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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeals of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEALS;
	CORPORATION FRANCHISE TAX APPEAL
RAGO DEVELOPMENT CORPORATION;[1]	Case No. 735761
LOUIS RAGO AND JUNE E. RAGO;	Case No. 725839
MICHAEL J. SMITH AND LYNN M. SMITH;	Case No. 725834
PAUL H. VERRIERE AND PATRICIA R. VERRIERE;	Case No. 727493
FREDRICK M. WOOSTER AND MARY L. WOOSTER;	Case No. 727483
LOUIS LA TORRE LIVING FAMILY TRUST;	Case No. 633028
MARTIN BRAMANTE AND ESTATE OF VELIA BRAMANTE (DEC'D);	Case No. 632713
FRANK SABELLA	Case No. 633944

[1] This consolidated appeal consists of two groups of taxpayers, with the "Rago" group comprised of the first five appellants listed above and the "Bramante" group consisting of the final three appellants. References to the briefing in this summary will distinguish between the briefs for the "Rago" and "Bramante" appeals.

Case No.	Year	Proposed Assessment[2]
735761	2003	$30,249
725839	2003	$174,472
725834	2003	$152,162
727493	2003	$156,096
727483	2003	$64,081
	2005	$10,545[3]
633028	2003	$128,074
632713	2003	$130,720
633944	2003	$128,533

Representing the Parties:

For Appellants: Edward I. Kaplan, Attorney
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For Franchise Tax Board: David Gemmingen, Tax Counsel IV

QUESTIONS: (1) Whether appellants have shown error in respondent's determination denying appellants' claimed deferral of gain pursuant to an attempted like-kind exchange under Internal Revenue Code (IRC) section 1031.

(2) Whether appellants have shown respondent abused its discretion in determining whether to abate interest.

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[2] The proposed assessment amounts listed here for Rago Development Corporation include proposed tax on $529,024 from the sale of the "Rancho Adobe" property. The assessment for appellants Michael J. Smith and Lynn M. Smith also includes gain of $430,590 added to their income from this sale, and appellants Louis Rago and June E. Rago have pass through income from Rago Development Corporation, which may include assessed gain from the same sale. As discussed below, respondent conceded at protest that the gain from the sale of the Rancho Adobe property was deferred through a proper IRC section 1031 like-kind exchange, and therefore gain should not be recognized on this sale in 2003; however, the gain was not removed from the proposed assessment when it was affirmed. Respondent should be prepared to state whether it concedes these amounts for 2003 and provide the new proposed assessment amounts for all affected taxpayers.

[3] Appellants Fredrick and Mary Wooster's proposed assessment for the 2005 tax year arises from a denial of carryover capital loss in the amount of $127,890 reported on their 2005 return and a net adjustment to their 2005 capital gain of $90,015. (Resp. Rago Op. Br., fn. 1.)

HEARING SUMMARY

This appeal involves an amount in controversy that is $500,000 or more and thus is covered by Revenue and Taxation Code (R&TC) section 40. Please see Staff Comments below for details.

Background

Wachovia Property

On December 20, 2002, appellants in the Rago group[4] entered into an IRC section 1031 exchange agreement with a qualified intermediary, Consolidated Title Services (CTS). On January 6, 2003, appellants sold a property, "Rancho Adobe," for $859,000. On January 10, 2003, appellants identified the "Wachovia property," which is an office building, as replacement property for the relinquished Rancho Adobe. On May 22, 2003, appellants' wholly-owned limited liability company (LLC) acquired the Wachovia property to complete their claimed like-kind exchange. Respondent audited the Rago group's tax returns and originally denied the claimed like-kind exchange. On July 31, 2012, after a protest period, respondent conceded that the above transaction was a proper like-kind exchange and should receive IRC section 1031 treatment.[5] (App. Rago Op. Br., exhibit C, pp. 1 & 6.)

Sand Creek Crossing

The Rago group sold two adjacent properties in St. Helena, California, on May 16, 2003, and May 27, 2003. On or around May 20, 2003, appellants in the Rago group entered into another like-kind exchange agreement with CTS. On June 2, 2003, appellants identified the Sand Creek Crossing shopping center as the replacement property for the like-kind exchange. (App. Rago Op. Br., exhibit D, p. 2.)

Appellants in the Bramante group were each partners with a one-third interest in the Sonoma Bell Apartments (SBA) general partnerships. On April 29, 2003, the Bramante appellants entered into an agreement with CTS to perform a like-kind exchange. Appellants, through SBA, sold

[4] The parties should be prepared to discuss which appellants were involved in the Wachovia transaction, as well as the portion of their proposed assessments arising from the Wachovia transaction.

[5] As discussed below, the proposed assessment amount for this transaction was conceded at the conclusion of protest, but was still included on the Notice of Action. Respondent stated at the pre-hearing conference that it will adjust the proposed assessment to reflect this concession.

apartments in San Rafael on May 1, 2003, and identified the Sand Creek Crossing property as the replacement property on June 2, 2003. (Resp. Bramante Op. Br., p. 5.)

On June 2, 2003, all appellants entered into a loan agreement with Greenwich Capital Financial Products (Greenwich Financial or lender) for $36,975,000 to purchase the Sand Creek Crossing property. On June 30, 2003, appellants purchased the Sand Creek Crossing property through their intermediary. Appellants' interest in the property was held as undivided interests in accordance with a Tenants-In-Common Agreement (TICA). (App. Rago Op. Br., exhibit C, p. 2.) Appellants hired Colliers International, an outside independent third party, to manage the Sand Creek Crossing property. (App. Rago Op. Br., p. 4.) The property consisted of two parcels forming the Sand Creek Crossing shopping center and two adjacent parcels of undeveloped "pads." Appellants formed Sand Creek Crossing, LLC, on January 23, 2004, and transferred the Sand Creek Crossing shopping center property to the LLC on January 31, 2004. Appellants also formed Sand Creek Crossing Pads, LLC, on January 23, 2004, and transferred the pads portion of the property to this LLC on January 31, 2004. (Resp. Bramante Op. Br., p. 7.)

Respondent audited appellants' 2003 tax year and determined that the attempted like-kind exchange failed based on various theories including partnership law and the substance over form doctrine. (App. Rago Op. Br., exhibit C, pp. 5-6.) Notices of Proposed Assessments (NPAs) were issued to the Rago appellants on March 21, 2008,[6] and to the Bramante appellants on March 26, 2008. (Appellants' Op. Briefs, attachments.) Appellants protested this determination, and protest hearings were held on April 9, 2010, and December 17, 2010, for the Bramante and Rago appellants, respectively. (App. Bramante Op. Br., p. 12; App. Rago Op. Br., p. 6.) Respondent's protest officer informed the Bramante group that a recommendation had been made and was being reviewed as of July 19, 2010. (*Ibid*.) Respondent ultimately held that the Sand Creek Crossing exchange did not qualify for gain deferral under IRC section 1031 because, under the step transaction doctrine, appellants received a partnership interest for their relinquished real property, and that does not meet the

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[6] Appellants in the Rago group state that an NPA was issued to them on March 2, 2009. The NPAs provided on appeal show issue dates of March of 2008, February of 2009, and May of 2009.

requirement that exchanged property be of like kind.[7] Respondent found that there was "a deliberate, methodical, and concerted plan to arrange an exchange of real property for a partnership interest." (App. Rago Op. Br., exhibit D, p. 9.) This determination was issued in the form of Notices of Action (NOAs) on September 4, 2012, for the Bramante group and May 16, 2013 for the Rago group.[8] (Appellants' Op. Briefs, attachments.) This timely appeal followed. At the conclusion of the briefing process, the Appeals Division conducted a prehearing conference to clarify the parties' contentions and remaining issues on appeal.

Contentions

Appellants' Contentions

Sand Creek Crossing Like-Exchange

Appellants assert that they held the Sand Creek Crossing property as replacement property in the like-kind exchange as a tenancy-in-common (TIC) for seven months, and that their subsequent transfer of their interests in the real property to an LLC should not negate their like-kind exchange and deferment of gain under IRC section 1031. (App. Rago Op. Br., pp. 2-3.) Appellants assert that the purpose of IRC section 1031 is to avoid the imposition of tax on those who do not cash in their investments. Appellants contend that they did not take any cash from the transaction, but continued to hold their investment in Sand Creek Crossing, albeit in a different form of ownership after seven months had passed. Appellants assert that that *Regals Realty* decision stated that taxpayers must have the intent to hold the property for investment purposes, but it did not, as respondent contends, state that the taxpayers must intend to *keep* the like-kind property acquired. (*Regals Realty* (B.T.A. 1940) 43 B.T.A. 194.) Appellants contend that a taxpayer may sell replacement property if a good offer arises, or enter into another like-kind exchange if an opportunity arises, and may transfer the property to a single-member LLC on the very day it acquires it. (App. Bramante Reply Br., p. 6.)

Appellants contend that the subsequent transfer of the property to an LLC was pursuant

[7] The protest officer reversed the audit determination regarding partnership law, finding that the Sand Creek Crossing joint venture as a tenancy-in-common was not a disguised partnership. (App. Rago Op. Br., exhibit D, pp. 6-9.)

[8] Appellants in the Rago group received a determination letter on July 31, 2012, and an updated determination letter on April 26, 2013, informing them of the determination that would be reflected in the NOA. (App. Rago Op. Br., exhibits C & D.)

to a customary provision in their loan document that called for appellants to reorganize their TIC interests into a single-asset entity within approximately seven months after acquiring the property. Appellants assert that this loan provision allows lenders to obtain a rating from Standard & Poor's Rating Services and Moody's Investors Service, which then aids the lender in selling the loan to a third party. Appellants note that this lender provision only applied to the Sand Creek Crossing shopping center and not the pads. Appellants contend that they individually held the right to partition, sell, or otherwise dispose of the property as well as had the ability to refinance the loan with a different lender or pay off the loan with Greenwich Financial for approximately seven months immediately following acquisition of Sand Creek Crossing. (*Id*. at pp. 4-5.) Appellants assert that they were not legally obligated to transfer the property to an LLC, and could not be sued by Greenwich Financial for damages or specific performance if they did not do so. Appellants contend that during their seven-month holding as a TIC, that they individually had all the liabilities of ownership, were subject to liens and foreclosures, and were subject to the probate rules in the event of a member death. (App. Bramante Op. Br., pp. 4-6.) Appellants assert that Sand Creek Crossing was and still is a member-managed LLC. (App. Rago Op. Br., p. 5.) Appellants contend that they met the requirements of IRC section 1031 by their intent to hold the Sand Creek Crossing property for investment. (App. Rago Reply Br., p. 13.)

Appellants contend that longstanding legal authority shows that "[t]he length of time between receipt of replacement property and its subsequent transfer is irrelevant under section 1031 if the owner's intent remains to hold that replacement property for investment." (App. Rago Op. Br., p. 8.) Appellants assert that the 9th Circuit court in *Magneson* found that there was a legitimate IRC section 1031 exchange, even though the taxpayers immediately contributed the replacement property to a limited partnership in exchange for a partnership interest pursuant to a pre-arranged plan, because the taxpayers exchanged investment property for like-kind investment property which they continued to hold for investment, albeit in a different form of ownership. (*Id*. at p. 9; *Magneson v. Comm'r* (1985) 753 F.2d 1490.) Appellants assert that the ruling in *Magneson*, *supra*, is not about whether the properties were like-kind, but whether changing the form of an investment in property (i.e., contributing it to a partnership) changes the fact that the property is still being held for investment, which it does not. (App. Rago Reply Br., p. 12.) Appellants contend that they had the intent to

continue their respective investments in the property following the transfer of those interests into Sand Creek Crossing, changing nothing other than the form of their ownership, and continue to hold the same interest as they had as a TIC through a different form of ownership more than ten years later. (App. Rago Op. Br., at p. 10.)

Appellants address respondent contention that *Magneson*, *supra*, is obsolete law. Appellants contend that respondent errs when it claims that the 9th Circuit based its decision on the operation of former section 15025 of the California Corporations Code. Rather, appellants assert that the court found that there are distinction between rights of a TIC and rights of a partner, but that these distinctions are not controlling in determining the holding for investment issue, and that as long as taxpayers continue to hold replacement property for investment, "a change in the mechanism of ownership which does not significantly affect the amount of control or the nature of the underlying investment does not preclude nonrecognition under section 1031(a)." (App. Bramante Reply Br., pp. 12-13, quoting *Magneson*, *supra*.) Appellants refer to the IRS FSA, which cites to *Magneson*, *supra*, as additional proof that it is still good law. (*Id*. at p. 14.)

Appellants assert that the United States Tax Court (USTC) also reviewed a like-kind exchange involving a pre-arranged plan, *Maloney*, wherein the corporation who performed the exchange distributed the replacement property to its sole shareholder approximately one month after the exchange. (App. Rago Op. Br., pp. 10-11; *Maloney v. Commissioner* (1989) 93 T.C. 89.) Appellants state that the USTC allowed the deferral of gain under IRC section 1031 in *Maloney*, *supra*, citing the court's reasoning that "[t]he instant case may be viewed as a variant of *Magneson* (exchange of like kind properties followed by a tax-free change in the form of ownership) . . . ." (App. Rago Op. Br., p. 11; *Maloney*, at p. 98.) Appellants contend that like-kind exchanges may be succeeded by a tax-free transfer at the back end of the exchange, quoting *Maloney*, *supra*, at page 98, and assert that the facts here show a like-kind exchange and then a tax-free transfer of Sand Creek Crossing to an LLC. Appellants contend that there is no required holding period for replacement property, and provide *Magneson*, *Maloney*, and *Bolker v. Comm'r* (9th Cir. 1985) 760 F.2d 1039, as authority of where courts allowed IRC section 1031 treatment when replacement property was transferred within one month of the like-kind exchange. (App. Rago Op. Br., pp. 11-12.) Appellants contend that *Bolker*, *supra*, shows

that the essential factor is a taxpayer's intent in holding the replacement property at the time of the exchange. (App. Rago Supp. Br., p. 9.)

Appellants discuss the *Marks* decision from the Oregon Tax Court, which they assert confirms the settled nature of this issue. (App. Rago Op. Br., pp. 15-16; *Dept. of Revenue v. Marks* (Or. T.C. 2009) 20 OTR 35, 2009 Ore. Tax LEXIS 241.) Appellants assert that *Marks*, *supra*, provides a well-reasoned review of the law since *Magneson*, *supra*, and concluded in favor of the taxpayers even when assuming that the taxpayers transferred real property received as replacement property in an IRC section 1031 exchange to a partnership after the exchange. Appellants contend that the reasoning of the Oregon court is not determinative but is compelling and the most complete review of the issue available. Appellants also note that Oregon partnership law underwent the same changes as California partnership law did after *Magneson*, *supra*, in response to respondent's contention that *Magneson*, *supra*, is no longer good law. (App. Rago Op. Br., pp. 15-16; App. Bramante Reply Br., pp. 14-15.)

Appellants contend that respondent's discussion of the *Click* decision focuses on the seven-month holding period in an attempt to show relevance to the facts in this appeal. (App. Rago Reply Br., p. 14; *Click v. Commissioner* (1982) 78 T.C. 225.) Appellants assert that the seven-month period during which the taxpayer held the replacement properties before transferring title to her children is irrelevant to the decision by the Tax Court, and that the court denied IRC section 1031 treatment because the taxpayer did not have the requisite intent to hold the properties for investment or productive use in a trade or business at the time she acquired the properties. Appellants contend that *Click*, *supra*, does not involve the step transaction doctrine in response to respondent's attempt to use the case to support its application of the step transaction doctrine in this appeal. (App. Rago Br., pp. 14-15; App. Bramante Reply Br., pp. 7-8.) Appellants contend that the *Wagensen* decision is more akin to their facts, because the taxpayer in that case held the replacement property for nine months and used it in the course of his business before ultimately gifting the property to his children. (*Wagensen v. Commissioner* (1980) 74 T.C. 653.) Appellants assert that the court found that "the taxpayer continued to be invested in real estate even though 'eventually' the ownership changed to another form," and the same is true in this appeal. (App. Bramante Reply Br., p. 8.) Appellants also provide the decision in *124 Front Street* as support for their assertion that there is no requirement that replacement property be

held for any specific length of time after an exchange to qualify for IRC section 1031 treatment. (App Rago Reply Br., p. 15; App Bramante Reply Br., p. 9; *124 Front Street v. Commissioner* (1975) 65 T.C. 6.)

Appellants also disagree with respondent's claims regarding *M.H.S. Company, Inc.*, (1976) T.C. Memo. 1976-165. Appellants contend that the facts in that decision are distinguishable from this appeal because the taxpayers in *M.H.S. Company*, *supra*, invested their funds directly into the joint venture and there was no evidence that appellants actually paid money to the grantor of the property. Appellants note that *Magneson*, *supra*, cites and distinguishes *M.H.S. Company*, *supra*, based on this factual distinction. Appellants distinguish *Thomas c. Sandoval, Jr.*, T.C. Memo. 2000-189, on the same factual distinction as well. Appellants states that respondent attempts to use the *Munkdale* decision for the proposition that a partner and a partnership are two distinct legal person, but appellants assert that *Magneson*, *supra*, recognized this distinction but determined that it did not make a difference in the IRC section 1031 analysis. (App. Bramante Reply Br., pp. 16-17; *Munkdale v. Giannini* (1995) 35 Cal.App.4th 1104.)

Appellants refer to a 1999 IRS Field Service Advice (IRS FSA) stating that the IRS will no longer pursue the position that an immediate transfer of property pursuant to a pre-arranged plan evidences a taxpayer's failure to hold that replacement property for the purpose of investment. (App. Rago Op. Br., p. 12; Int.Rev. Service, FSA 199951004 (December 23, 1999).) Appellants assert that the IRS FSA shows that the IRS understands that case law on this matter fully supports transactions such as appellants' like-kind exchange. (App. Rago Reply Br., p. 3.)

Appellants contend that respondent relies upon an unpublished decision to attempt to state that *Magneson*, *supra*, does not apply to members of an LLC, but respondent cannot cite any cases supporting this position. To the contrary, appellants note that the IRS has acknowledged that whatever limitations might have been inferred from *Magneson*, *supra*, were soon disregarded in *Bolker*, *supra*.[9] Appellants contend that numerous federal and state cases and Revenue Rulings have cited *Magneson*, *supra*, with approval and no mention of distinguishing between types of partnerships, including

[9] As support for this statement, appellants specifically cite to a 1997 Non-Docketed Service Advice Review number 5402.

Maloney, supra. Furthermore, appellants assert that even if *Magneson, supra,* is read to apply only when substitute property is later transferred for a general partner interest, appellants contend that they were managing members of the LLC and therefore were akin to general partners, not limited partners. (App. Rago Op. Br., pp. 12-15; *Gregg v. United States* (D. Or. 2000) 186 F. Supp.2d 1123.)

Step Transaction

Appellants assert that the step transaction doctrine does not apply to the facts of this appeal. Appellants indicate that the pads portion of the Sand Creek Crossing property was not included in the loan agreement, and therefore there was no provision, pre-arranged plan, or binding commitment requiring that those two parcels be transferred to an LLC. Appellant contends that respondent's denial of IRC section 1031 treatment for all of the Sand Creek Crossing property is done without regard to whether there was any pre-arranged plan, and if respondent were to deny one exchange based on a pre-arranged plan while allowing an identical exchange where there is no pre-arranged plan would be contrary to the rulings in *Magneson, Bolker, and Maloney* wherein the courts ruled that a pre-arranged plan does not invalidate a like-kind exchange. Appellants contend that the step transaction doctrine, which is a subset of the substance over form test, should not be applied to like-kind exchanges because the entire structure of IRC section 1031 "exalts form over substance." Appellants assert that application of the step transaction doctrine would disqualify every transaction where a qualified intermediary was used. (App. Rago Op. Br., pp. 17-19.) Appellants contend that the very essence of an IRC section 1031 exchange requires parties to take certain steps that are solely designed and arranged to accomplish a particular tax result pursuant to technical requirements, and therefore would never withstand a step transaction doctrine analysis as applied by respondent in this appeal. (App. Rago Reply Br., pp. 7-8.)

Appellants contend that courts use either the end result test, the mutual interdependence test, or the binding commitment test to determine whether to apply the step transaction doctrine. Appellants assert that under the end result test, which looks at whether formally distinct steps are really pre-arranged parts of a single transaction, their like-kind exchange ended with them holding Sand Creek Crossing as a TIC, which they continued to do so with the benefits and burdens of ownership for

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another seven months.[10] Appellants contend the mutual interdependence test, which looks to see whether any particular step in the series of transactions would be fruitless without a completion of the series, has no application here because the holding of the property as a TIC for seven months had significant economic effect and was not meaningless. Appellants contend that the acquisition of the properties was independent of what occurred in the following year when the LLCs were organized. (App. Rago Op. Br., pp. 20-22; App. Bramante Op. Br., pp. 8-9; see also App. Bramante Reply Br., pp. 9-12.)

Appellants also contend that the binding commitment test, which can apply if there is a binding commitment to complete a final step at the time the first step is taken to accomplish a particular result, does not apply. Appellants assert their first step was to enter into a purchase agreement to acquire Sand Creek Crossing in a like-kind exchange, and the final step was acquiring the property. Appellants contend that it was only when financing the acquisition that the requirement to form a single purpose entity was created, and even then any number of events could have occurred during the seven month period that would have prevented the forming of the LLCs from ever occurring. Appellants assert that the transfer of properties to the LLCs was not a binding commitment formed when they took the first step toward acquiring Sand Creek Crossing and was not required to accomplish the goal of acquiring the property. (App. Rago Op. Br., pp. 22-23.) Appellants contend that it is absurd to believe that they would not have engaged in the like-kind exchange in the absence of the subsequent step of transferring their TIC interests into the LLCs. (App. Rago Reply Br., p. 11.) Furthermore, appellants contend that the binding commitment test requires a legal obligation to take subsequent steps and, here, while the right to continue with the initial financing imposed a lender-imposed requirement, there was no legal obligation to convert their property interests into an LLC. (App. Bramante Op. Br., pp. 8-9.)

Appellants assert that respondent misinterprets *Crenshaw* and *True*, and provides quotes from those cases unrelated to any analysis of an IRC section 1031 transaction. (*Crenshaw v.*

[10] Appellants contend that the only holding period imposed in IRC section 1031 is in subsection (f), which requires a taxpayer to hold the replacement property for two years if it is acquired from a related party. (App. Rago Supp. Br., p. 4.) That subsection does not apply here.

United States (5th Cir. 1971) 450 F.2d 472; *True v. U.S.* (10th Cir. 1999) 190 F.3d 1165.) Appellants contend that the step transaction doctrine is applied to disallow a broader transaction within which is an otherwise valid like-kind exchange, and neither case applies the step transaction doctrine to disallow an IRC section 1031 exchange. (App. Rago Reply Br., pp. 2, 4-6.) Appellants provide an example from *True*, *supra*, quoting, "End result and interdependence analysis does not invalidate complex or multi-party § 1031 exchanges standing alone, only those forming part of an otherwise invalid step transaction." (*Id*. at pp. 5-6; *True*, at fn. 14.) Appellants also cite to the IRS FSA, which summarizes the decision in *Crenshaw*, *supra*, and, according to appellants, shows that the court did not invalidate the IRC section 1031 exchange through use of the step transaction doctrine, but rather found that the taxpayers did not have an actual interest in the property it contended was exchanged. (App. Supp. Br., pp. 7-8.)

Appellants assert the step transaction doctrine cannot apply here because appellants had direct and substantial economic rights and liabilities by reason of owning Sand Creek Crossing. Appellants assert that they negotiated leases, signed management contracts, entered into operating agreements, paid property taxes, acquired property and liability insurance, and filed federal and state returns as members of a TIC. (App. Bramante Supp. Br., p. 2.) Appellants cite to the decision in *Holman*, where the Tax Court determined that the doctrine did not apply because the taxpayer bore a risk of economic change for a mere six day period. (*Holman v. Commissioner* (2008) 130 T.C. 170.)[11] Appellants also cite to the *Gross* decision, wherein the step transaction doctrine was not applied there was an eleven day period of economic risk, and noting that the IRS was not successful in arguing that future events and actions in these cases were interdependent under the step transaction doctrine. (*Gross v. Commissioner* T.C. Memo. 2008-221.) Therefore, appellants contend, "respondent cannot interrelate that steps occurring months apart and resulted in a relationship back that ignore the intervening right and liabilities." (App. Bramante Op. Br., p. 6.) Appellants contend that the step transaction doctrine exists and should be applied judiciously, but assert that it does not apply in this case. (App. Bramante Reply Br., p. 3.)

[11] Appellants cite to *Hoffman v. Commissioner* (2008) 130 T.C. 26, which does not exist, but it appears they are referencing the *Holman* decision cited here.

Appellants cite the *Frank Lyon* decision when contending that taxpayers be accorded deference when analyzing the tax consequences of business transactions whose form is "compelled or encouraged by business or regulatory realities" and which are "imbued with tax-independent consideration." (App. Rago Op. Br., p. 16; *Frank Lyon Co. v. U.S.* (1978) 435 U.S. 561.) Appellants assert that they deliberately chose the form of the exchange to comply with IRC section 1031 requirements, as provided by the IRS in Revenue Procedure 2002-22, and complied with all those provisions. (App. Rago Op. Br., p. 16; App. Bramante Op. Br., pp, 9-10.) Appellants contend the one aspect they did not choose was the lender provision to place the property into a single entity, and that this provision was the requirement of Greenwich Financial's own business and regulatory reasons. (App. Rago Op. Br., p. 16.)

Appellants assert that respondent has misstated appellants' position on virtually every point, and attempts to counter arguments that appellants never made. For example, appellants are not suggesting the Board avoid consideration of the transfer of the TIC interests to the LLCs seven months after acquisition, but rather assert that judicial authority shows that such subsequent transfers do not invalidate a like-kind exchange. With regard to their contentions regarding intent, appellants assert that IRC section 1031 requires looking to the taxpayers' intent at the time of acquisition to determine whether they held the replacement property for a proper purpose, and appellants assert that their actions clearly show that their intent was to hold their TIC interests, which is entirely consistent with the statutory requirement to hold the property for investment or use in a trade or business. Appellants contend that subsequent transfers, whether required or not, do not evidence a change in that intent. Appellants also assert that any "what ifs" presented by them were not to separate themselves from the events as they transpired, but to show the inapplicability of the step transaction doctrine. Appellants assert that compliance with the lender provision at issue was not interdependent of the like-kind exchange, that the end result of the transactions was the acquisition of the property as a TIC, and that it is absurd to believe that appellants would not have embarked on this exchange in the absence of contributing the property to the LLCs. (App. Rago Reply Br., pp. 8-11.)

Interest Abatement

Appellants in the Bramante group state that respondent's protest officer indicated on

July 19, 2010, that a recommendation had been made and was being reviewed internally, but the NOA was not issued until September 4, 2012. Appellants contend they made numerous calls and sent letters to respondent inquiring about the status of their protest, but no response was received during this period. Appellants in the Bramante group contend there was an unreasonable delay from July 19, 2010, to September 4, 2012, for which interest should be abated. (App. Bramante Op. Br., p. 12.) The Rago group appellants similarly indicate that their protest was heard by respondent's protest unit on December 17, 2010, and no further communication was received from respondent until July 31, 2012, when they received a determination letter. (App. Rago Op. Br., p. 6.)

The parties discussed the matter of interest abatement at the prehearing conference. Respondent restated that it was going to abate interest for the Bramante group of appellants from September 1, 2010, through August 30, 2012. The Bramante group stated that it still believes interest should be abated for an additional period of approximately 48 days, which would appear to include July 19, 2010, to September 1, 2010, and from August 30, 2012, to September 4, 2012. Although the Rago appellants indicate in their brief that there was a period of over 16 months between when their protest hearing was held and when they received their determination letter, there is no argument in the briefs requesting interest abatement pursuant to R&TC section 19104.

Respondent's Contentions

Burden of Proof

Respondent contends that its determination of fact is presumptively correct, and appellants bear the burden of showing error in such determination, citing *Todd v. McColgan* (1949) 89 Cal.App.2d 509, and *Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, decided on November 18, 1980. Respondent asserts that the party claiming an exception to the general rule of recognition of gain must show the exception is met, which includes showing both adherence to the code for an excepted exchange and satisfying the underlying purpose for which such exchange is excepted from the general rule of gain recognition. Respondent contends that appellants have failed to meet their burden. (Resp. Bramante Op. Br., pp. 16-17.)

Wachovia Transaction

At the prehearing conference, respondent indicated that adjustments would be made to

the proposed assessments for members of the Rago group of appellants. Respondent should be prepared to detail the amount of any adjustments and to which appellants these adjustments apply, including the amount of the reduction in the proposed assessment of additional tax for each affected appellant.

Sand Creek Crossing Like-Exchange

Respondent contends that the question before the Board is whether appellants borrowed $36,975,000 to acquire property with an agreement at the time of borrowing to contribute that property to an LLC, resulting in the exchange of non-like kind intangible personal property, and therefore voided their attempted IRC section 1031 like-kind exchange and are liable for the assessment proposed by respondent on appeal. (Resp. Rago Op. Br., pp. 1-2.) Respondent asserts that *Regals Realty*, *supra*, states that a taxpayer "must intend to keep the like-kind property acquired, and intend to do so with an investment purpose." (Resp. Bramante Op Br., p. 1.) Respondent contends that there must be some intent to hold property for investment at the time the replacement property is acquired.[12] Respondent asserts that the Deed of Trust between the lender and appellants shows that appellants' intent at the time they acquired the Sand Creek Crossing property was to convey it to an LLC, and not to hold it for investment. (*Id.* at p. 19.)

Respondent asserts that appellants had an immediate contractual obligation under the Deed of Trust between Greenwich Capital and themselves to transfer the property to a single entity by January 31, 2004, or lose the property by creating an event of default. (See Resp. Bramante Op. Br., p. 3 & exhibit A, pp. 16 & 21, Sections 15A & 19(b).) Respondent contends that this obligation began on June 25, 2003. Respondent contends that appellants were mere stewards of the property pending transfer to the LLC, and references Section 15 of the Deed of Trust limiting appellants from selling or transferring the property, Section 16 restricting any further encumbrances such as mortgages or liens, and Section 28 prohibiting alterations in excess of five percent of the loan amount without prior

[12] Respondent also states in its briefs, with respect to appellants' assertion that their intent was to engage in a valid 1031, that ". . . the best of intentions are irrelevant in determining whether a valid 1031 exchange took place. Rather appellants' actual actions and obligations are determinative of how their affiliated transactions should be characterized for tax purposes." (Resp. Rago Op. Br., p. 10.) Respondent should be prepared to discuss the relevance of a taxpayer's intent in determining whether a valid IRC section 1031 exchange occurred.

consent. Respondent also asserts that the loan document itself contained a substantial prepayment penalty, which reduced the likelihood of refinancing the loan. (Resp. Bramante Op. Br., pp. 6-7 & exhibit B, p. 5.) Respondent asserts that, even without directly applying the step transaction doctrine, you must still perform a continued review of the transactions after the acquisition of the purported replacement property to determine whether the transaction satisfies the statutory requirements of IRC section 1031. This continued review includes seeing how the taxpayers use the replacement property, whether they put the property into a trade or business or used it for investment, and whether they exercised ownership and all its burdens and benefits. (Resp. Bramante Reply Br., pp. 7-8.)

As discussed below, respondent contends that the step transaction doctrine operates here to show that appellants exchanged real property for an interest in an LLC. Respondent cites California Corporations Code section 17300, which states that LLC membership is personal property of the member, and LLC members have no interest in specific limited liability company property. Therefore, respondent asserts that appellants failed to execute a valid IRC section 1031 like-kind exchange because they exchanged real property for an interest in an LLC, which are not like-kind. (Resp. Bramante Op. Br., pp. 17-18, 30-31.) To further distinguish the ownership status of property held by individuals versus in a partnership entity, respondent cites to *Munkdale*, *supra*, and asserts that the transferring of property between a partner and a partnership constitutes a change in ownership. (*Id*. at pp. 32-33.)

Respondent cites to *Regals Realty*, *supra*, in which the court found that the taxpayer acquired replacement property with the intent to sell the property, and even though it did not actually sell the property, the intent to sell disqualified it for IRC section 1031 treatment. Respondent contends that the court also looked at what actually happened, wherein the acquiring corporation dropped the property into a subsidiary and distributed shares of the subsidiary to its shareholder, and found that its actions made it impossible for the corporate taxpayer to hold the property as an investment. The decision found that what actually transpired failed to support the taxpayer's assertion that it intended to hold the property for investment. Respondent cites to *Click*, *supra*, wherein the Tax Court determined that IRC section 1031 did not apply because the taxpayer acquired the property with the intent to dispose of it by gift, even though the taxpayer held the property for seven months before disposing of it.

Respondent cites to the decision in *Griffin*, where the taxpayer acquired property was held for sale and no other purpose, and the *Barker* decision, where property was acquired for the purpose of completing an exchange, as additional support for its contention that that taxpayer must acquire property with the intent to hold the property and not sell, exchange, or otherwise dispose of the property to qualify for IRC section 1031 treatment. (*Griffin v. Commissioner* (1967) 49 T.C. 253; *Barker v. U.S.* (C.D. Ill. 1987) 668 F.Supp. 1199.) Respondent contends that appellants fail this requirement, because they acquired the property with the intent and contractual obligation to dispose of the property at the time they acquired the property, and they neither retained the property at the end of the related transactions nor held the real property for investment. (Resp. Bramante Op. Br., pp. 26-30.)

Respondent references an unpublished consolidated appeal considered by the Board previously, which respondent refers to as Diamond and Aries decisions. Respondent urges the Board to follow its previous decision and find that appellants fail the like-kind requirement.[13] (Resp. Bramante Reply Br., pp. 9-10.)

Respondent asserts that *Magneson*, *supra*, and *Marks*, *supra*, are inapplicable. (Resp. Bramante Op. Br., p. 4.) Respondent contends that the *Magneson* decision is based on former California Corporations Code section 15025, which was replaced by section 16501 of that same code in January of 1999, with the effect of clarifying that a partner is not a co-owner of partnership property and has no interest in the property of the partnership. Respondent asserts that the court in *Magneson*, *supra*, allowed the like-kind exchange when the taxpayer immediately transferred acquired property to a partnership because be California Corporations Code at the time provided that partners have ownership interests in the property held by the partnership, and therefore the taxpayer changed the form of ownership but still had ownership rights over the property. (*Id*. at pp. 35-36.) Respondent contends the court focused on the holding requirement of IRC section 1031 rather than any intent. (Resp. Rago Reply Br., pp. 12-13.) Respondent contends that, since the code has since changed and the holding in

[13] The consolidated Diamond and Aries appeal from 2010 was resolved through a Letter Decision, which may not be cited as precedent in any appeal or other proceeding before the Board. (See Cal. Code Regs., tit. 18, § 5450, as of August of 2008.) In income tax appeals, the Board's decisions are only precedential when the Board adopts a Formal Opinion. Staff observes that appeals involving IRC section 1031 and the substance-over-form doctrine are factually intensive and, while respondent prevailed in the appeal it cites, it has not always prevailed before the Board. In staff's opinion, prior Letter Decisions, whether in respondent's favor or not, should not be cited to support a party's position.

Magneson, supra, is now based on repealed law, that case should not be followed. Respondent also asserts that *Marks, supra*, should not be followed because it is nonprecedential, involves Oregon's interpretation of IRC section 1031 instead of California's, does not acknowledge the material change in California partnership law discussed above,[14] and is devoid of any discussion concerning a partner's lack of ownership in partnership property. (Resp. Bramante Op. Br., pp. 35-36.) Respondent also contends that *Bolker, supra*, is factually different because the taxpayer in that case only exchanged and retained real property, and the question was whether it was held for investment purposes, whereas the question here, according to respondent, is what property did appellants receive at the conclusion of their related transactions and not whether it was held for investment purposes. (Resp. Rago Reply Br., p. 9.)

Respondent asserts that appellants' reliance on Revenue Procedure 2002-22 is an attempt to look at the transactions at a single point in time, which is in contravention to the review necessary to determine whether a valid like-kind exchange took place. Respondent states that this revenue procedure is a red herring that deals with whether the IRS will determine property interests should not be deemed partnership or business enterprises, and is completely inapplicable to this appeal. (Resp. Bramante Op. Br., p. 20.) Respondent also contends that appellants' references and comparisons to the law regarding single-member LLCs is misplaced and should be disregarded. Respondent asserts that the Sand Creek Crossing LLCs at issue here were not single-member LLCs but rather multi-member LLCs, that single-member LLCs carry significantly different tax consequences than multi-member LLCs, and that appellants' assertions and attempt to apply the analysis from IRS Private Letter Ruling 199911033, which dealt with a single-member LLC that was a disregarded entity, is improper and does not apply here. (Resp. Bramante Reply Br., pp. 4-6.)

Step Transaction

Respondent asserts that the step transaction doctrine applies here. Respondent contends that the step transaction doctrine can apply even when there is "no binding commitment to complete the prearranged plan . . . there is ample authority for linking several prearranged or contemplated steps,

[14] As noted by appellants in their contentions, it appears as though Oregon underwent a nearly similar change in partnership law as California did between *Magneson, supra*, and *Marks, supra*.

even in the absence of a contractual obligation or financial compulsion to follow through." (Resp. Bramante Op. Br., p. 1, quoting *Brown v. U.S.* (9th Cir. 2003) 329 F.3d 664, 672.) Respondent quotes from the *King Enterprises* decision for the proposition that the step transaction doctrine derives "vitality . . . from its application where the form of a transaction does not require a particular further step be taken; but, once taken, the substance of the transaction reveals that the ultimate result was intended from the outset." (*Ibid*, quoting *King Enterprises, Inc. v. U.S.* (Ct.Cl. 1969) 329 F.2d 664, 672.) Respondent asserts that, contrary to appellants' contentions, they had an obligation to contribute the Sand Creek Crossing property to the LLCs, that events occurring over a course of days or months can be aggregated for purposes of the step transaction doctrine, and that there is no requirement in the doctrine that a step lack economic substance. Respondent contends that appellants are not allowed to exchange real property for intangible personal property (i.e., LLC membership interest) in an IRC section 1031 like-kind exchange. (*Id*. at p. 2.)

Respondent asserts that the mutual interdependency test is met when the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series. Respondent contends that the test is met here, because appellants would not have obtained the loan without undertaking the LLC contribution obligation, which was ultimately timely satisfied pursuant to the terms of the contract. Respondent also asserts the end result test because appellants entered into the loan agreement under the loan's funding condition that the property be contributed to a single-purpose entity, which is what occurred. Respondent contends that appellants are attempting to play a game of "what ifs" rather than accept what actually transpired, resulting in the 'end result' of obtaining an LLC interest. (Resp. Rago Op. Br., pp. 12-13.) Respondent also disagrees with appellants' contention that the seven months that they held the property as a TIC stops the application of the step transaction doctrine. Respondent references *Click, supra*, noting that the taxpayer in that case attempted a like-kind exchange, held the replacement property for about seven months, and then gifted it to her children, and the court disallowed the attempted IRC section 1031 gain deferral, noting that evidence showed she had an intent to locate properties to give to her children a year before she performed the exchange. (*Id*. at p. 16.)

Respondent contends that for the step transaction to apply there must be a prearranged

plan with defined steps before combining the multiple transactions into a single transaction, citing *Appeal of Western Icee Corp.*, 80-SBE-001, decided on January 8, 1980, and *Appeal of Chris-Craft Industries, Inc.*, 68-SBE-011, decided on March 26, 1968. Respondent asserts that there is no doubt that appellants intended to acquire personal property LLC membership interest with the proceeds of the relinquished property; a transaction not falling within the requirements of IRC section 1031. Respondent asserts appellants' acquisition of the Sand Creek Crossing property was transient and contractually temporary that was not retained by appellants personally. Respondent contends it is improper under the step transaction doctrine to view appellants' acquisition of title to Sand Creek Crossing at an isolated moment in time, but instead the Board must recognize that it is just one of several pre-arranged and carefully orchestrated steps in appellants' overall plan to acquire LLC interests to replace their real property interests in the relinquished property. Respondent contends that, because a partnership in the Bramante group of appellants liquidated after acquiring the LLC interest, it shows that appellants' intent was to revise their investment strategy into a different form of investment and "go their separate ways." Respondent refers to *Sandoval*, *supra*, asserting that the court concluded that the transactions at issue there failed the like-kind exchange requirements based on an intent to hold partnership interests rather than real property interest. (Resp. Bramante Op. Br., pp. 31-34.)

Respondent asserts that it is appellants' "actual, ultimate, anticipated and interrelated acquisition of its LLC membership interest that gives rise to its failure to effect a 'like-kind' exchange, as the steps are collapsed to determine that [appellants] did not intend to effect a valid 1031 exchange when it organized its affairs in 2003." (Resp. Bramante Reply Br., p. 3.) Respondent asserts that appellants' statement that "it cannot be rationally said that they intended and it was their purpose to acquire a partnership interest," is nonsense, since appellants also admit that they transferred their TIC interest to an LLC, which was taxable as a partnership, pursuant to the lender's requirement. (Resp. Rago Op. Br., p. 3; App. Rago Op. Br., pp. 2, 21.)

Respondent addresses the IRS FSA, quoting that the IRS ". . . disagree[s] with the conclusion that a taxpayer that receives property subject to a prearranged agreement to immediately transfer the property 'holds' the property for investment," but that the IRS is not pursuing these cases in litigation. Respondent contends that the IRS clearly does not agree with appellants' position on appeal,

but chooses not to relitigate an issue "that checks its action in similar cases," and refers to a *Golsen* policy.[15] (Resp. Rago Op. Br., pp. 5-6.) Respondent clarifies in its reply brief that this reference to a *Golsen* policy is not a reference to the actual Tax Court doctrine arising from that case, but rather a reference to the informal and internal IRS policy, based on the *Golsen* decision, that leads to the IRS' reluctance to pursue some IRC section 1031 cases. Respondent's attorney authoring the brief states that he has had conversations with "IRS personnel who administer 1031 policy in Washington DC," and was simply sharing his understanding. (Resp. Rago Reply Br., pp. 7-8.) Respondent contends that the question in the FSA was whether the replacement property was held for investment, whereas the question in this appeal is what property was actually received in replacement for real property.[16] (*Id*., at p. 9.)

Respondent asserts that the end result test of the step transaction doctrine is met here, because appellants completed the required transfer to the LLC in return for membership interests. Respondent contends that appellants received their contracted for intangible personal property (i.e., LLC membership interest) as part of their investment plan, and they did not, therefore, receive qualifying like-kind property and the attempted like-kind exchange fails. Respondent asserts that since appellants contracted for the LLC membership interests, the binding commitment test is also met. Finally, respondent asserts that the interdependence test is satisfied because appellants' ability to secure the loan was dependent upon appellants' contractual agreement with the lender to contribute the Sand Creek Crossing property to the LLC. Respondent disagrees with appellants' contention that the contribution of the property to the LLC was purely due to lender requirements and supersedes statutory

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[15] Appellants address the "Golsen policy," which they assert is actually the "Golsen rule," and does not prevent the IRS from challenging appellants' transactions. Instead, appellants contend, the Golsen rule simply states that the U.S. Tax Court has bound itself to apply the precedent of the circuit court of appeals to which its decision could be appealed, and has nothing to do with the IRS' decision of whether or not to pursue issues through litigation. (App. Rago Reply Br., pp. 2-4; *Golsen v. Commissioner* (1970) 54 T.C. 742.) *Golsen*, *supra*, provides, ". . . better judicial administration requires us to follow a Court of Appeals decision which is squarely in point where appeal from our decision lies to that Court of Appeals and to that court alone." (*Golsen*, at p. 757.)

[16] However, respondent continues to state that the FSA makes the distinction between the issues of "(A) what property was actually conveyed and received by the taxpayer . . . and (B) for what reason, investment or otherwise, did the taxpayer hold the property," and then asserts that the FSA was clearly only focused on issue (A), what property was conveyed and received. (Resp. Rago Reply Br., p. 9.) This appears to potentially contradict the assertion made by respondent above, and respondent may wish to clarify its contention with regard to the issue of focus in the IRS FSA.

requirements and judicial doctrines. Respondent notes that appellants chose to acquire the Sand Creek Crossing property and agree to the lender agreement, but could have structured a different transaction and acquire different real property to satisfy IRC section 1031's requirements. (Resp. Bramante Op. Br., pp. 10-12.)

Respondent asserts that business purpose does not excuse noncompliance with like-kind requirements, citing, among other cases, *South Bay Corp. v. Commissioner* (2nd Cir. 1965) 345 F.2d 698, 703; *True v. U.S.*, at 1177; *Kuper v. Commissioner* (5th Cir. 1976) 533 F.2d. 152, 158. Respondent states that like-kind exchanges require a review of the taxpayer's action over an extended time frame, and not only to look at the initial and transitory acquisition of replacement property, as respondent contends appellants assert. (Resp. Bramante Op. Br., pp. 12-15.) Furthermore, respondent contends that the Board has applied the step transaction previously in appeals involving a prearranged plan, citing *Appeal of Sargent Industries, Inc.*, 93-SBE-008, decided on April 22, 2008, and *Appeal of Chris-Craft Industries, Inc., supra*. (*Id*. at p. 15.) Respondent discusses, *Crenshaw*, *supra*, stating that the 1031 transaction an integral part of the structured transaction and was disallowed as one of the steps in the court's application of the step transaction doctrine. (Resp. Rago Reply Br., pp. 10-12.)

Interest Abatement

On appeal, respondent has stated that it will abate interest for the Bramante appellants from September 1, 2010, to August 30, 2012. (Resp. Bramante Op. Br., p. 4.)

Applicable Law

Burden of Proof

Respondent has the initial burden of showing that its proposed assessment is reasonable and rational. Once this burden is met, respondent's determination is presumed correct and appellant has the burden of proving it to be wrong. (*Todd v McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Richard Byrd*, 84-SBE-167, Dec. 13, 1984.)

IRC section 1031 Like-Kind Exchanges

California conforms to IRC section 1031 at R&TC sections 18031 and 24941. To qualify for nonrecognition treatment under IRC section 1031, the following general requirements must be satisfied: (1) the transaction must be an exchange; (2) the exchange must involve like-kind

properties; and (3) both the property transferred (the *relinquished property*) and the property received (the *replacement property*) must be held for a qualified purpose. (Int.Rev. Code, § 1031(a)(1)-(3).) Property is held for a qualified purpose if it is held for a productive use in a trade or business or held for investment. (*Ibid*.) IRC section 1031(a)(2)(D) provides that the exchange of interests in a partnership will not qualify for the like-kind exchange treatment.

Regals Realty (B.T.A. 1940) 43 B.T.A. 194

The U.S. Board of Tax Appeals, a precursor to the current U.S. Tax Court, discussed the requirement for replacement property to be held for investment in *Regals Realty supra*, a decision from 1940. In that case, the corporation attempted to perform an IRC section 1031 exchange in which it received the replacement property with the immediate intent to sell the replacement property as part of a liquidation. In determining whether the replacement property was held for investment, the court focused on the intent of the taxpayer, and specifically whether the taxpayer's "mental state was such that it intended to hold the property received as investment." (*Regals Realty*, at p. 208.) The court found that appellant's intent was clearly to arrange for an outright sale of the property, and only for tax purposes has it been compelled to create the appearance of a tax-deferred exchange. The court noted that, "given no tax problem, [the transaction] would almost certainly have been carried out in another way." (*Id*. at p. 209.) The court focused on the taxpayer's stockholder meeting less than two weeks after the property acquisition in which they decided to liquidate the taxpayer promptly and sell off all properties, stating that this action makes it difficult to believe that there was an intent to hold the property for investment. Although the property was, in fact, not immediately sold and was retained by the corporation did not alter the court's decision that the exchange failed the statutory requirements due to a lack of intent to hold the property for investment or use in a business or trade.

Wagensen v. Commissioner (1980) 74 T.C. 653

Appellant was involved in ranching for over 50 years, and during the years of the transaction was operating a cattle ranching business in partnership with his son. Appellant owned all the real property used in the business. Appellant was approached by potential buyers seeking to purchase his land for cash, but appellant insisted on receiving other property on which he could continue his ranching business. Ultimately, appellant received the Napier ranch as partial consideration

for the sale of his land on January 18, 1974, and appears to have used that land in his business after acquisition. Subsequent to receiving this property, appellant discussed possible gift tax implications of transferring the property to his children. On October 15, 1974, nine months after acquisition, appellant gifted the land to his two children.

The court determined that appellant's exchange was not a cashing in on his investment, but rather an increase in ranching property acreage and a continuation of his investment. The court noted that appellant's goal from the beginning of negotiating the property exchange was to obtain other ranch land to replace the land he would relinquish, and after the exchange he used that land for productive use in his business for nine months. The court disagreed with the IRS's contention that appellant's ultimate plan was to give the land to his children, stating that he had no concrete plans do so when he acquired the land. IRC section 1031 gain deferral was allowed.

Click v. Commissioner (1982) 78 T.C. 225

Same court, two years after *Wagensen, supra*, dealt with similar facts in *Click, supra*. The taxpayer held farm land for investment purposes, and began receiving offers to purchase her farm that including the option to exchange properties. At the same time, appellant's children were looking for a new home, and appellant advised them to seek a suitable home that she could choose as her replacement property. Appellant received two homes in the exchange and on or about the same day allowed her children to move into the two homes, and her children began paying for substantial improvements, insurance, and property tax on the homes. Seven months later, appellant gifted the houses to her children.

Like it did in *Wagensen, supra*, the court stated that the "taxpayer's intent to hold property for investment must be determined as of the time of the exchange." (*Click*, at p. 231.) However, unlike the previous decision, here the court found that the facts showed appellant's primary purpose of obtaining the replacement properties was to provide homes for her children to live in, and therefore she did not have an investment intent in accepting the homes in the swap.

Magneson v. Commissioner (9th Cir. 1985) 753 F.2d 1490

Magneson, supra, was the first of two IRC section 1031 cases decided by the Ninth Circuit Court of Appeals in 1985. In *Magneson,* the issue presented was whether the acquisition

of property in a like-kind exchange with the intention of contributing the property to a partnership satisfied the requirements of IRC section 1031. Pursuant to a pre-arranged plan, the taxpayers completed an exchange of property, and then, on the same day, contributed the property to a limited partnership, and in return became general partners of the limited partnership. The court found that the requirements of IRC section 1031 were satisfied and declined to apply the step-transaction doctrine.

The court stated that "[t]he case law, the regulations, and the legislative history are . . . all in agreement that the basic reason for nonrecognition of gain or loss on transfers of property under sections 1031 and 721 [which permits nontaxable contributions to partnerships] is that the taxpayer's economic situation after the transfer is fundamentally the same as it was before the transfer; his money is still tied up in investment in the same kind of property." (*Magneson, supra*, at p. 1494.) The court held that "this principle exactly describes the Magnesons' situation[,]" reasoning that the Magnesons only changed the form of their ownership from a tenancy in common to a partnership and they took no cash or non-like-kind property of the transaction. (*Ibid.*)

The court rejected the argument that the partnership interest received and the tenancy-in-common interest given up were so substantially different that the Magnesons could not be considered to have continued to hold the property for investment. In doing so, the court looked to California state law existing at that time and observed that a partner is co-owner with his partners and that general partners had the right to possess partnership property. The court stated that, while there are "significant distinctions" between a tenancy in common and a partnership interest, the distinctions are not controlling, and the taxpayers continued their investment interest when they held the property through their general partnership interest. (*Id.* at pp. 1495 -1496.)

The court also rejected the argument of the IRS that step transaction doctrine should apply so that the transaction should be viewed as an exchange of real property in return for a partnership interest. The court found that the Magnesons could have structured their transaction differently, but there was no more direct method than the method actually used. The court stated that "[b]etween two equally direct ways of achieving the same result, the Magnesons were free to choose the method which entailed the most tax advantages to them." (*Id.* at p. 1497.) The court further stated that, even if it did collapse the transaction, the transaction would still qualify under IRC section 1031,

though it noted that Congress had recently amended the statute, for years after the years at issue in the case, to exclude exchanges of partnership interests. (*Id.* at pp. 1497-1498, fn. 4.) The court concluded by stating that "a critical basis for [its] decision [was] that the partnership in this case had as its underlying assets property of like kind to the Magnesons' original property, and its purpose was to hold that property for investment." (*Id.* at p. 1498.) The court stated that its holding was limited to exchanges of property where the property is contributed in return for a general partnership interest. (*Ibid.*)

Bolker v. Commissioner (9th Cir. 1985) 760 F.2d 1039

Shortly after its decision in *Magneson, supra*, the Ninth Circuit issued its decision in *Bolker, supra*. In *Bolker*, "for tax purposes," the taxpayer liquidated his own wholly owned corporation, and received a distribution of real estate. On the same day as the liquidation, he contracted to exchange the distributed property for other like-kind property. The actual exchange took place three months later. The IRS argued that the corporation, not the individual taxpayer, exchanged the property. In the alternative, the IRS argued that the taxpayer did not hold the property for trade or business or investment. The trial court and the Ninth Circuit rejected these arguments. On appeal to the Ninth Circuit, the IRS also argued, for the first time, that the step transaction doctrine should apply, but the court stated it would not consider this argument because, as a general rule, it will not consider arguments that were not raised at trial.

The Ninth Circuit explained that in *Magneson* it based its decision "on our holding that the Magnesons intended to and did continue to hold the acquired property, the contribution to the partnership being a change in the form of ownership rather than the relinquishment of ownership." (*Id.* at p. 1044.) The court held that ". . . if a taxpayer owns property which he does not intend to liquidate or to use for personal pursuits, he is 'holding' that property 'for productive use in trade or business or for investment' within the meaning of section 1031(a)." (*Id.* at p. 1045.) Applying this holding, the court found that the intent to exchange a property does not disqualify a property from qualifying for like-kind treatment.

Maloney v. Commissioner (1989) 93 T.C. 89

In *Maloney*, the Tax Court considered whether the requirements of IRC section 1031

were satisfied on the following basic facts. The corporation entered into an agreement to exchange real property and, shortly before the exchange occurred, determined that it wished to liquidate and distribute the property following completion of the exchange. As a result, three days after the exchange, the corporation adopted a plan to liquidate and distribute the replacement property to its shareholder. The liquidation then occurred within a few weeks. Citing *Magneson* and *Bolker*, the tax court held that the addition of another nontaxable transaction did not disqualify the exchange for non-recognition of gain under IRC section 1031. The Tax Court found that *Magneson* was applicable because, in both *Magneson* and its case, property was exchanged for like-kind property. The court noted that, in *Magneson*, the exchange was followed by a tax-free transfer to a partnership, while in its case, the exchange *preceded* a tax-free liquidation. The court found that this "minor variation" did not warrant treating taxpayers in a "dramatically different" manner. (*Maloney*, *supra*, at p. 98.)

The court further stated that, even without *Magneson*, it believed the taxpayer's position was correct. It explained that, where a taxpayer surrenders stock in a corporation in a liquidation, and receives in return property owned by the corporation, ". . . he continues to have an economic interest in essentially the same investment, although there has been a change in the form of ownership." (*Id.* at pp. 98-99.) The court stated "Section 1031 is designed to apply to these circumstances and to defer the recognition of gain where the 'taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture." (*Ibid.*)

Department of Revenue v. Marks (Or. T.C. 2009) 20 OTR 35, 2009 Ore. Tax LEXIS 241

In *Marks*, the taxpayers received replacement property in an IRC section 1031 exchange and immediately contributed it to a partnership. In its analysis, the court assumed that the transfer was the result of a pre-arranged plan. (*Id.* at p. 40, fn. 3.)

The Department argued that the taxpayers did not hold the property for investment and, further, that the substance-over-form and step-transaction doctrines should apply such that the taxpayers should be deemed to have received a partnership rather than like-kind property. The Department further argued that *Magneson* was distinguishable because (i) it pre-dated amendments to IRC section 1031 that prohibited exchanges of partnerships interests for partnership interests and (ii) *Magneson* relied on state partnership laws that did not reflect Oregon's current laws.

The court rejected all of the Department's arguments. Reviewing *Magneson, Bolker*, *Maloney*, and FSA 199951004, among other authorities, the court determined that the central rationale of *Magneson* was that the taxpayer continued his investment. The court noted that *Bolker* and *Maloney* followed *Magneson*, and reflected the same rationale. Citing legislative history and the plain language of the statute, it further found that the amendments to IRC section 1031 only prohibited exchanges of partnership interests for partnership interests, rather than prohibiting an exchange of real property that is followed by the contribution of that property to a partnership. With regard to the changed partnership laws, it found that the changes in the uniform partnership act did not alter the fact that the taxpayers essentially continued their investment in a new form.

With regard to the substance-over-form and step-transaction doctrine, the court found that the steps taken reflected the substance of the transaction and were permitted. It stated as follows: "[t]he point of *Magneson* is that taxpayers may engage in IRC section 1031 transactions and then, pursuant to a pre-existing plan or intent, contribute replacement property to a partnership . . . . The department is not authorized or permitted to rearrange facts to produce a different transaction." (*Id.* at p. 52.) However, the court denied the defendants' motion for partial summary judgment in order to allow more factual development with regard to whether the partnership continued to hold the replacement property for investment.

IRS Field Service Advice 199951004, December 24, 1999[17]

The FSA reviewed a very complicated series of transactions. In the transactions, the taxpayer, a partnership, agreed to dissolve a partnership in which it held an investment, and then exchange certain of the properties received. The exchange intermediary then acquired the properties to be relinquished in the exchange. The owner of 97.5 percent of the taxpayer/partnership then acquired the replacement properties, directly or indirectly through another limited partnership, and agreed to exchange the properties with the exchange intermediary, which, in turn, agreed to transfer the replacement property to the taxpayer/partnership. The FSA stated that the details about one property

[17] An IRS Field Service Advice (FSA) is not citable as precedent. However, given that, as relevant to the issues on appeal, California law conforms to federal law with respect IRC section 1031, staff believes the FSA provides useful insight as to how the IRS handles similar types of appeals at the federal level.

("Property 4") were unclear but there was evidence that the owner transferred the property to a LLC several years after the period in dispute.

The FSA stated that a substance over form analysis might be applied to find that, in substance, the taxpayer exchanged a partnership interest rather than like-kind real property. To this end, the IRS counsel noted that the transactions were "convoluted" and all occurred on a single date. Further, the counsel found that the "ultimate result" was the disposal of the taxpayer's interest in the partnership, rather than the dissolution of the partnership. The counsel also found that the form of the transaction merited scrutiny due to ". . . the lack of a non-tax based advantage to either of the parties in the chosen structure of the transaction."

However, the FSA cautioned that "[w]hether the form of this transaction should be respected is a factual issue subject to the interpretive whims of the court[,]" citing *Bolker, supra,* and *Mason v. Commissioner*, T.C. Memo. 1988-273, aff'd 880 F.2d 420 (11th Cir. 1989).[18] The FSA recommended that the facts be more fully developed. The FSA also acquiesced to the Ninth Circuit's decisions in *Magneson* and *Bolker,* stating as follows:

> . . . we agree with you that the facts concerning whether Property 4 was actually transferred to Taxpayer and whether the exchange agreement met the requirements [under the regulations] should be developed further. We do not recommend pursuit of the argument that Taxpayer did not hold the property for investment within the meaning of section 1031(a). As you have noted, this position has been rejected on several occasions. [citing *Magneson v. Commissioner*, (9th Cir. 1985) 753 F.2d 1490, and *Bolker v. Commissioner*, *supra*.] **Although we disagree with the conclusion that a taxpayer that receives property subject to a prearranged agreement to immediately transfer the property holds the property for investment, we are no longer pursuing this position in litigation in view of the negative precedent.** [emphasis added]

Step Transaction Doctrine

The Ninth Circuit Court of Appeals has explained that "[t]he step transaction doctrine is one of the many 'substance-over-form' doctrines in tax law." (*Linton v. United States* (9th Cir. 2011) 630 F.3d 1211, 1223.) Although the doctrine considers the substance over the form of the transaction, the taxpayer "is not bound to choose the pattern which will best pay the Treasury." (*Id.* at p. 1224; see

[18] In *Mason*, the Tax Court allowed an IRC section 1031 exchange where it found that two partners received property in a partnership liquidation and then exchanged the properties distributed.

also *Magneson, supra*, at p. 1497 ["Between two equally direct ways of achieving the same result, the [taxpayers] were free to choose the method which entailed the most tax advantages to them."].)

Courts have generally used three alternative tests in determining whether to apply the step transaction doctrine: (i) the end result test; (ii) the interdependence test; and (iii) the binding commitment test. Generally, only one of the tests needs to be satisfied in order for the step transaction test to apply. (See, e.g., *Falconwood Corp. v. United States* (Fed. Cir. 2005) 422 F.3d 1339, 1349; *McMillin-BCED/Miramar Ranch North v. County of San Diego* (1995) 31 Cal.App.4th 545.)

In *Esmark, Inc. v. Commissioner* (T.C. 1988) 90 T.C. 171, 195, the court stated that:

> The existence of an overall plan does not alone, however, justify application of the step-transaction doctrine. Whether invoked as a result of the "binding commitment," "interdependence," or "end result" tests, the doctrine combines a series of individually meaningless steps into a single transaction. (See also *Linton*, *supra*, 1223 [quoting *Esmark, Inc.*].)

Under the end result test, "purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." (*King Enterprises v. United States* (Ct. Cl. 1969) 418 F.2d 511, 516 [internal citation omitted].)

The interdependence test looks to each step of the transaction to see whether the legal effects of one of the steps seem fruitless without completion of the overall transaction. (*True v. United States, supra*, 190 F.3d at pp. 1175-1181.) Application of the interdependence test will be unsuccessful if the steps have "reasoned economic justification standing alone," but the step transaction doctrine will apply if the only reasonable conclusion from the evidence is that the steps have "meaning only as part of the larger transaction." (*Id.* at p. 1178 [quoting *Security Industrial Ins. Co. v. United States* (5th Cir. 1983) 702 F.2d 1234, 1246-1247].) The interdependence test states that the individual steps need to be "the type of business activity we would expect to see in a bona fide, arm's length business deal between unrelated parties," and make sense "standing alone without contemplation of the subsequent steps in the transaction." (*Id.* at p. 1179.) Under this test, it may be "useful to compare the transactions in question with those we might usually expect to occur in otherwise bona fide business settings." (*Id.* at p. 1176; see also *Linton, supra*, at pp. 1224 – 1225 [quoting *True*].).

The third step transaction test, the binding commitment test, is applicable to transactions where one step creates a binding commitment by the taxpayer to take a second action at a substantially later time. (*Id.* at p. 1175, fn. 8.) The Ninth Circuit has stated that the binding commitment test "only applies to transactions spanning several years." (*Linton*, *supra*, at pp. 1224 – 1225; see also *True*, at p. 1175 [stating that "[t]he binding commitment test is seldom utilized . . . ."].)

Crenshaw v. U.S. (5th Cir. 1971) 450 F.2d 472

The taxpayer in *Crenshaw*, *supra*, was approached by her fellow partners with an offer to buy out her share of the partnership. The taxpayer's attorney suggested that it would be financially advantageous for taxpayer to exchange her partnership interest for income-producing property rather than for cash. The other partners did not have such property, but the taxpayer's former husband's estate did. They devised a plan wherein (i) taxpayer withdrew from the partnership in exchange for an undivided interest in the partnership's real property (apartments), (ii) taxpayer then performed a like-kind exchange of this interest in the apartments for real property belonging to her husband's estate, (iii) appellant had her husband's estate sell for $200,000 the apartments to her former partners' newly-formed closely-held corporation, which in turn (iv) contributed the interest in the apartments back to the partnership in exchange for the partnership interest formerly owned by the taxpayer. Through this circular exchange, appellant essentially received $200,000 for her partnership interest without recognizing any taxable gain, whereas had the former partners paid her $200,000 in cash for her partnership share, she would have taxable gain.

The court determined that what really occurred was a sale, and the parties would have been in substantially the same positions had they chosen a direct path instead of the circuitous one. The court focused on the importance of the interest in the apartments being ultimately put back into the partnership, since without that final end step, the other partners might not have agreed to the deal at all, making it indispensable regardless of whether taxpayer was aware of it or not. The court found that the true nature of the sale cannot be avoided by constructing a series of successive transfers, each nontaxable in themselves, that together work to the same result as a direct sale.

True v. U.S. (10th Cir. 1999) 190 F.3d 1165

Appellants engaged in a multi-stage purchase, exchange, and transfer involving

ranchland properties.[19] Appellants acquired several ranch properties during the 1980s by having one of their oil companies purchase the lands and provide their ranch company with operating rights, then do a like-kind exchange under IRC section 1031 of the ranchland from one oil company to another for oil and gas lease rights. The oil company would immediately distribute the land to the True family members as partners, who then contributed the land to the ranching company. This series allowed for the first oil company to exchange non-depreciable land for cost-depletion deductions in the leases, while the second oil company received land with zero basis because the relinquished leases were fully cost-depleted, and the ranching company received the lands with zero basis. Ultimately, the True family members benefited from turning non-depreciable assets (ranchlands) into cost-depletable assets (leases) while ridding the second oil company of fully cost-depleted assets (leases) and leaving the ranching company with a zero basis in otherwise non-depreciable assets (ranchlands).

The court reviewed the transactions under the end result test of the step transaction doctrine, noting that the taxpayer's subjective intent is especially relevant in order to determine whether the taxpayer intended to reach a particular result by structuring a series of transactions in a certain way. Meanwhile, the interdependence test looks to see whether it is unlikely any one step would have been undertaken except in contemplation of the other integrating acts. The court noted that business purpose and economic effect are not always sufficient alone to preclude application of the doctrine. The taxpayers admitted that their ultimate goal was to get the land in the hands of the ranching company, and the court also noted that the operating rights were given to the ranching company at the onset. Therefore, the court found the end result test applied, and the intervening steps should be disregarded for taxing purposes. The court also applied the interdependence test, concluding that the intervening steps prove pointless without contemplation of the overall transaction. It should be noted that the court in *True* cautioned that it was using the step transaction doctrine to evaluate an overall sequence of transactions involving an IRC section 1031 exchange rather than invalidating an IRC section 1031 exchange. (*True*, at p. 1180, fn. 14.)

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[19] This decision also included a set of separate oil and gas transactions. The court did not grant summary judgment on this issue and returned it to the lower court for further proceedings.

Brown v. U.S. (6th Cir. 1989) 868 F.2d 859

This decision involves a taxpayer in the coal mining business who engaged in leases to acquire mineral rights in exchange for advanced mineral coal royalties, which payments were to be credited against future earned royalties. The taxpayer, a lessee, deducted these royalties as business expenses, which a sublessor would not be able to do. The IRS argued that these payments could not be deducted, because appellant made advanced royalty payments at the time he intended to sublease, and therefore should be treated as a sublessor. The court viewed the facts under the step transaction doctrine to determine whether the taxpayer had the intent to later sublease at the time he entered into the original leases (not when he made the advanced royalty payments). Having determined that the "taxpayer's intent for the purposes of the step transaction doctrine must be evaluated at the outset," for purposes of the step transaction doctrine, and finding that appellant did not have the intention to sublease when he entered into the original leases, the court found in favor of the taxpayer.

Holman v. Commissioner (2008) 130 T.C. 170;

Gross v. Commissioner T.C. Memo. 2008-221

These appeals contain similar facts wherein the taxpayers held stock of significant value and determined to gift the stock to their children through the use of a partnership. In *Gross*, *supra*, the taxpayer formed the partnership and contributed the stock to the partnership approximately 11 days before gifting limited partner shares to her children. In *Holman*, *supra*, the taxpayer contributed the stock at issues approximately 6 days before gifting limited partnership shares to the children. Taxpayers thereby attempted to avoid the gift tax that would be due on a direct gift of stock to their children.

The court in *Holman*, *supra*, reviewed the transaction under the interdependence test, but determined that it did not apply because the fluctuation in the price of the stock between the time it was contributed to the partnership and when the partnership interest was gifted 6 days later was significant, and therefore there was independent significance to the passage of time. In the *Gross* decision, the court reviewed the determination in *Holman*, *supra*, and reached the same result, giving significance to the time that passed between when the taxpayer held the partnership with the stock contributed to when the taxpayer gifted partnership interests to her children.

Interest Abatement

Interest is not a penalty but is merely compensation for a taxpayer's use of the money. (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle*, *supra*.) Respondent's determination not to abate interest is presumed correct, and the burden is on an appellant to prove error. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) The Board's jurisdiction in an interest abatement case is limited by statute to a review of respondent's determination for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, an appellant must establish that, in refusing to abate interest, respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)

Under R&TC section 19104, subdivision (a)(1), respondent may abate all or a part of any interest on a deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay committed by respondent in the performance of a ministerial or managerial act.[20] A decision concerning the proper application of federal tax law, or other federal or state laws, to the facts and circumstances surrounding a taxpayer's tax liability is not a ministerial or managerial act. (Treas. Reg., § 301.6404-2(b); *Bucaro v. Comm'r*, T.C. Memo. 2009-247.) An error or delay can only be considered when no significant aspect of the error or delay is attributable to the appellant and after

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[20] In the *Appeal of Michael and Sonia Kishner* (99-SBE-007), decided September 29, 1999, the Board adopted the language from Treasury Regulation section 301.6404-2 (b)(2), which defines a "ministerial act" as:

> A procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal law (or other federal or state law) is not a ministerial act.

Further, as we did in the *Appeal of Michael and Sonia Kishner*, we turn to Treasury Regulation section 301.6404-2 (b)(1) for the definition of a "managerial" act. The regulation defines a managerial act as:

> [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act. Further, a general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system, is not a managerial act for which interest can be abated . . . .

respondent has contacted the appellant in writing with respect to the deficiency or payment. (Rev. & Tax. Code, § 19104, subd. (b)(1).)

STAFF COMMENTS

Concessions

On appeal, respondent has conceded interest abatement for a period of September 1, 2010 through August 30, 2012. Respondent has also acknowledged that its protest representative determined that the Wachovia transaction was a valid IRC section 1031 like-kind exchange, but failed to remove from the NOA the portion of the proposed assessment based on the original denial of this transaction as a like-kind exchange. Should the Board find in favor of respondent, in part of in full, the decision should take into account these concessions made by respondent on appeal. Respondent should be prepared to affirm or otherwise discuss these concessions at the hearing.

Sand Creek Crossing Like-Kind Exchange

There are three primary requirements for a like-kind exchange qualifying under IRC section 1031: (1) the transaction must be an exchange; (2) the exchange must involve like-kind properties; and (3) both the relinquished and replacement properties must be held for investment or productive use in a trade or business. Appellants contend that only the third requirement is at issue here, and the key to resolving this appeal is determining whether they held the replacement property for investment or productive use in a trade or business. Respondent contends that the second requirement is also at issue, asserting that the step transaction doctrine applies here and appellants, in reality, exchanged real property interests for interest in an LLC, which are not like-kind in nature.[21]

The parties should be prepared to discuss whether appellants maintained a continuity of investment in the replacement property under *Magneson*, *Bolker*, *Maloney*, and *Marks*. As noted in Applicable Law, in *Magneson*, the Ninth Circuit Court of Appeals addressed a situation in which, pursuant to a pre-arranged plan, the taxpayers immediately contributed replacement property to a limited partnership, and in return became general partners of the limited partnership. The court stated

[21] It appears as though respondent denies, either in tandem or in the alternative to this assertion, that appellants also failed the third requirement. Respondent should be prepared to provide at the hearing any clarification as to its primary argument and any additional alternative arguments it wishes to pursue.

that "a critical basis for [its] decision [was] that the partnership in this case had as its underlying assets property of like kind to the Magnesons' original property, and its purpose was to hold that property for investment." (*Id*. at p. 1498.) *Magneson* declined to apply the step-transaction doctrine because there was not a more direct path to the result achieved. In the context of addressing the holding requirement, *Magneson* discussed then existing uniform partnership law, and it stated its holding was limited to exchanges of property in return for a general partnership interest. However, later cases and authorities have applied the rationale of *Magneson* to cases that do not involve the prior uniform partnership law.[22]

The parties should be prepared to address whether appellants' intent when they determined to enter into the IRC section 1031 exchange was to continue holding like-kind property. In this connection, the parties should discuss *Bolker*, *supra*, and its finding that a taxpayer maintains the requisite intent as long as he or she does not intend to liquidate or use the property for personal pursuits.[23] The parties should also be prepared to compare case law disallowing gain deferral where there is an intent to gift (e.g., *Click*) or sell property (e.g. *Regals Royalty*) upon acquisition to case law that allows for gain deferral even when there is a prearranged plan to transfer the property to a different form of holding (e.g., *Maloney*, *Marks*), and discuss which cases better mirror the fact pattern in this appeal.

Respondent cites to *Crenshaw*, *supra*, and *True*, *supra*, to show that the step-transaction doctrine potentially applies to fact patterns involving IRC section 1031 transactions. The parties should be prepared to discuss whether the multi-stepped transactions in those cases are similar to the transactions that occurred here. The parties should be prepared discuss what other possible paths appellants could have taken to acquire the Sand Creek Crossing properties and whether the acquisition of the replacement property was an unnecessary or meaningless step on the facts of this appeal.

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[22] See *Bolker*, *supra* [applying *Magneson*'s continuity-of-investment rationale to a corporate liquidation]; *Maloney*, *supra* [holding that where a taxpayer surrenders stock in a corporation in return for the replacement property the taxpayer continues to have an economic interest in essentially the same investment]; *Marks*, *supra* [finding that *Magneson*'s rationale also applied following revisions to the uniform partnership law]; FSA 199951004 [in which the IRS acquiesces to *Bolker* and *Magneson*, even where there is a pre-arranged plan, without indicating that *Magneson*'s rationale is limited to cases involving prior partnership law].

[23] While *Bolker*, *supra*, considered the holding requirement for the relinquished property, the decision looked specifically at the plain language meaning of "held for productive use in a trade or business or for investment," without specifying a difference for that requirement whether it be on the front end or back end of the like-kind exchange.

Interest Abatement

Interest may be abated when it is attributable to any unreasonable error or delay committed by respondent in the performance of a ministerial or managerial act. Here, the Bramante appellants argued for interest abatement for the long delay beginning after July 19, 2010, when they were told by respondent that a recommendation on their protest had been made and was being reviewed, to September 4, 2012, when the NOA was issued. Respondent consented to abate interest for a two-year period from September 1, 2010, to August 30, 2012. If the Bramante appellants wish to pursue the remaining claimed days of interest abatement, approximately 48 days, they should be prepared to discuss what ministerial or managerial act performed by respondent caused the asserted unreasonable delay for these remaining days. The Rago appellants noted that there was a length of time from December 17, 2010, when their protest hearing was held, to July 31, 2012, when they received their determination letter, but have not asserted a claim for interest abatement.

Section 40

As noted above, this matter is subject to Revenue and Taxation Code section 40. Therefore, within 120 days from the date the Board's vote to decide the appeal becomes final, a written opinion (i.e., Summary Decision or Formal Opinion) must be published on the Board's website. (Cal. Code Regs., tit. 18, § 5552, subds. (b), (f).) The Board's vote to decide the appeal will become final 30 days following the date of the Board's vote, except when a petition for rehearing is filed within that period.[24] (Cal. Code Regs., tit. 18, § 5460, subd. (a).)

Following the conclusion of this hearing, if the Board votes to decide the appeal, but does not specify whether a Summary Decision or a Formal Opinion should be prepared, staff will expeditiously prepare a nonprecedential Summary Decision and submit it to the Board for consideration at a subsequent meeting. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(2).) Unless the Board directs otherwise, the proposed Summary Decision would not be confidential pending its consideration by the Board (Cal. Code Regs., tit. 18 § 5551, subd. (b)(5)); accordingly, it would be posted on the Public Agenda Notice for the meeting at which the Board will consider and vote on the Summary Decision.

[24] If a petition for rehearing is filed, the Board's decision will not become final, and no written opinion under Section 40 will be considered until after the petition for rehearing is resolved.

A taxpayer may request that the Board hold in abeyance its vote to decide the appeal so the taxpayer may review the Board's written opinion prior to the expiration of the 30-day period for the filing of a petition for rehearing. If the vote is held in abeyance, the proposed Summary Decision will be confidential until it is adopted by the Board. (Cal. Code Regs., tit. 18, § 5551, subd. (b)(5).) Any request that the Board's vote be held in abeyance should be made in writing to the Board Proceedings Division prior to the hearing or as part of oral argument at the hearing. Any such request would then be considered by the Board during its deliberations on the appeal.

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