).

¹⁰ The \$1,214,804 amount consists of: \$3,340,000 (sales price) – \$1,625,196 (adjusted basis) - \$500,000 (IRC section 121 exclusion).

- At the end of the list there is a Division and Phase Total of \$190,508 for Floor Covering.
26. The December 2020 Bradford Report estimates a subtotal of \$3,606,767. After adding tax, overhead, and profit, the December 2020 Bradford Report estimates a 2020 construction cost of \$4,295,960 for the property.

January 2021 Keystone Valuation Report

27. Appellants also hired Keystone Experts + Engineers (Keystone) to provide a residential construction cost valuation report utilizing the Swift Residential program that respondent used to create its report.
28. However, according to Keystone's January 18, 2021 Valuation Report (January 2021 Keystone Valuation Report), CoreLogic representatives advised Keystone that "the CoreLogic Segregated Estimator is the primary tool within CoreLogic to include custom components and features that are not represented in the typical square footage allowances within the CoreLogic Square Foot Estimator."
29. According to Keystone, since it was of the professional opinion that "[n]o off-the-shelf program is sufficiently suitable to account for [appellants'] unique house," it worked with appellants and Bradford to produce the December 2020 Bradford Report, which Keystone then used with software from CoreLogic, specifically the CoreLogic – SwiftEstimator/Segregated Estimator - Summary Report (Swift Segregated program) to prepare a report "captur[ing] the appropriate construction cost for the custom components."
30. Included in the January 2021 Keystone Valuation Report was newly provided documentation, such as external and internal photographs, architecture and engineering drawings, building diagrams, and floor plans of the La Jolla property.

December 2020 Keystone CoreLogic Report

31. Keystone used the costs provided in the December 2020 Bradford Report to prepare its December 2020 Keystone Report.
32. The December 2020 Keystone CoreLogic Report indicates a "Report Date" and a "Base Date" of December 2020 for a three-story "High Value Residence" with a floor area of 5,327 square feet and uses "exceptional" for quality and "excellent" for condition of the La Jolla Property. The report has four columns under "Additions" – system/description; units, cost; and depreciation. For example, under subheading "Built-in construction" is a line in system/description for "Glass Floor Bridge"; 1 unit at a cost of \$13,800; and "No" for depreciation.

33. The December 2020 Keystone CoreLogic Report estimates a 2020 construction cost of \$4,295,961 for the La Jolla property.
34. Keystone, using the CPI Inflation Factor, determined that \$1.00 in 1993 is equivalent to \$1.81 in 2020.
35. Keystone included in the December 2020 Keystone CoreLogic Report a report utilizing a “Report Date” and a “Base Date” of September 1993. Under subheading “Built-in construction” is a line in system/description for “Glass Floor Bridge”; 1 unit at a cost of \$7,624;¹¹ and “No” for depreciation.
36. The December 2020 Keystone CoreLogic Report estimates a 1993 construction cost of \$2,373,459 for the La Jolla property.

January 2021 Keystone Xactimate Report

37. Also included in the January 2021 Keystone Valuation Report is a valuation utilizing the Xactimate Residential Valuation program. Keystone prepared the January 2021 Keystone Xactimate Report utilizing the costs provided in the December 2020 Bradford Report.
38. The January 2021 Keystone Xactimate Report has seven rows: Owner Information; General Information; Foundation; Exterior/Interior; Key Rooms/Attached Structures; User-Defined Features; and Systems. Under “User-Defined Features” is: 1 Glass Floor Bridge (\$13,800 each).
39. The January 2021 Keystone Xactimate Report includes a “Cost Breakdown” listing 15 items: Foundation; Rough Framing; Exterior Finish; Windows; Roofing; Electrical; Plumbing; Heating/AC; Floor Covering; Interior Finish; Appliances; Specialty Features; Additional Features; Pools & Spas; and Pre-Engineered Metal Structure. The items are not itemized; rather, each item is given a single cost. For example, for Floor Covering, the cost is \$124,564; however, there is no mention of a glass bridge in the “Cost Breakdown” information.
40. The January 2021 Keystone Xactimate Report estimates a 2020 “replacement cost” of \$4,187,582 for the La Jolla property.

2021 Swift Residential Report

41. Respondent’s Valuations Team reviewed the January 2021 Keystone Valuation Report and the newly provided documentation, and sent appellants a letter dated

¹¹ I.e., $\$13,800 \div 1.81$.

- August 4, 2021, notifying them that based on its review, respondent revised its 1993 construction cost estimate from \$885,382 to \$1,251,435.
42. Respondent included information it used for its estimate. For example, under “Additions” is “Glass Bridge” with the notation that respondent did internet research for the pricing and: “Glass bridge 4’X6’=24sf. Research indicates range of [\$]100 to [\$]1,000 per sf. Using middle amount of [\$]450.”
 43. Respondent’s Valuation Team used the Swift Residential program to prepare its revised estimate (2021 Swift Residential Report). The 2021 Swift Residential Report includes a line item “Glass Bridge” and 24 units at a unit cost of \$561,¹² for total cost of \$13,462 for the glass bridge.
 44. Respondent determined that appellants’ adjusted basis was \$1,962,866¹³ at the time of sale, and that appellants understated their gain by \$877,134,¹⁴ for additional tax due of \$96,597.

Proposed Assessment & Protest

45. On October 27, 2021, respondent issued appellants a Notice of Proposed Assessment (NPA) proposing additional tax of \$96,597, plus applicable interest.¹⁵
46. Appellants timely protested the NPA, and on February 3, 2023, respondent issued a Notice of Action affirming the NPA.
47. Appellants timely filed this appeal.

OTA Appeal

48. Upon inquiry from OTA during the appeal, respondent noted that the \$28,383 in previously allowed capital improvements is not included in the revised calculation of

¹² OTA notes that while respondent indicates that it would use the “middle amount” of \$450 per square foot to estimate the glass bridge cost, the 2021 Swift Residential Report uses \$560.91 per square foot to estimate a total cost of \$13,462 for the glass bridge, a difference which is in appellants’ favor.

¹³ The \$1,962,866 amount consists of: \$495,000 (land purchase cost) + \$830 (land purchase fees) + \$197,327 (closing costs) + \$1,251,435 (2021 Swift Residential Report construction cost estimate) + \$10,027 (specialties) + \$8,247 (clean-up). This amount does not include the \$28,383 in capital improvements.

¹⁴ The \$877,134 amount consists of: \$3,340,000 (sales price) - \$1,962,866 (adjusted basis) - \$500,000 (IRC section 121 exclusion).

¹⁵ The NPA was timely since appellants signed a waiver extending the statute of limitations for respondent to issue a proposed assessment for the 2016 tax year to June 29, 2022. (R&TC, §§ 19057, 19067.)

appellants' tax basis, as reflected in the NPA. After applying the allowed capital improvements, the updated adjusted basis is \$1,991,249, for an updated proposed understated capital gain of \$848,751. During the appeal, respondent also provided a declaration of J. Davis, an employee of respondent's Valuation Team, dated and signed under penalty of perjury on May 8, 2023.

49. At the hearing, appellants called M. Christopher, president at Christopher+Kagur Architects, Inc., and C. White, director of building consultancy at Keystone, as expert witnesses. M. Christopher presented a slide presentation titled "Rice Residence – Exceptional Quality and Uncommon Characteristics," and a real estate video of the La Jolla property uploaded onto YouTube on October 15, 2013.
50. After the hearing, appellants provided additional information, including a copy of the SwiftEstimator Help Guide for Single-Family Residence Excellent Quality,¹⁶ the CoreLogic calculator method guide for High-Value Residences,¹⁷ and two cost estimate reports using the CoreLogic – Swift Estimator/Segregated Estimator – Detailed Report software purportedly utilizing the "High Value Residences" calculator guide.
 - a. The first report indicates a survey date of September 1993 and a cost-as-of-date of April 2025 (2025-1 Segregated Report) for a three story "High Value Residence" with a floor area of 5,327 square feet and uses "exceptional" for

¹⁶ According to the Single-Family Residence Excellent Quality guide:

Residences of Excellent Quality are usually individually designed and are characterized by the high quality of workmanship, finishes and appointments and the considerable attention to detail. Although residences at this quality level are inclusive of high-quality material and workmanship, and are somewhat unique in their design, these costs do not represent the highest cost in residential construction.

The Excellent Quality does not include the extremely expensive homes, but is a very gracious residence, usually designed individually, with good detail and workmanship. Special attention is given to both the quality and the quantity of exterior and interior ornamentation. Better quality floor and wall coverings may be found.

If costs are needed for truly high-value or luxury-type homes, up to double the cost of this quality and as large as 20,000 square feet, consider ordering our manual, "*Exceptional Homes: A Cost Guide for High-value and Unique Residences.*"

(Bold and italics in original.)

¹⁷ According to the "High-Value Residence" guide:

The high-value or luxury residence is of individual design with many varied interior appointments. As such, it would best be costed by the Segregated Method, where the pricing level of each component can be considered in detail and further refined from Unit-in-Place where necessary.

quality and “excellent” for condition of the La Jolla Property. Under the subheading “Floor Structure” is a 1 unit “Custom Glass Bridge” at a cost/cost new/depreciation cost of \$22,317. The 2025-1 Segregated Report estimates a 2025 construction cost of \$6,495,795 for the La Jolla property, followed by the last line indicating “Improvements New as of 12/2020” of \$4,696,081.¹⁸

- b. The second report also indicates a survey date of September 1993 and a cost as of date of April 2025 (2025-2 Segregated Report). The 2025-2 Segregated Report includes the same information as the 2025-1 Segregated Report except the last line indicates “Improvements New as of 9/1993” of \$2,118,688.¹⁹

51. After the hearing, respondent also provided additional information, including the description levels available in the Swift Residential program for “Quality” and “Condition,”²⁰ as well as reports using varied combinations of the description levels for the La Jolla property. For example, when Excellent (6), Very Good/Excellent (5.5), and Very Good (5) is selected for both Quality and Condition, the 1993 estimated construction cost for the La Jolla property, according to the Swift Residential program, is \$1,251,435, \$850,773, and \$758,755, respectively.

DISCUSSION

Respondent’s determinations are generally presumed to be correct, and the taxpayer has the burden of proving otherwise. (*Appeal of Nag and Rudd*, 2023-OTA-150P.) In order to rebut the presumption of correctness, the taxpayer must provide credible, competent, and relevant evidence showing the determination is erroneous. (*Ibid.*) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) A preponderance of evidence means the taxpayer must establish by documentation or other evidence the circumstances it asserts are more likely than not to be correct. (*Appeal of Carr*, 2022-OTA-157P.) Unsupported assertions are insufficient to satisfy the taxpayer’s burden of proof. (*Appeal of Silver*, 2022-OTA-408P.)

As relevant here, California conforms to federal rules for computing the basis of property to determine the loss or gain on the sale of such property. (R&TC, § 18031.) Gross income

¹⁸ Appellants do not indicate how the \$4,696,081 amount was calculated.

¹⁹ Appellants do not indicate how the \$2,118,688 amount was calculated.

²⁰ The description levels available for “Quality” are Low (1), Fair (2), Average (3), Good (4), Very Good (5), and Excellent (6), and those available for “Condition” are Worn Out (1), Badly Worn (2), Average (3), Good (4), Very Good (5), and Excellent (6).

includes gains from dealings in property. (IRC, § 61(a)(3).) A taxpayer must recognize gain on the sale of property in an amount equal to the difference between the amount realized and the taxpayer's adjusted basis in the property. (IRC, § 1001; *Saccato v. Commissioner*, T.C. Memo. 2023-96.) The adjusted basis is the cost of the property with proper adjustments made for capital expenses and capital recoveries. (IRC, § 1016.) Capital expenses increase the initial basis and capital recoveries decrease the initial basis so that on the date of disposition the adjusted basis reflects the unrecovered cost or other basis of the property. (IRC, § 1016(a).) Capital expenses include the cost of capital improvements and betterments made to the property by the taxpayer. (*Ibid.*) These expenditures are distinguishable from expenditures for the ordinary repair and maintenance of the property, which are neither capitalized nor added to the initial basis. (IRC, §§ 162, 212, 1011(a), 1012(a), 1016(a); Treas. Reg. § 1.1016-2(a).)

Taxpayers may increase their adjusted basis in property for costs they expend to improve the property, but they generally bear the burden of proving basis increases they claim. (*Chandler v. Commissioner* (2014) 142 T.C. 279, 291.) Proof of basis is a specific fact which the taxpayer has the burden of proving. (*O'Neill v. Commissioner* (9th Cir. 1959) 271 F.2d 44, 50.) Exclusions from gross income are construed narrowly. (*Commissioner v. Dunkin* (9th Cir. 2007) 500 F.3d. 1065, 1069.) Taxpayers who fail to meet their burden of demonstrating that they are entitled to a basis in an asset sold may be considered to have a zero basis in the asset. (*O'Boyle v. Commissioner*, T.C. Memo. 2010-149.)

If a taxpayer with inadequate records shows that deductible expenditures were made, but cannot substantiate the exact amount, the expenditures may be estimated under the *Cohan* rule announced in *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540 (*Cohan*). The *Cohan* rule was adopted when the famous theatrical producer George M. Cohan claimed he spent substantial sums of money on business entertainment expenses, but failed to keep records of these expenses, and therefore could not establish the exact amount of the deduction. (*Ibid.*) Even though Cohan established he incurred expenses, the IRS disallowed the entire deduction. (*Id.* at p. 543.) The United States Board of Tax Appeals (the Tax Board),²¹ noting that it “can not [*sic*] doubt, upon the record, that [Cohan] was required to and did spend large sums of money in traveling and entertaining during the period,” nevertheless affirmed disallowing the entire deduction, finding that it was impossible to tell how much Cohan had in fact spent in the absence of any items or details. (*Cohan v. Commissioner* (B.T.A 1928) 11 B.T.A. 743, 761.)

²¹ The United States Board of Tax Appeals is a predecessor to the United States Tax Court. (See <https://www.ustaxcourt.gov/history/>)

The Second Circuit Court of Appeals reversed, holding that when the Tax Board acknowledged the legitimacy of a claimed deduction, the deduction could not be disallowed entirely merely because the taxpayer cannot prove an exact figure. The court held that, where a taxpayer has established that the taxpayer paid an expense for which a deduction may properly be claimed but is unable to document the exact amount of the expense, a court may make a reasonable estimate of the deduction in certain circumstances, “bearing heavily” against the taxpayer whose inexactitude is of their own making. (*Cohan, supra*, 39 F.2d at p. 544.) In essence, due to the *Cohan* rule, a court cannot make a finding that considerable allowable expenditures were made, while at the same time disallowing a deduction entirely because of the lack of specific proof. (*Haines v. Commissioner* (9th Cir. 1988) 843 F.2d 501.) The Second Circuit Court of Appeal, noting the inconsistency in the Tax Board finding that considerable allowable expenditures had been made, while at the same time disallowing a deduction entirely because of the lack of specific proof, remanded the matter to the Tax Board with instructions to make some estimate of *Cohan*’s deductible entertainment expenses. The court noted that “[t]he amount [allowed] may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any” (*Cohan, supra*, 39 F.2d at p. 544.)

Courts continue to rely on the *Cohan* rule to estimate the amount of a claimed deduction in cases where the taxpayer is unable to produce evidence substantiating the exact amount expended. As applicable here, the *Cohan* rule has also been applied to estimate a taxpayer’s basis in property. (See, e.g., *Dockery v. Commissioner*, T.C. Memo. 1978-63.) The *Cohan* doctrine is not a taxpayer right; rather, it is an equitable doctrine that allows the trier of fact to approximate expenses only to the extent supported by the evidence. In fact, while the trier of fact may have considerable latitude in estimating the amount of the allowable deduction, the *Cohan* rule “certainly does not require that such latitude be employed.” (*Williams v. Commissioner* (5th Cir. 1957) 245 F.2d 559, 560.) Courts have been reluctant to follow *Cohan* where a taxpayer fails to provide evidence that would permit an informed estimate of the amount of a deduction. The Ninth Circuit Court of Appeals in *Coloman v. Commissioner* (9th Cir. 1976) 540 F.2d 427, in upholding the U. S. Tax Court’s finding the taxpayers had a zero basis in stock, noted that establishing basis is a factual matter and the IRS’s determination is accepted by the U.S. Tax Court as presumptively correct, and stated that the *Cohan* doctrine should not be used as a “substitute for [the taxpayer’s] burden of proof.” (*Coloman v. Commissioner, supra*, 540 F.2d at pp. 429, 431-432.) For similar reasons, courts have declined to apply the *Cohan* rule in cases where there is no doubt that the taxpayer incurred some deductible expense, but the taxpayer failed to present evidence sufficient to allow the court to

make an accurate finding on the amount of the deduction. (See *Norgaard v. Commissioner* (9th Cir. 1991) 939 F.2d 874.)

It is well settled that valuation is necessarily an approximation; it is not necessary that the value arrived at is a figure for which there is specificity, if it is within the range of figures that properly may be deduced from the evidence. (*Hamm v. Commissioner* (8th Cir. 1963) 325 F.2d 934, 939-940.) Nevertheless, there must be some evidentiary basis on which an estimate may be made. (*Vanicek v. Commissioner* (1985) 85 T.C. 731, 743.) In other words, to make an estimation, there must be “sufficient evidence to satisfy the trier that *at least* the amount allowed in the estimate *was in fact* spent or incurred for the stated purpose. Until the trier has that assurance from the record, relief to the taxpayer would be unguided largesse.” (*Williams v. Commissioner, supra*, 245 F.2d at p. 560, italics added.) “Proof of the cost or adjusted basis is necessary because recovery of an amount in excess of cost constitutes income.” (*Namyst v. Commissioner*, T.C. Memo. 2004-263, citing *Cullins v. Commissioner* (1955) 24 T.C. 322, 328.) In addition, the court must explain the method used to arrive at its estimate. (*Gill v. Commissioner*, T.C. Memo. 1994-92, citing *Concord Control, Inc. v. Commissioner* (6th Cir. 1980) 615 F.2d 1153, 1156 [remanded to the U.S. Tax Court to explain its method of calculation].)

Here, appellants sold the La Jolla property for \$3,340,000. On their 2016 tax return, appellants claimed a tax basis of \$2,900,000 and, after applying the IRC section 121 exclusion, reported zero taxable gain on the La Jolla property.

In support of their claimed basis, appellants provide source documentation substantiating the land purchase price of \$495,000; land purchase fees of \$830; and closing costs of \$197,327. These amounts are not in dispute. Appellants also provide 41 checks totaling \$38,062.64, dated April 18, 2007, to August 26, 2016, to substantiate \$31,843.50 in claimed capital improvements. Respondent determined that 16 of the checks, totaling \$28,383, substantiated a portion of appellants’ claimed capital improvement costs. OTA reviewed the 41 checks and finds that appellants have not established that the disallowed costs were for capital improvements, as opposed to repairs; thus, an additional adjustment based on capital improvements is not warranted. Accordingly, appellants have substantiated with source documentation that they are entitled to a basis of \$721,540;²² therefore, without the *Cohan* rule,

²² The \$721,540 amount consists of: \$495,000 (land purchase price) + \$830 (land purchase fees) + \$197,327 (closing costs) + \$28,383 (capital improvements).

appellants have a taxable gain of \$2,118,460 (\$3,340,000 - \$721,540 - \$500,000) from the sale of the La Jolla property.

There is no dispute that appellants have provided no source documentation to support the claimed construction costs of \$2,175,000 for the La Jolla property. Appellants contend that due to the “unique and rare” nature of some of the property’s materials and structural components, appellants decided it would be best to leave “the drawings, receipts and all documents related to the construction” of the property with E. Bastarache “in case of a repair or any questions regarding the design and material used in the construction of the home.” Appellants further contend that E. Bastarache kept the documents in the basement and that the “[d]ocumentation for improvements and modifications to the property were destroyed” in late 2017 due to a basement flood. While it is unclear why copies were not made of purportedly important documentation, it is nevertheless appellants’ burden to establish their basis in the La Jolla property, and the fact that basis may be difficult to establish does not relieve appellants of their burden. (*O’Neill v. Commissioner, supra.*)

There is also no dispute that despite appellants being unable to substantiate their exact construction cost, the La Jolla property was constructed while under appellants’ ownership. As such, respondent did not limit the allowed basis to the substantiated amount of \$721,540; rather, respondent decided to estimate the construction cost of the La Jolla property under the *Cohan* rule to determine appellants’ basis. Respondent calculated its estimate using the Swift Residential program and the CPI Cost Index as of 1993, the year the La Jolla property was constructed. Respondent originally estimated a 1993 construction cost of \$885,382; however, after receiving additional documentation (i.e., photographs, drawings, diagrams, and floor plans) from appellants it revised the estimate. Respondent’s valuation gave the La Jolla property “excellent” quality and condition ratings, applied a standard local multiplier of 1.14 for the local area, which is above average costs, and characterized the property as a Zone 4 seismic area, which provided more value for seismic construction. In August 2021, respondent revised its 1993 construction cost estimate to \$1,251,435.

Appellants assert that respondent underestimated the construction cost of the La Jolla property. Appellants also assert that they underreported the construction cost on their return since their calculation purportedly did not include the contract for the foundation of the house, which appellants contend was for approximately \$110,000.²³

²³ Appellants have not provided a copy of the purported foundation contract.

In support of their assertions, appellants provide the following reports: (1) January 2020 Bradford Report, estimating a construction cost of \$3,529,082; (2) December 2020 Bradford Report estimating a 2020 construction cost of \$4,295,960; (3) January 2021 Keystone Valuation Report, which included the December 2020 Keystone CoreLogic Report (estimating a 2020 construction cost of \$4,295,961, and a 1993 construction cost of \$2,373,459 after using the CPI inflation factor), and the January 2021 Keystone Xactimate Report (estimating a 2020 replacement cost of \$4,187,582); (4) 2025-1 Segregated Report estimating a 2025 construction cost of \$6,495,795 and a 2020 construction cost of \$4,696,081; and (5) 2025-2 Segregated Report estimating a 2025 construction cost of \$6,495,795 and a 1993 construction cost of \$2,118,688. Appellants contend these reports were prepared in consultation with many of the original architects, designers, craftspersons, and subcontractors involved in constructing the La Jolla property in 1993.

Appellants argue that the Swift Residential program is merely a “standard square foot estimator” that does not have the ability to adjust or add in the value of many custom luxury components found in the La Jolla property (i.e. the caisson grade piers and glass bridge and that no one, even in their best efforts, “could [] get the detail in the [Swift Residential program] . . . needed in order to capture the replacement cost value of [the La Jolla property].” Appellants contend that the top tier option available in the Swift Residential program (i.e., “excellent” for both quality and condition) does not capture custom luxury high-end properties; rather, it is generalized for excellent features in standard-grade building.

As additional support for their assertions, appellants provided expert witness testimony from M. Christopher and C. White at the hearing. M. Christopher asserted that the features of the La Jolla property are not common, ordinary, or even excellent; rather, they are “exceptional.”²⁴ C. White spoke about the “cost-estimating challenges” of the La Jolla property due to the “custom unique [and] luxury pieces within the home.” C. White testified that while respondent used the Swift Residential program, the Swift Segregated program, according to

²⁴ M. Christopher presented a slide presentation titled “Rice Residence – Exceptional Quality and Uncommon Characteristics,” and a real estate video of the La Jolla property uploaded onto YouTube on October 15, 2013. M. Christopher spoke about the La Jolla property, including the “rather complicated nature” of the house’s foundation on a “challenging hillside”; “the unique design of the house” with many “punched opening” windows being “recessed back in” with “double the framing” and “stair stepping” on the front of the house; a cantilevered canopy over the front door that requires special framing; cindercrete countertops; 29 caissons, 24-inch in diameter and anywhere from 8 to 24 feet in depth, which required a “big oil drilling rig” to drill the holes in the ground, that support the house and pool and are connected by a grade beam; and five terne-coated roofs.

CoreLogic, is the “only appropriate CoreLogic software” to use for the La Jolla property.²⁵

C. White states that he was “unable to get the [Swift Residential program] to come anywhere close to the accurate scope and cost that was originally allowed for [the La Jolla property].”

Instead, appellants opted to use both Xactimate and the Swift Segregated program. First, Keystone did “an initial estimate” in Xactimate to come up with the replacement cost or construction cost for the La Jolla property. Then, when using the Swift Segregated program, Keystone used the Bradford Reports to “help [Keystone] support the cost adjustments in each of the components to understand where the actual value was in the foundation, and [to] try to cost out the actual foundation cost.” Keystone then compared the two estimates and noticed similar results.²⁶ Appellants contend that the Swift Residential program that respondent used for its estimation is “fundamentally inappropriate” for the La Jolla property and that, for luxury and highly customized homes with unique design and materials, “starting with 1993 costs and inflating them is fundamentally inappropriate because there is no reliable 1993 costs data for such unusual, non-standard, hand-crafted custom houses.” Appellants assert that based on the various reports, expert testimony, and the “exceptional” components of the La Jolla property, appellants have substantiated their claimed basis of \$2,900,000.

In circumstances where respondent has allowed part of an expense, OTA will not alter that determination unless facts appear from which a different approximation can be made. (*Appeal of Seddiqui*, 2024-OTA-280P.) OTA is reluctant to disturb respondent’s determinations involving unsubstantiated amounts without independent facts on which to base a different finding. (*Ibid.*) A taxpayer must demonstrate some basis on which an estimate can be made that goes beyond mere speculation, unsupported allegations, or mere inference. (*Ibid.*; *Vanicek v. Commissioner*, *supra.*)

Appellants provide external and internal photographs, architecture and engineering drawings, building diagrams, floor plans, and visual presentations of the La Jolla property. While this evidence establishes the construction of the La Jolla property and its features and components, it does not establish the amounts appellants paid in 1993 for its construction. Appellants have not provided invoices, receipts, credit card statements, bank statements, complete contracts, or other similar source documentation showing expenditures in excess of

²⁵ C. White asserts that he had at least two telephone calls with a CoreLogic employee who stated the Swift Estimator program was inappropriate to estimate the construction costs of the La Jolla property.

²⁶ For the La Jolla property, the December 2020 Keystone CoreLogic Report estimates a 2020 “construction cost” of \$4,295,961 (before using the CPI inflation factor), and the January 2021 Keystone Xactimate Report estimates a 2020 “replacement cost” of \$4,187,582.

the \$1,251,435 in construction costs as estimated by respondent. Instead, appellants provide numerous reports with varying estimated amounts to support their claimed construction costs.

As for the January 2020 Bradford Report, which indicates a construction cost of \$3,529,082, it is unclear to which year the amounts in the report pertain, as the accompanying CPI inflation calculator shows that \$3,529,082 in August 2016 has the same buying power as \$2,126,103 in September 1993. However, as noted by appellants, the 2016 year “is relevant only as the sale year of the house,” and has no bearing on appellants’ 1993 construction costs. The use of August 2016 in the accompanying CPI inflation calculator appears to indicate that the amounts entered in the January 2020 Bradford Report and the \$3,529,082 total pertain to 2016, as opposed to 2020, which would impact the purported September 1993 buying power.

Appellants also provide the January 2021 Keystone Valuation Report (which includes the December 2020 Keystone CoreLogic Report (estimating a 2020 construction cost of \$4,295,961, and, after using the CPI inflation factor, a 1993 construction cost of \$2,373,459) and the January 2021 Keystone Xactimate Report (estimating a 2020 replacement cost of \$4,187,582)), and two Segregated Reports estimating a 2025 construction cost of \$6,495,795, a 2020 construction cost of \$4,696,081, and a 1993 construction cost of \$2,118,688. As confirmed at the hearing, Keystone “utilized the Bradford cost estimate” when it entered amounts into its reports (i.e., \$13,800 for the glass bridge). However, appellants have proffered no evidence as to how Bradford determined the costs. For example, in the December 2020 Bradford Report, six chrome bathroom accessory sets of towel bars, paper holder, and robe hooks, were priced at \$248 a set. Appellants have laid no evidentiary foundation as to how Bradford determined that each bathroom accessory set in the La Jolla property would purportedly cost \$248 in 2020. Moreover, even if appellants did lay such evidentiary foundation, there is the issue of appellants using the CPI inflation factor in estimating the 1993 construction costs. The CPI inflation factor is akin to a general national level adjustment, as compared to the CPI Historical Cost Index that respondent used, which is a construction cost index that localizes labor and material costs to a given location. In other words, if a specific index (i.e., the CPI Historical Cost Index) exists that measures the rate of inflation in a particular industry or for a particular service or for a particular good, then use of the specific index, as opposed to general index (i.e., the CPI inflation factor), yields a cost estimate closer in approximation to the actual cost.

Appellants have expressed disagreement with respondent’s use of the Swift Residential program to create its report and assert that the Swift Segregated program is the “only appropriate CoreLogic software” to use for the La Jolla property. Respondent provides

evidence regarding the Swift Residential program (i.e., definitions, descriptions, etc.), how the software is generally used (i.e., components, additions, etc.), and how respondent utilized the software in this matter (i.e., a detailed breakdown, applying a standard local multiplier of 1.14, etc.). OTA finds respondent's use of the Swift Residential program to estimate the 1993 construction costs in this matter to be reasonable. Furthermore, while appellants mention many "unique features" of the La Jolla property, it appears that respondent's estimate includes such features. For example, the 2021 Swift Residential Report includes a glass bridge, dumbwaiter, curved staircase, and caissons. Appellants have not specified or demonstrated that the 2021 Swift Residential Report failed to include a specific feature or addition.

While appellants may not agree with the amounts in the 2021 Swift Residential Report and may even find them to be "trivial and unsatisfactory," OTA notes that any uncertainty as to amounts includable in appellants' basis will "bear[] heavily" against appellants since the inexactitude is of their own making. (See *Cohan, supra*, 39 F.2d at p. 544.) While there is no doubt appellants incurred some construction costs, OTA finds that appellants have failed to provide sufficient evidence that would permit OTA to make an informed estimate of appellants' purported construction costs in excess of respondent's estimate, and the *Cohan* doctrine should not be used as a substitute for appellants' burden of proof. (*Coloman v. Commissioner, supra*.) OTA finds that appellants have failed to show entitlement to additional construction costs and, therefore, appellants have failed to meet their burden of overcoming the presumptive correctness of respondent's determination

Although OTA finds that appellants have not met their burden, OTA nevertheless finds adjustments are warranted in this matter due to discrepancies OTA notices between respondent's two reports, the 2020 Swift Residential Report and the 2021 Swift Residential Report. Respondent indicates the 2021 Swift Residential Report is a result of additional information appellants provided, which resulted in an increase of respondent's construction cost estimate. However, upon comparison of the two reports, OTA notes that the unit costs of some items in the 2021 Swift Residential Report were reduced from those in the 2020 Swift Residential Report. For example, in the 2020 Swift Residential Report, the unit cost of a "Single 2-Story Fireplace" is \$6,903; however, in the 2021 Swift Residential Report, the unit cost of a "Single 2-Story Fireplace" is listed as \$6,844, for a reduction of \$59 per unit. Since both reports list Quality and Condition as excellent, the reason for the unexplained unit cost reductions is unclear to OTA. OTA finds that there is sufficient evidence that at least the higher per unit cost amount allowed between respondent's two estimates was incurred by appellants for the stated purpose. (See *Williams v. Commissioner, supra*.) OTA also finds that the unexplained unit cost

discrepancies are independent facts from which a different approximation can be made, such that an altering of respondent's determination, and therefore appellants' adjusted basis, goes beyond speculation, unsupported allegations, or inference. (*Appeal of Seddiqui, supra; Vanicek v. Commissioner, supra.*) The following items had the unit cost reduced in the 2021 Swift Residential Report:

- Base Cost - 5,327 units went from \$65.75 to \$65.04 per unit, for a reduction of \$0.71 per unit and a total reduction of \$3,782 (i.e., 5,327 x \$0.71).²⁷
- Plumbing Fixtures - 40 units (i.e., 23 +17) went from \$2,301 to \$2,291 per unit, for a reduction of \$10 per unit and a total reduction of \$400.
- Raised Subfloor – 5,327 units went from \$9.06 to \$8.99 per unit, for a reduction of \$0.07 per unit and a total reduction of \$373.
- Carpet, Custom or High-Value – 784 units went from \$25.52 to \$25.23 per unit, for a reduction of \$0.29 per unit and a total reduction of \$227.
- Ceramic Tile, Custom or High-Value – 4,943 units went from \$30.09 to \$29.87 per unit, for a reduction of \$0.22 per unit and a total reduction of \$1,088.
- Warmed & Cooled Air – 5,327 units went from \$4.82 to \$4.78 per unit, for a reduction of \$0.04 per unit and a total reduction of \$213.
- Plumbing Rough-ins – 1 unit went from \$578.20 to \$574.20 per unit, for a reduction of \$4 per unit and a total reduction of \$4.
- Single 2-Story Fireplace – 1 unit went from \$6,903 to \$6,844 per unit, for a reduction of \$59 per unit and a total reduction of \$59.
- Outside Entrance Below Grade – 1 unit went from \$2,566.50 to \$2,537.50 per unit, for a reduction of \$29 per unit and a total reduction of \$29.
- Slab Porch with Roof – 64 units went from \$27.99 to \$27.66 per unit, for a reduction of \$0.33 per unit and a total reduction of \$21.
- Slab Breezeway with Roof – 120 units went from \$26.96 to \$26.65 per unit, for a reduction of \$0.31 per unit and a total reduction of \$37.
- Cement Balcony, Iron Rails, Plastered Soffit – 201 units went from \$35.70 to \$35.67 per unit, for a reduction of \$0.03 per unit and a total reduction of \$6.
- Cement Balcony w/Roof, Iron Rails, Plastered Soffit – 48 units went from \$63.13 to \$62.64 per unit, for a reduction of \$0.49 per unit and a total reduction of \$24.
- Cement Stairway – 5 units went from \$2,610.75 to \$2,581 per unit, for a reduction of \$29.75 per unit and a total reduction of \$149.

²⁷ The total reduction amounts are rounded.

- Wrought Iron – 88 units went from \$13.54 to \$13.46 per unit, for a reduction of \$0.08 per unit and a total reduction of \$7.
- Gate, Wrought Iron – 24 units went from \$16.52 to \$16.39 per unit, for a reduction of \$0.13 per unit and a total reduction of \$3.
- Concrete Block Walls, 8” – 3,600 units went from \$9.15 to \$9.08 per unit, for a reduction of \$0.07 per unit and a total reduction of \$252.
- Paving, Concrete w/Base – 840 units went from \$5.86 to \$5.83 per unit, for a reduction of \$0.03 per unit and a total reduction of \$25.
- Landscaping, Complex – 1,200 units went from \$5.20 to \$5.16 per unit, for a reduction of \$0.04 per unit and a total reduction of \$48.
- Pool, Lap – 360 units went from \$61.95 to \$61.48 per unit, for a reduction of \$0.47 per unit and a total reduction of \$169.
- Pool Heaters – 1 unit went from \$4,454.50 to \$4,437 per unit, for a reduction of \$17.50 per unit and a total reduction of \$18.

The above items result in a discrepancy totaling \$6,934. OTA finds that the \$6,934 amount is to be added to appellants' basis for a revised basis of \$1,998,183.²⁸

²⁸ The \$1,998,183 amount consists of: \$495,000 (land purchase cost) + \$830 (land purchase fees) + \$1,251,435 (construction costs of the La Jolla property) + \$10,027 (specialties) + \$8,247 (clean-up) + \$28,383 (capital improvements to the La Jolla property) + \$197,327 (escrow closing costs) + \$6,934 (OTA adjustments)

HOLDING

Appellants are entitled to an additional basis of \$35,317²⁹ in the La Jolla property.

DISPOSITION

Respondent's determination as to appellants' adjusted basis is increased by \$28,383, as conceded by respondent, as well as by \$6,934, as adjusted by OTA, for a revised adjusted basis of \$1,998,183.

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

We concur:
Signed by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

Date Issued: 2/26/2026

²⁹ This amount consists of \$28,383 (capital improvements to the La Jolla property) + \$6,934 (OTA adjustments).